THE TAX ADVISER’S PRIVILEGE IN TRANSACTIONAL MATTERS: A SYNOPSIS AND A SUGGESTION

Bruce Kayle*

“[]In the area of taxation, it is often difficult to determine where business ends and the law begins. . . .”1

I. INTRODUCTION

Along with the right to remain silent, the inviolate secrecy of communications between attorney and client and of the contents of the attorney’s files is among the most widely known elements of our legal system. It is almost instinctive to the clients of America that neither what they say to their attorney nor the attorney’s work product can be revealed voluntarily by the attorney2 or by compulsion of an adversary. However, just like the right to silence has proven to be far from absolute, the sanctity of attorney-client communications and attorneys’ files is also considerably less pristine than popularly perceived. Indeed, the attorney-client privilege and its later-born cousin, the work-product privilege, are each available only if a number of detailed criteria are satisfied and numerous exceptions avoided. Those criteria and their exceptions have been defined largely in the context of controversies not involving matters of taxation. Nonetheless, much the same rules are applied in matters relating to taxation, and at least a few particular rules have developed in the tax field.

Despite the fact that the concept of privilege had its origin in a world that predated the federal income tax, the attorney-client and work-product privileges play an extremely important role in controversies involving taxation. Moreover, the privileges may play a broader role in tax matters than in non-tax matters, since they may be invoked not only in litigation but also in administrative phases of a tax controversy. Overall, with an apparent upswing in tax litigation, at least in the area of corporate tax shelters, issues of attorney-client privilege and work-product privilege in transactional matters can be expected to increase.

Part II of this article provides a brief historical background of the attorney-client and work-product privileges. Part III outlines the contours of the attorney-client and work-product privileges, as well as their principal exceptions and limitations, especially insofar as they are implicated in transactional tax practice.

*Partner, Milbank, Tweed, Hadley & McCloy LLP, New York, New York; B.A., B.S.E., University of Pennsylvania, 1979; J.D., Harvard Law School, 1982. An earlier version of this article was presented to the Tax Forum in New York City on February 5, 2001. The author gratefully acknowledges the research assistance of Tim Franzen and Yanira Baez.


2MODEL CODE OF PROF’L RESPONSIBILITY DR 4-101(B) (1980) states: “[A] lawyer shall not knowingly: (1) Reveal a confidence or secret of his client. (2) Use a confidence or secret of his client to the disadvantage of the client. . . .” See also ABA MODEL RULES OF PROF’L CONDUCT, R. 1.6 (client confidences); FED. R. EVID. R. 501 (privilege); FED. R. CIV. P. 26(b)(3) (work product).
Part IV of the article describes certain common transactional settings and analyzes the availability of the privileges to certain common types of communications and documents found in these settings. Finally, Part V examines the premise that the privileges are appropriately applied in tax related matters in the same manner as in non-tax related matters. This part also raises the possibility of limiting the application of the privileges in tax related matters.

II. BACKGROUND—A BRIEF HISTORY OF PRIVILEGE

The attorney-client privilege is most commonly thought of as applying in ordinary civil or criminal litigation. Specifically, the attorney-client privilege allows a client to “refuse to disclose and to prevent any other person from disclosing confidential communications between he and his attorney.” The privilege represents an exception to any person’s duty to provide evidence to a court when asked to do so. The work-product privilege, on the other hand, does not protect communication, but as the name suggests, protects the work product of an attorney from discovery by an adverse party. Both privileges had their origins in common law, albeit several hundred years apart, and have since been incorporated into the relevant statutes.

A. Common Law Origins

1. Attorney-Client Privilege

   The attorney-client privilege has been in existence since the early 1500s. The early attorney-client privilege applied only to a communication made after the start of litigation and only to the case in reference to which the communication was made. English courts in the late 1700s began to extend the privilege to communications that were not made for the purposes of the present litigation. Something of a breakthrough occurred in 1820, when attorney-client communications relating to the drafting of a deed were held privileged where no litigation was involved.

