Practical Privilege Issues

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Panelists

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Agenda

• General Rules Governing Protection from Disclosure
• New Challenges in a Digital World
• Practical Example – Privilege in an Interconnected World
• Privilege Hot Topics
• Audit Considerations
• Best Practices
Why Privilege Matters to Your Client

Documents within IRS summons power, unless privileged

Documents you would rather not give the IRS, or a judge, or the Times

Documents protected from disclosure by privilege

• Privileges can be difficult to attach, and fragile. Traps for the unwary, especially in the digital age
• By understanding the limitations of privilege, you’ll know when NOT to write that email
• Know how to create conditions for full and frank discussions, internally or with advisors
• Avoid inadvertent waivers
The Basics of the Major Privileges
Attorney-Client Privilege ("ACP") – Elements

- Confidential oral or written communication
- From client to attorney for the purpose of obtaining legal advice; or
- From attorney to client and either (i) contains legal advice or (ii) reveals confidential information on which client seeks advice
- Dual purpose documents: primary purpose test
Attorney-Client Privilege: Limitations

• The client must have an expectation of confidentiality
  – Third Parties
  – Special rules for experts, joint clients, and common-interest

• The communication must contain legal advice
  – Business advice is not protected
  – Tax return preparation and financial reporting are not covered

• The client is the company
  – Not its employees, officers, or directors

• Blanket claims of privilege are generally ineffective
  – Must be claimed on an item-by-item basis
ACP in Corporate Context

• The client
  – Can include current and former employees or executives as well as agents of the client

• The attorney
  – Can be in-house counsel or outside counsel
  – But communications with in-house counsel are more likely to include business advice

• Privileged legal advice can be shared among employees who “need to know”
Section 7525/Accountant-Client Privilege

- With respect to tax advice, communications between a taxpayer and any “federally authorized tax practitioner” are privileged to the same extent as communications with an attorney.

- Can apply with respect to internal and external accountants.
Section 7525 - Limitations

- Only applies with respect to tax advice
- Does not apply to foreign accountants or advice on foreign taxes
- Only applies in federal tax proceedings
  - State tax proceedings
  - Shareholder and regulatory litigation
  - Waiver for federal tax purposes!
- Cannot be asserted in any criminal matter
- Does not apply to communications relating to the promotion of any tax shelter
- Accountants wear lots of hats
  - In camera review more likely
Kovel Arrangements


- Elements of *Kovel* Arrangement
  - Expert engaged must be necessary or at least highly useful, for effective consultation between client and lawyer
  - Expert must be employed by, and acting at the direction of, the attorney, not independently or at the direction of the client
  - Privilege only applies to communications after the date of the engagement
Common Interest Doctrine

• If two clients are *actively working together* to pursue a common *legal* interest, communications among the clients and their attorneys to further the common legal interest *do not waive* attorney-client privilege
  – Does *not* create a privilege for the communications themselves. Common interest doctrine is an exception to waiver, only.
  – A common business or commercial interest is not sufficient.

• Can facilitate sharing of confidential tax analyses in M&A contexts
  – Protocols
  – Common interest agreement
Work Product ("WP") Protection–Elements

• Prepared in anticipation of litigation, or in other words “because of” the prospect of litigation
• By or for a party or its representative
  – Extends beyond an attorney’s work
  – Protects litigation strategies and analyses of litigation hazards
• Joint purpose document: would it have been prepared in substantially similar form if litigation had not been anticipated?
• When is litigation anticipated in tax planning?
  – “Litigation” doesn’t always mean litigation, e.g. arbitration, mediation, administrative proceedings
  – Can include adversarial administrative proceedings such as IRS examinations and Appeals but there is contradictory case law
  – Likely IRS Appeals?
• NOTE: Anticipation of litigation triggers document retention obligations
Work-Product Doctrine: Key Points

• Potentially broader application than attorney-client privilege as positions may, in the view of certain courts, be provided to auditor without waiver

• But only covers a narrower subset of documents—those prepared in anticipation of litigation

• Also covers materials prepared by non-lawyers; however need to show that lawyers were preparing for litigation rather than performing accounting or business functions

• NOTE OF CAUTION: Think about the timing of invoking work product protections, as they are commensurate with document preservation obligations. If you haven’t put a litigation hold in place, or don’t have documents otherwise preserved, do not invoke work product protection.
Privileges You Sometimes Wish Existed ... But Don’t

- “But it’s not really relevant”
- “But that was just a draft”
- “But they didn’t keep it”
- “But they never actually saw it”
- “But I copied a lawyer”
- “Because I said so”
- Bad document privilege
New Ways to Communicate = New Challenges and New Opportunities

• Now take what we talked about with the basics of the privileges and try to apply the basics to new forms of communication
  – Channel forms, DropBox, Google Docs, iMessage, What’sApp, WebEx
  – Duty to preserve
Waiver

- Attorney-client and section 7525
  - Voluntary disclosure to a third party generally results in broad waiver as to all communications concerning the same subject matter
    - But see Federal Rule of Evidence 502 …
Waiver

