SPECIAL REPORT: ATTORNEY-CLIENT AND WORK PRODUCT PRIVILEGES—OVERVIEW, TAX PRACTICE PRIMER, AND WHAT REMAINS AFTER THE TAX SHELTER ASSAULT*

INTRODUCTION: On Wednesday, April 13, 2005, at 1:00 pm EST, the Tax Section together with ABA-CLE will sponsor another in its annual **Tax Link Live** teleconference series. This special, 90-minute ethics program will feature a discussion on *"Attorney-Client and Work Product Privileges: Overview, Tax Practice Primer, and What Remains After the Tax Shelter Assault,"* which will be led by **B. John Williams**, Shearman & Sterling LLP, Washington, DC, and **David W. Aughtry**, Chamberlain, Hrdlicka, White, Williams & Martin, Atlanta, GA, with **G. Michael Yopp**, Waller, Lansden, Dortch & Davis, PLLC, Nashville, TN, moderating. There will be ample opportunity for questions from those who are participating in the teleconference. The following Report constitutes the material for the program. For details on registering and obtaining CLE ethics credit, please see the ad following this Report on page 23.

GENERAL OVERVIEW

A recent series of cases involving tax shelters and privilege have highlighted the importance of understanding the attorney-client and work product privileges for a tax practice. This article provides a general overview of the privileges and their application in a tax practice.

Attorney-Client Privilege. WIGMORE ON EVIDENCE sets forth the classic formulation:

> When legal advice of any kind is sought from a professional legal advisor in his capacity as such then the communications relating to that purpose, if made in confidence by the client are, at the client's insistence, protected from disclosure by the client or the legal advisor unless the privilege is waived.

Two other aspects of the privilege should be noted. One, the Tax Court regards the attorney-client privilege as a mere rule of evidence. Two, the privilege covers communications much more narrowly than the attorney's ethical duty to keep client communications confidential. Thus, an attorney may be ethically required not to divulge a client confidence even where privilege has been waived.

The purpose of the privilege is to facilitate a client's seeking legal advice free of fear that the information provided to the attorney could be used to the client's detriment without his or her consent. *See* Upjohn Co. v. United States, 449 U.S. 383 (1981). The privilege also works to protect communications from the lawyer to the client that would reveal the nature of the client's communications. *See* Alexander v. F.B.I., 198 F.R.D. 306, 309 (D.D.C. 2000).

Work Product Doctrine. The formulation of the Work Product Doctrine is found in Hickman v. Taylor, 329 U.S. 495 (1947). Under this doctrine, the work product of an attorney prepared under the direction of the attorney or his or her staff in anticipation of litigation is protected from disclosure unless the other party demonstrates a need for such items to prepare his or her case, or the other party is unable to obtain the substantial equivalent. The purpose of the doctrine is to promote uninhibited, thorough, trial preparation. The work product doctrine is predicated on preventing an unfair advantage to a party's opponent.

Tax Advisor Privilege – IRC § 7525. The communications that a taxpayer has with a federally authorized tax practitioner (e.g., accountant, enrolled agent) that would be covered by the attorney-client privilege if they had been with an attorney are privileged, *but* only in civil tax proceedings (e.g., not in SEC or criminal tax proceedings), *and* not if the communications are made in connection with the promotion of a corporate tax shelter as defined in section 6661. The purpose of this privilege is to ensure that the right to privilege regarding tax advice before the Internal Revenue Service does not depend on the type of advisor. Because the client's expectation of confidentiality is a foundational part of the privilege, it is unclear how effective section 7525 is in protecting communications with practitioners whose firms are also financial auditors.

* Adapted by G. Michael Yopp from papers presented at the 2004 Tennessee Federal Tax Institute by B. John Williams and David W. Aughtry.

APPLICATION OF PRIVILEGES AND WAIVER OF THE PRIVILEGES IN TAX CASES

In every tax practice, the practitioner should be aware of implications for his client's communications. A brief discussion of these follows.