   American courts struggled with issues of privilege from their earliest days, and over time have adopted a broad view of the attorney-client privilege. A relatively recent articulation of the policy around which the privilege has developed was delivered by the Supreme Court in Upjohn Co. v. United States.

   3BLACK’S LAW DICTIONARY 129 (6th ed. 1990). Recognition of the privilege thus avoids a conflict between the attorney’s obligation to the judicial system and the attorney’s duty of confidentiality to the client.

   4FED. R. CIV. P. 26(b)(1).

   5See 8 WIGMORE, EVIDENCE ¶ 2290, at 544 (McNaughton rev. 1961).


   7See id. at 1088-90 nn.121-31.

   8See 8 WIGMORE, EVIDENCE ¶ 2294, at 563.

There, the Court stated that the purpose of the privilege is to:

encourage full and frank communication between attorneys and their clients
and thereby promote broader public interests in the observance of law and
administration of justice. The privilege recognizes that sound legal advice or
advocacy serves public ends and that such advice or advocacy depends upon
the lawyer being fully informed by the client.10

The articulation of the underlying policy also suggests that the privilege should
have some boundaries, which have in fact been recognized by courts over time.
For example, in 1851 a court, departing from the precedent it cited, held that an
attorney’s testimony was not privileged where the attorney was requested to
identify his client as an undisclosed principal.11 The court reasoned that the
privilege was inapplicable in such a situation because the attorney was acting
merely as a business agent.12 Courts have developed other limitations over the
years. Since the attorney-client privilege is a stark exception to the general duty
to be forthcoming to a court, courts have tended to limit the application of the
privilege or to create exceptions where the general policy behind the privilege is
not served on a particular set of facts. The Wigmore treatise on evidence has
incorporated the broad requirements and implicit exceptions surrounding the
attorney-client privilege into the following often quoted sentence:

[w]here legal advice of any kind is sought, from a professional legal adviser in
his capacity as such, the communications relating to that purpose, made in
confidence, by the client, are at his instance permanently protected, from dis-
closure by himself or by the legal adviser, except the protection be waived.13

This statement is now frequently repeated by the courts verbatim14 and is today
the accepted articulation of the privilege. The specifics of these requirements are
discussed in Part III.A., below.

2. Work-Product Privilege

Courts realized that providing the protection of a privilege solely to the client’s
communications with an attorney could well be insufficient to foster the privilege’s
intended purpose. Since the attorney’s work product naturally would be created
following and as a result of the substance of communications that are privileged,
protection for the latter could well be undermined if items created by the attor-
ney were subject to discovery. In response to this problem, the courts developed
the work-product privilege, which protects from discovery in certain cases items
created by an attorney. Unlike the attorney-client privilege which developed

10Id. at 389.
12Id.
13See 8 Wigmore, Evidence § 2292, at 554.
14See, e.g., United States v. Bein, 728 F.2d 107, 112 (2d Cir. 1984); United States v. Kovel, 296
F.2d 918, 921 (2d Cir. 1961).
slowly over hundreds of years, the work-product privilege was essentially created by one modern-day case, *Hickman v. Taylor*.\(^{15}\) In *Hickman*, the Supreme Court refused to enforce the plaintiff’s interrogatory inquiring whether the defendant’s in-house counsel had taken any statements of witnesses and, if so, what was the nature of such statements. The court reasoned that if such materials were “open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten. . . . Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial.”\(^{16}\)

B. Adoption of Privilege in Court and Service Rules

The attorney-client and work-product privileges, as they have developed at common law, have been recognized by statute. The Federal Rules of Civil Procedure make an exception to the general discovery rules for anything that is “privileged.”\(^{17}\) Courts have used the same rules to determine whether an item requested in discovery is privileged, and to determine whether the item is privileged for evidentiary purposes.\(^{18}\) The Federal Rules of Evidence, however, provide only sparse guidance concerning what is privileged, stating “the privilege of a witness . . . shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.”\(^{19}\) Thus, despite the statutory recognition, the attorney-client privilege is essentially as developed by the courts.