• Federal Rule of Evidence 502
  – Rule 502(a) addresses subject matter waiver when there has been an intentional disclosure in a federal proceeding or to a federal office or agency. It applies only to the information disclosed, unless a broader waiver is made necessary by the holder’s intentional and misleading use of privileged or protected communications or information.
  – 502(a) addresses the problem by providing that, when a party produces one privileged or protected document, any resulting waiver of the privilege or protection would not extend to other related documents, so long as there was no intentional and misleading use of protected information. If a party intentionally places protected information into the litigation in a selective, misleading and unfair manner, then there will be a waiver as to the undisclosed information concerning the same subject matter.
  – Subsection (a) clarifies existing law and rejects the position taken by some courts that inadvertent disclosure of protected material can constitute a general subject matter waiver.
Waiver

- **Federal Rule of Evidence 502**
  - Fed. R. Evid. 502(b) provides that disclosure of privileged or protected materials will not be a waiver of the privilege if (1) disclosure is inadvertent; (2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and (3) the holder took reasonable steps to rectify the error, including following Fed. R. Civ. Proc. 26(b)(5)(B) if applicable.
  - Subsection (b) resolves the current split among the courts regarding the consequences of inadvertent disclosure. Basically, the rule opts for the middle-of-the-road approach. Subsection (b) literally posits a two-part test that only accounts for the reasonable precautions taken and the promptness of the measures taken to rectify the error. The middle-of-the-road approach adopted by the courts was a multi-part test rather than a two-part one.
  - Advisory Committee notes
Waiver

• ABA Model Rule 4.4(b) – a lawyer who receives a document or ESI relating to the representation of the lawyer's client and knows or reasonably should know that the document or ESI was inadvertently sent shall promptly notify the sender.

• Fed. R. Civ. P. 26(b)(5)(B) – if information produced in discovery is subject to a claim of privilege or work product protection, party making claim may notify any party that received the information of the claim and basis for it. After being notified, receiving party must promptly return, sequester or destroy the information and any copies; must not use or disclose the information until the claim is resolved; must take reasonable steps to retrieve the information if the party disclosed it before being notified; and may promptly present the information to the court under seal for a determination of the claim. Producing party must preserve information until the claim is resolved.
Waiver

- Work product protection
  - Waiver only as to specific document
  - Waiver only when disclosure is inconsistent with purpose of maintaining secrecy from adversaries. Compare:
    - U.S. v. Textron, 577 F.3d 21 (1st Cir. 2009) (Textron waived attorney-client privilege by disclosing to outside auditor);
    - U.S. v. Deloitte, 610 F.3d 129 (DC Cir. 2010) (Dow Chemical did not waive work product protection by disclosure to outside auditor)
Disclosure Pros & Cons

Pros
• Tax enforcement trending to increasing transparency
• Disclosures can help you demonstrate cooperation and end inquiries early
• Helps you demonstrate that you have nothing to hide
• Privileged communications and documents can support your position

Cons
• Disclosure in one country can mean global disclosure across jurisdictions with varying tax laws
• Discussions where parties assumed privilege can be glib and, taken out of context, unhelpful to your position
• Potential lack of control on impact - “Minor” disclosure (waiver) can completely waive all privilege forever on an entire subject matter
Practical Example – Privilege in the Interconnected World

- As the world grows increasingly interconnected, communications increase while privilege rules become trickier to apply.

- Case Study:
  - A multinational company headquartered in the UK (UKCo) seeks to acquire a competitor in the United States (USCo). Ultimately, the parties reach agreement on a merger of UKCo and USCo, with the resulting company being incorporated in Ireland (IrishCo). UKCo and USCo were each advised by separate U.S. tax counsel. Both UKCo and USCo had accounting firms advising on tax matters. In-house counsel of UKCo and USCo also participated in discussions regarding the merger.
Parties with Privilege Power (maybe)

• A multinational company headquartered in the UK (UKCo) seeks to acquire a competitor in the United States (USCo). Ultimately, the parties reach agreement on a merger of UKCo and USCo, with the resulting company being incorporated in Ireland (IrishCo). UKCo and USCo were each advised by separate U.S. tax counsel. Both UKCo and USCo had accounting firms advising on tax matters. In-house counsel of UKCo and USCo also participated in discussions regarding the merger.
Communications During the Deal

• Sometimes the parties’ advisors and in-house counsel communicated directly with their clients about the merger; other times, the parties’ advisors and their clients all participated in joint communications about the merger.

• Which of these communications if any are privileged?
  – Confidentiality
  – Waiver
  – Joint defense and common interest
A few years later, during an IRS audit of the transaction, the IRS asked for all documents related to the transaction.

- What communications, if any, can the IrishCo. withhold based on privilege?