Beware of Waiver. Any action inconsistent with the maintenance of a privilege may constitute waiver and that waiver may extend to the entire subject matter. Bernardo v. Commissioner, 104 T.C. 677, 682 (1995), *citing* In re Sealed Case, 737 F.2d 94, 98-99 (D.C. Cir. 1984).

a. At least in the Tax Court, the party asserting the privilege bears the burden of proving the negative that he has not waived it. A system of segregating privileged material from non-privileged material may be essential for such proof.
b. Even though the privilege always belongs to the client and the lawyer is not free to waive it without client authorization, a third party is entitled to enforce a waiver based on the actions of that same lawyer as an agent with apparent authority. Hartz Mountain Indus. v. Commissioner, 93 T.C. 521, 525 (1989).
c. Under the precedent of the D.C. Circuit—which governs evidentiary rulings in all Tax Court cases –even an *inadvertent waiver* by the lawyer (or the *Kovel* CPA) generally constitutes an enforceable waiver. *In re Sealed Case, supra*.
d. That waiver generally extends to the entire subject matter. *Bernardo, supra*. *But see*, Long-Term Capital Holdings v. United States, 2003 U.S. Dist. LEXIS 14579 (D. Conn., May 5, 2003) (Disclosure of gist of "more-likely-than-not" tax opinion to auditors did not constitute waiver as to entire opinion).

The *Kovel* Doctrine: The attorney-client privilege will not be waived if communications are shared with a third-party expert who is serving as an interpreter to facilitate confidential communications between the client and the attorney. *See* United States v. Kovel, 296 F.2d 918 (2d Cir. 1961) (Friendly, J.). Consequently, it is routine for attorneys to retain experts, such as accountants, to provide non-legal advice in connection with the preparation of a case. Under the *Kovel* doctrine, these experts' work and advice can be covered by the attorney-client and work product privileges.

Bills and Invoices. IRS agents routinely ask for invoices relating to all payables. Be aware that the attorney's invoices may describe substantial confidential information.

Receipt and payment of a lawyer's bill are generally not privileged. United States v. Ellis, 90 F.3d 447, 450-51 (11th Cir. 1996) ("receipt of attorney's fees normally [is] not [a] privileged matter"); Chaudhry v. Gallerizzo, 174 F.3d 394, 402 (4th Cir. 1999).

The descriptions in the invoices can be privileged—provided that privilege is not waived. Clarke v. Am. Commerce Nat'l Bank, 974 F.2d 127, 129 (9th Cir. 1992) ("[C]orrespondence, bills, ledgers, statements, and time records which also reveal the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided…fall within the privilege"). Providing such statements to auditors waives any privilege. Generally, the best course is to segregate invoices describing services performed from invoices showing the amounts due.

Tax Opinions. Tax advice and tax opinions by counsel can be privileged. United States v. Tel. & Data Sys, Inc., 2002-2 U.S.T.C. ¶ 50,569 (D. Wis. 2002); Wojdak v. First W. Gov't Sec., Civ. Action No. 83-1076, 1991 U.S. Dist. LEXIS 11482, *4-5 (E.D. Pa., Aug. 15, 1991) (draft tax opinions protected by attorney-client privilege because they "were for the purpose of giving legal advice to a client, and were expressly treated by the sender and the recipient as confidential").

Audit or Tax Return Work Papers Not Protected. Accountant's work papers and work product generally are not privileged unless derived from the attorney's work product privilege. United States v. Arthur Young & Company, 465 U.S. 805 (1984). The Supreme Court in *Arthur Young* noted that guidelines issued by the IRS during the course of litigation provided that the examiner should seek tax accrual work papers only in "unusual circumstances" and only as a "collateral source for factual data." *Id*. at 821 n. 17. This policy has recently been changed. In 2002, the IRS announced that it was modifying the policy. *See* Announcement 2002-63, 2002-27 I.R.B. 72. In particular, revenue agents may request tax accrual work papers if the return being examined involves a "listed transaction" at the time of the request.

What Constitutes Litigation? The work product doctrine requires that the product be prepared "in anticipation of litigation." What about a proposed transaction? The fact that a work product relates to a proposed transaction is just one factor that suggests it was not prepared in anticipation of litigation and is not, in and of itself, dispositive. United States v. Addmon, 68 F.3d 1495, 1502 (2d Cir. 1995) (corporate officer obtained tax memorandum regarding proposed transaction from accountant/lawyer at Arthur Andersen; the memorandum was held to be subject to the work product "privilege.")

Recent Court Opinions/Identity Privilege. Historically the IRS prevails in summons enforcement cases, and recently, that is where the war over privileges has been fought.

KPMG. In U.S. v. KPMG, LLP, 91 A.F.T.R. 2d 2003-317 (D.D.C. Dec. 20, 2002), the IRS moved to enforce a stock of IRS summonses relating to FLIP/OPIS BLIP and other structured transactions, and KPMG sought a protective order. KPMG asserted (i) the section 7525 Tax Practitioner privilege, (ii) the Attorney-Client Privilege, and (iii) what the Court labeled KPMG's "Own Privilege." The firm also sought to submit a categorical description of the privileged documents for *in camera* review by the Court, rather than a privilege log describing every document.