The Federal Rules of Civil Procedure separately recognize the work-product privilege. Federal Rule of Civil Procedure 26(b)(3) requires a party, when requesting materials prepared by the other party’s attorney, to show it has “substantial need of the materials . . . and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means.”\(^{20}\) However, even if this substantial-need test is met, the same rule protects the

---

\(^{15}\) 329 U.S. 495 (1947).

\(^{16}\) Id. at 511.

\(^{17}\) FED. R. CIV. P. 26(b)(1).


\(^{19}\) FED. R. EVID. 501. The question of whether a matter is privileged in a federal court may be a matter of either state or federal law. The well-known *Erie* doctrine requires federal courts sitting in diversity to apply state substantive law and federal procedural law. See Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938); see also Guaranty Trust Co. v. York, 326 U.S. 99 (1945). In diversity matters, federal courts have consistently applied state law to attorney-client privilege issues. See, e.g., Palmer v. Fisher, 228 F.2d 603 (7th Cir. 1955); Engl v. Aetna Life Ins. Co., 139 F.2d 469 (2d Cir. 1943). When a federal court’s jurisdiction is based on a federal question, however, federal substantive and procedural law applies. See, e.g., Atlantic Coast Line R. Co. v. Dixon, 207 F.2d 899 (5th Cir. 1953); United States v. Schennault, 201 F.2d 1 (7th Cir. 1952). Consequently, federal courts have usually held that federal privilege law applies to matters involving federal income tax matters. See Colton v. United States, 306 F.2d 633 (2d Cir. 1962); *In re Albert Lindley Lee Memorial Hosp.*, 209 F.2d 122 (2d Cir. 1953); Falsone v. United States, 205 F.2d 734 (5th Cir. 1953). *But see* Baird v. Koerner, 279 F.2d 623 (9th Cir. 1960) (prior to the enactment of the Federal Rules of Evidence, state attorney-client privilege law was applied).

\(^{20}\) Id.
attorney’s “mental impressions, conclusions, opinions, [and] legal theories” even if the above showing is made.\textsuperscript{21} States generally recognize the attorney-client privilege and work-product privilege in the same way as the Federal Rules of Civil Procedure and the Federal Rules of Evidence.\textsuperscript{22}

Section 7602 gives the Internal Revenue Service authority to summon taxpayer documents and testimony. Although the Code does not so specify, it is well established that the attorney-client and work-product privileges apply to such a Service summons.\textsuperscript{23} The attorney-client and work-product privileges also apply in the Tax Court. Under section 7453, the Federal Rules of Evidence are made applicable to Tax Court proceedings.\textsuperscript{24} In addition, Tax Court Rule 70\textsuperscript{25} states “[t]he information or response sought through discovery may concern any matter not privileged and which is relevant to the subject matter involved in the pending case.” \textsuperscript{26} Accordingly, the privilege rules applicable to Tax Court proceedings are essentially the same as in other federal courts.\textsuperscript{27}

C. Tax Practitioner Privilege

Before 1997, numerous courts held that there was no general accountant-client privilege.\textsuperscript{28} While this was a fairly self-evident proposition when it came to the provision of accounting services, it created something of an anomaly

\textsuperscript{21}Id.

\textsuperscript{22}See, e.g., N.Y. C.P.L.R. 3101(b) (McKinney 1991 & Supp. 2000) (stating “[u]pon objection by a person entitled to assert the privilege, privileged matter shall not be obtainable”); N.Y. C.P.L.R. 4503(a) (McKinney 1991) (stating “[u]nless the client waives the privilege, an attorney or his employee, or any person who obtains without the knowledge of the client evidence of a confidential communication made between the attorney or his employee and the client in the course of professional employment, shall not disclose, or be allowed to disclose such communication, nor shall the client be compelled to disclose such communication, in any action, disciplinary trial or hearing, or administrative action, proceeding or hearing conducted by or on behalf of any state, municipal or local governmental agency or by the legislature or any committee or body thereof.”); N.Y. C.P.L.R. 3101(c) (McKinney 1991) (stating “[t]he work product of an attorney shall not be obtainable”); N.Y. C.P.L.R. 3101(c) (McKinney 1991) (stating “materials . . . prepared in anticipation of litigation . . . may be obtained only upon a showing that the party seeking discovery has substantial need of the materials . . .”).


