Planning and Privilege

ABA Fall Tax Meeting- San Francisco
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Privilege and Planning

Agenda

• Review of privileges with special attention to issues raised by *Estate of Morrissette*
• Review of the law of waiver
• Background of *Estate of Morrissette*
• Discussion of arguments against privilege protections raised by IRS in *Morrissette*
• Discussion of implications of IRS’s arguments for estate planners, and tax practitioners generally
Attorney-Client Privilege

Required Elements and Considerations

• To be protected by the attorney-client privilege a communication must be:
  – Confidential
  – Between a client and a legal advisor
  – For the purpose of giving or receiving legal advice

  Consider-
  - Who may be included in the communication and still maintain its confidential nature?
  - Who may be a legal advisor? In-house counsel? Business advisor?
  - What about advice that is both legal and business advice?
Work Product Doctrine

Required Elements and Considerations

• The work-product protection guards against compulsory disclosure of materials prepared in anticipation of litigation.
  – Broader in that it covers materials beyond communications and also covers materials created by non-lawyers.

  ▪ Two types:
    ▪ Factual work product
    ▪ Opinion work product

• Key consideration: What constitutes “in anticipation of litigation”? What about proposed transactions? Planning?
  – “Because of” v. Primary Purpose Test
Tax Practitioner Privilege

Required Elements and Consideration

• Statutory protection extending privilege to cover communications with a federally authorized tax practitioner for tax advice as if they were with an attorney for legal advice.
  – Limited to non-criminal matters before the IRS, or tax proceedings in federal court brought by or against the United States.
  – Protection will not extend to communications related to tax shelters.
  – Return preparation is not covered.

• What constitutes return preparation vs. tax advice?
Waiver

Privilege may be waived

• Actions that are inconsistent with maintaining privilege may constitute waiver.

• Waiver may be specific to the particular document at issue, or may cover all materials related to the subject-matter discussed in the document at issue.
  – Implied waiver- When privileged material or advice is offered by the party holding the privilege, privilege is waived for all of the material related to that issue.
  – Express waiver- When a privileged document or advice is shared with a third party, privilege may be waived just for that particular item, depending on circumstances.

• Although recent amendments to the FRE protect parties in the case of inadvertent waivers, attorneys should still take steps to guard against these problematic disclosures.
Waiver

**Privilege may be waived**

- The party asserting the privilege will generally bear the burden of proving that they have not waived the privilege.

- No sword and shield: the advice of counsel can not be advanced as a justification for action without exposing that advice to disclosure in its entirety.

- Parties may decide that such waiver is necessary in order to assert certain defenses that are based on advice of counsel or advice of tax practitioner.
  - Ex. Reasonable cause defenses often include the disclosure of opinions or advice received in a privileged manner.
Estate of Morrissette: Background

Clara Morrissette’s Estate Planning

• Clara Morrissette, through her revocable trust, entered into several split-dollar arrangements with dynasty trusts established to benefit her sons and their descendants.

• Under the split-dollar agreements, the Morrissette trust transferred funds to the dynasty trusts to pay the initial premiums and to acquire universal life insurance policies insuring the lives of Morrissette’s sons.

• Each split-dollar agreement terminates upon the death of the insured shareholder, at which time the Morrissette trust would receive a portion of the death benefit of the policies insuring his life equal to the greater of (i) the cash surrender value of the applicable policies; or (ii) the aggregate premiums paid by the Morrissette trust on the applicable policies.
Estate of Morrissette: Background

Clara Morrissette’s Estate Planning

• Mrs. Morrissette died on September 25, 2009.
• The Morrissette trust engaged James McNair and Patton Boggs LLP as estate planning attorneys.
• These attorneys, in turn, engaged Valuation Services Inc. (“VSI”) to value the amounts the Morrissette trust was entitled to receive with respect to each policy.
Estate of Morrissette: Background

Legal Background

• Although Sections 2036 and 2038 pull assets transferred during the taxpayer’s lifetime back into the estate if certain conditions are met, there is an exception for transfers that resulted from a bona fide sale for full and adequate consideration.