The District Court's opinion contains some faulty language and conclusions which imply that tax

advice associated with return preparation is necessarily not privileged—a result that seems to defy the distinction enacted by Congress between tax advice and tax return preparation. On that basis, the court generally rejected the claimed section 7525 privilege, required production of the KPMG tax opinions, but recognized the section 7525 privilege with respect to the outside attorneys' opinions.

The court also held that a lawyer is barred from practicing law as a member or employee of an accounting firm and on that basis, generally rejected the assertion of the attorney-client privilege and attorney work product doctrine by KPMG.

The court buttressed its denial of the attorney work product doctrine on the grounds that Section 7525 does not include a work product component and the documents were, in the court's view, not prepared in anticipation of litigation.

The court upheld elements of KPMG's "Own Privilege" relating to communications involving its General Counsel's Office relating to contracts, liability, etc.

Finally, the court rejected the request for a categorical privilege log, although it acknowledged the burden would be great.

BDO Seidman. In U.S. v. BDO Seidman, et al., 2004 U.S. Dist. LEXIS 12145 (N.D. Ill., Feb. 4, 2002), the District Court held that "the motivation is itself a confidential communication." The Court stated a four factor test for determining if a document was privileged:

a. Was the purpose of the tax practitioner's representation to provide tax advice?
b. Would revealing the taxpayers' names reveal their motives for seeking tax advice?
c. Have the taxpayers waived the privilege?
d. Was the document at issue communicated or generated for the purpose of preparing the taxpayer's tax returns?

In order for section 7525 privilege to apply, the answer to question 1 must be yes, to question 2 yes, to question 3 no, and to question 4 no. In United States v. BDO Seidman, 337 F.3d 802, (7th Cir. 2003), the Seventh Circuit affirmed the District Court's denial of the plaintiff's Motion to Intervene in an IRS enforcement action against BDO.

Arthur Andersen. In United States of America v. Arthur Andersen, LLP, 2003 U.S. dist. LEXIS 14228 (N.D. Ill., August 15, 2003), a District Court first held that intervenors may continue to use fictitious names in an action for enforcement of summonses against Arthur Andersen, LLP, that the section 7525 privilege applies, and that any information about the intervenors' identities is to be redacted before complying with the summonses.

Later the District Court withdrew this favorable opinion and issued an adverse Memorandum Opinion following the Seventh Circuit's BDO opinion. Ironically, the intervenors in BDO filed for *en banc* review by the Seventh Circuit *only ten days earlier* based on the uncontroverted fact that the disputed transactions were not "listed" at the time they were consummated and therefore, the investors did in fact expect their identities and activities to remain confidential.

Wachovia (Jenkens & Gilchrist). In John Doe #1 et al. v. Wachovia Corporation, 286 F. Supp. 2d 627 (2003), a North Carolina District Court denied investors injunctive relief in regard to preventing a bank from turning over investor lists, after determining that the law firm that issued "more likely than not" opinion letters to the investors did not enjoy a traditional attorney-client relationship with them. The court also held that the section 7525 privilege was inapplicable.

As the foregoing discussion demonstrates, every tax practitioner should be acquainted with the attorney-client, work product and tax practitioner privileges. Failure to do so could result either in wrongly advising a client that material will be privileged or in an inadvertent waiver of a client's privilege. ■

CHAIR

FROM THE **CHAIR**

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and other IRS officials to discuss the then-proposed Circular 230 regulations and the Service's new initiatives aimed at promoting audit currency. In early December, we briefed Acting Assistant Treasury Secretary Greg Jenner, IRS Chief Counsel Korb, and other Treasury and IRS officials on guidance issues arising under the American Jobs Creation Act of 2004 that our committees had identified as areas where prompt guidance was needed. The list reflects another fine performance by our committees acting under a short time deadline.

CLE ON THE ROAD/ SECTION TELE-CONFERENCES

In November, we launched a CLE effort, "Tax CLE on the Road," designed to bring Tax Section CLE to members in cities where the Tax Section has not sponsored programs before. ABA member surveys have identified that practitioners prefer local CLE programming. Our pilot program on "Allocation-Based Versus Distribution-Based Partnership Agreements," was held in Saint Louis and Dallas. I would like to thank Bob McKenzie and Elinore Richardson for their leadership in this new effort. Mark Martin and Philip Wright assisted with local planning and sponsor-

SEE FROM THE **CHAIR**, NEXT PAGE