\textsuperscript{24}I.R.C. § 7453, states that “Except in the case of proceedings under section 7436(c) [employment status] or 7463 [disputes involving $50,000 or less], the proceedings of the Tax Court and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Tax Court may prescribe and in accordance with the rules of evidence applicable in trials without a jury in the United States District Court of the District of Columbia.” The Federal Rules of Evidence apply in the United States District Court of the District of Columbia, and therefore the also apply in the Tax Court.

\textsuperscript{25}Although the Tax Court is a federal court, the Federal Rules of Civil Procedure do not apply.

\textsuperscript{26}There are some subtle differences in the application of the work-product privilege in Tax Court and other federal courts. See Ronald A. Stein, Preserving Client Confidences and Work Product Privacy, 72 TAX NOTES TODAY (Sept. 3, 1996).

when an accountant was asked for tax advice, as often is true. The same question that if asked of a lawyer would be in a privileged conversation, at best only arguably would be privileged if asked of an accountant. In 1997, after considerable lobbying by the accounting profession, Congress enacted Code section 7525 to address this seeming anomaly.

Under section 7525, the same privilege that applies with respect to communications between a client and an attorney applies to communications between a client and a “federally authorized tax practitioner” with respect to “tax advice.” A federally authorized tax practitioner generally is any individual authorized to practice before the Service. This would include CPAs and enrolled agents. Tax advice is defined as advice that is “within the scope of the individual’s authority to practice” before the Service. Although there has been considerable debate over the meaning of tax advice so defined, the legislative history accompanying the enactment of section 7525 suggests that it is such advice that would be privileged if communicated between a client and an attorney. The privilege under section 7525 does not extend either to criminal matters or to matters in connection with a tax shelter, as defined in section 6662(d).

So long as it is assumed that the scope of the privilege accorded the federally authorized tax practitioner is not greater than what would have been enjoyed if an attorney were involved, the practical significance of section 7525 is relatively limited. Its main effect will be in the context of CPAs providing routine tax advice to individual clients or to corporations not acting through an attorney. In those and all other cases, however, the myriad of issues discussed in the next section must be resolved in order to determine whether the privilege exists.

III. THE ELEMENTS OF ATTORNEY-CLIENT AND WORK-PRODUCT PRIVILEGES

A. Attorney-Client Privilege

The Wigmore formulation of the requirements of the attorney-client privilege reflects different elements of the privilege that courts focused on from time

29The dividing line between a request for accounting services and tax advice has not always been so clear. See infra text accompanying notes 44-60.
30See Ronald A. Stein, Preserving Client Confidences and Work Product Privacy, TAX NOTES TODAY (Sept. 3, 1996), for the case for conferring the privilege upon accountant-client communications in the context of tax advice.
31I.R.C. § 7525(a)(1).
36I.R.C. § 7525(a)(2).
37I.R.C. § 7525(b).
38As discussed in the text accompanying notes 62-74, infra, communications between an attorney and an accountant assisting the attorney to render legal advice can be privileged.
39See supra note 13 and accompanying text.
to time. Some of these elements are more important than others in the transactional tax context. Each of the parts will at least be commented on below, with the more relevant parts discussed more fully.

1. *Where Legal Advice of Any Kind is Sought*

The first major requirement for the attorney-client privilege to apply is that the advice sought be *legal* advice. If the attorney is hired to provide non-legal services, the attorney-client privilege does not apply. Furthermore, if the attorney is hired to provide legal services and non-legal services are provided as well, the communications relating to the non-legal services are not protected.