• Section 2703 contains special valuation rules that essentially disallow the use of discounts.
  – However, there is an exception that allows taxpayers to benefit from discounted valuations if the transfer was (i) a bona fide business arrangement, (2) not a device to transfer property to members of decedent's family for less than full or adequate consideration, and (3) the terms are comparable to similar arms’ length transaction.
Estate of Morrissette: Background

Legal Background

• The IRS seeks to include the amounts transferred from Morrissette trust pursuant to the split-dollar agreements in the estate.
• The IRS argues that the split-dollar agreements are not bona fide business arrangements, and therefore do not qualify for the exceptions.
• The case is currently pending in Tax Court.
• Cross- motions for summary judgment were denied, and the case is proceeding to trial.
• However, litigation over the past year has focused on the discoverability of documents over which the estate has claimed attorney-client privilege and/or work product protection.
Estate of Morrissette: IRS Privilege Arguments

Waiver due to Estate claiming it qualifies for “bona fide transaction” exception

• IRS argued that the Estate “put at issue” whether or not the split-dollar arrangements were bona fide business transactions.

• IRS claims that the split-dollar arrangements are estate planning tools designed and implemented by McNair and Patton Boggs.

• Therefore, because the Estate argues that the split-dollar arrangements qualify for the bona fide transaction exceptions, the Estate has waived attorney client privilege over any communications related to those arrangements.
Estate of Morrissette: IRS Privilege Arguments

Waiver due to Estate claiming it qualifies for “bona fide transaction” exception

• Wholesale waiver due to assertion of a legal position is generally disfavored by courts.

• The court here apparently disagreed with the IRS’s position, in favor of a more nuanced analysis.

• Beware of this argument as it relates to other exceptions or safe harbors for which your clients may qualify.
Estate of Morrissette: IRS Privilege Arguments

Estate Planner as “Business Advisor”

• The Court asked the parties to address the implications for privilege when an attorney is acting in a “non-attorney capacity.”

• The IRS argues that McNair was acting as a business advisor in that his services and advice were aimed at business goals (succession planning) rather than legal advice.

• The Estate points to the retention agreement which states that Patton Boggs was retained to review and assist with the administration of the trusts, and argues that the advice given was legal advice.

• If you are expecting to have privileged communications with your clients, be careful to make your role explicit and segregate legal from business advice.
Estate of Morrissette: IRS Privilege Arguments

Reasonable Cause = Waiver of Attorney Client Privilege

• The IRS argues that the Estate has waived attorney client privilege to the extent that it seeks to assert a reasonable cause defense to penalties under Section 6662.

• The Estate asserts that there is no requirement that it share its attorneys’ advice with the IRS in order to advance such a defense. It intends to mount a reasonable cause defense based on the sons’ reliance on the valuations. It argues that taxpayers should not be forced to choose between a defense and maintaining privilege.

• Beware that assertion of a reasonable cause defense without subject matter waiver may be challenging.
Estate of Morrissette: IRS Privilege Arguments

Work Product and Estate Planning

• The IRS has argued that the work product protection does not apply to the transactional planning done by McNair and Patton, because it was not done because of the anticipation of future litigation. The IRS argues that litigation may only be reasonably anticipated once a notice of deficiency has issued.

• The Estate argues that the size of the estate, and the disfavored status of split dollar arrangements put the Estate on notice that litigation was likely to ensue early in the planning process.

• Be careful to make the anticipation of litigation explicit, and state that the document is being prepared because of that anticipated litigation.
Estate of Morrissette: IRS Privilege Arguments

Disclosure to Third Parties

• The IRS argues that the Estate waived work product and attorney client privilege when it disclosed documents to third parties, including the Morrissette sons’ business partner, and the valuation consultant.

• The Estate argues that the business partner has a common interest with the Estate, and that VSI was operating under a Kovel agreement with the estate planning attorneys.

• Be clear which third parties may be included on communications without waiving and make the basis for extending the privilege to those parties explicit.
Beyond Estate of Morrissette

Possible broader implications of the IRS’s position

• Consider other instances in which taxpayers must show that a transaction was arms’ length or a bona fide business arrangement. Could the IRS make the same waiver arguments in those contexts?

• When privilege issues are litigated, many result in lengthy in camera review of the disputed documents. Best practice includes thinking ahead to that in camera review when you are creating documents that you believe to be covered by the attorney/client, 7525, or work product protections.