- Which country’s privilege laws will govern this determination?
Tax Man Cometh – The Sequel

• Similarly, the HMRC asked for all documents related to the transaction during an audit.
  – What communications, if any, can the IrishCo. withhold based on privilege?
  – Which country’s privilege laws will govern this determination?
Tax Man Cometh – Part 3

• Massachusetts also opened an audit related to the transaction.
  – What communications, if any, can the IrishCo. withhold based on privilege?
  – Which country’s privilege laws will govern this determination?
Later, the EU Commission opened a state-aid investigation into whether Ireland improperly promised IrishCo certain tax benefits on a go-forward basis.

IrishCo worked with Irish Counsel, US Counsel, and Belgium Counsel in responding to the state aid investigation.

After the EU Commissioner issued its ruling, the IRS issued an IDR seeking: 1) all documents that IrishCo provided to the EU Commission; and 2) all documents that IrishCo provided to Ireland.

- What documents, if any, can the IrishCo. withhold based on privilege?
- Which country’s privilege laws will govern this determination?
Hot Topics

(Things to consider now to prevent your later privilege claims from becoming a dumpster fire.)
Mixed Purpose Communications: ACP and 7525 for In-House Advisors and Accounting Firms

• Business, financial, accounting, or valuation advice vs. legal advice
• Emails (and attachments)
  – Nature of engagements
• Emails among in-house advisors. Examples:
  – Portion of email from in-house counsel to executives titled “purchase price”
  – Email from Tax Director to employees incorporating tax advice from in-house CPAs
  – Redaction to email generally concerning business negotiation
Audit Considerations – Privilege Logs

• Documents withheld on the basis of attorney-client or work product or tax practitioner privilege must be described to the opposing party in litigation and sometimes in administrative proceedings
  – Privilege logs are often an afterthought but are critically important

• Privilege log requirements include:
  – Date
  – Authors & Recipients
  – Type of document
  – Subject matter
  – What type of privilege is being claimed
  – Why this document is privileged
Mitigating Email Risk: Use It Less

- When in doubt, pick up the phone
  - Email: “Let’s discuss this by phone”
- Push back on “put it in writing”
- Keep distribution lists on “need to know” basis
- Limit email chains
  - Create a new chain
  - Do not mix threads for different projects

### Choice of Media

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Hypothetical: Board Presentation

- Company’s Tax Department prepares a slide deck and memo to be presented to the Board of Directors explaining the tax risks of a proposed transaction
- Does it matter who drafted the deck and memo?
- Is there a waiver:
  - If the tax presentation is described in the Board Minutes (and the Minutes are later requested in an IDR)?
  - If the auditors see the tax materials?
  - If Company’s public relations consultants attend the Board meeting?
- What should be done with the deck and the memo after the meeting to protect privilege?
Hypothetical: Waiver Consequences

• If privilege on a tax opinion is waived, what are the consequences?
  – Are the advisor’s files and emails discoverable?
  – Can the advisors be interviewed or deposed?
  – Can the privilege waiver be limited to communications with one advisor but not any other advisors on the same issue?
Hypothetical: Internal Communication

• Transaction approval memorandum presented to Board of Directors
  – “Due to structuring negotiated by the deal team, the projections are accurate to a high
degree of confidence, and all transactional risks have been mitigated.”

• Email between two Tax Department employees
  – “We needed to get this memo done in a hurry, so I made up something to stick in the
‘business purpose’ section. Hope it’s okay.”

• Internal self-evaluation by corporate employee used to justify bonuses
  – “I made the company over $100 million by helping negotiate for us a role as an
accommodation party in structured tax deals.”

• Cover email describing transaction and attaching termsheet
  – “Please pay particular attention to the exit options. We have the right to stay in the
transaction for 10 years, but under any conceivable set of economic circumstances, we will
exercise the option after two weeks.”
Best Practices to Ensure YOU are in Control of Disclosure
Mitigating Email Risk: Best Practices

• Focus on facts
• Include context
• Avoid vagueness
• Don’t add color commentary
• Don’t provide opinions, unless absolutely necessary and identified as such
• Don’t give IRS a “roadmap” of potential challenges
• If you wear multiple hats, be clear about which one you’re wearing
• Consider labeling emails privileged and be consistent
Top 5 To-Dos

• Address legal communications to lawyers and use your legal title when conveying legal advice; tax advice to tax advisors.

• Specifically reference any anticipated litigation or audits.

• Include (meaningful) notations like “Privileged Attorney-Client Communication- Do Not Forward;” and designate documents “Work Product.”

• Segregate legal and business advice into separate communications.

• If communicating on a privileged basis across multiple jurisdictions, assess the lowest common denominator for maintaining privilege across all jurisdictions. Consider siloing.
Top 5 Don’ts

- Don’t forward emails outside of the core group.
- Don’t assume that all in-house lawyer’s communications are privileged.
- Don’t assume U.S. privilege law will apply outside of the U.S.
- Don’t disclose counsel’s advice without considering the waiver implications.
- Don’t recirculate advice within the company more than necessary, and when you do, use entire work product rather than excerpts.
Questions