In transactional practice, clients frequently request an attorney’s assistance without expressly asking for legal advice. For example, when an attorney is asked to draft a contract, no specific legal questions may be asked or answers sought. In this situation, the client only impliedly is requesting that the attorney use legal knowledge when preparing the contract. There seems to be no clear test applied by the courts to determine what communications are made for the purpose of requesting legal advice. In *Diversified Industries v. Meredith*, the Eighth Circuit en banc quoted Wigmore stating:

"[i]t is not easy to frame a definite test for distinguishing legal from non-legal advice. . . . The most that can be said by way of generalization is that a matter committed to a professional legal adviser is prima facie so committed for the sake of the legal advice which may be more or less desirable for some aspect of the matter and is therefore within the privilege unless it clearly appears to be lacking in aspects requiring legal advice. Obviously, much depends upon the circumstances of individual transactions."

In a transactional matter, it is not a foregone conclusion that an attorney will be considered to have been consulted for the purpose of rendering legal advice. For example, in real estate transactions, courts often find attorneys are not providing legal advice. In *United States v. De Vasto*, the court held the attorney’s testimony was not privileged because he was merely assisting in the transfer of real estate.

When it comes to taxes, a favorable presumption of the existence of privilege often is greeted very cynically. One area that has received a great deal of attention in the case law is the preparation of tax returns. Typical of the many cases involving a tax return is *United States v. Willis*. In *Willis*, the taxpayers hired an attorney to prepare their tax returns and perform other legal tasks. In holding that the taxpayers should be given an opportunity to show that the documents in question did not constitute mere underlying detail to their returns, which would not have been privileged, the court nonetheless declared “the *Diversified* pre-

---

40572 F.2d 596 (8th Cir. 1977) (en banc).
41Id. at 610, quoting Wigmore, supra note 5, § 2292.
4252 F.2d 26 (2d Cir. 1931).
44Id. at 1193. See infra notes 99-100 and accompanying text.

*Tax Lawyer*, Vol. 54, No. 3
sumption [is] inapplicable in the income tax return preparation context.” While the Willis court recognized that “questions occasionally arise in the income tax preparation context which require research and interpretation of the tax statutes and regulations,” it went on to hold that income tax preparation was virtually always an accounting, rather than legal, activity. Courts before and after Willis routinely have held that tax return preparation is an accounting service and therefore does not give rise to the attorney-client privilege even if performed by an attorney. Therefore, an attorney can be required to testify about the contents of any information given to the attorney for the purpose of preparing a tax return. Furthermore, the Seventh Circuit recently held that information given to an attorney both for the purpose of securing legal advice and also for use in preparation of a tax return will not be privileged.

Taken to its logical extreme, almost all work of a tax professional ultimately involves something related to tax return preparation, but the courts have not taken so extreme a view. A logical dividing line is to limit non-privileged “preparation” to the mere processing of paperwork, transferring numbers, and similar tasks. The Ninth Circuit, without articulating the line as such, has suggested that communications relating to advice concerning the tax consequences of completed transactions can be protected. In United States v. Abrahams, the Service issued a summons to an attorney who prepared tax returns for his clients and represented them in tax disputes. The attorney was being investigated for possibly filing improper amended returns for his clients. The court stated that “[a]lthough communications made solely for tax return preparation are not privileged, communications made to acquire legal advice about what to claim on tax returns may be privileged.”

The court stated that the attorney had a chance in the district court to show that his clients were seeking legal advice but that he failed to make such a showing. Accordingly, the court held the privilege did not apply in that situation.

Although the precise dividing line still remains unclear, a recent case confirms that a communication is more likely to be privileged the farther removed it is from the preparation of a tax return. Boca Investerings Partnership v. United States involved American Home Products Corporation’s misadventure with a now notorious corporate tax shelter. The Service moved to compel production of documents prepared by the company’s chief tax officer, who was an attorney.

---

45Id. at 1190.
46Id.
47See, e.g., Olender v. United States, 210 F.2d 795, 806 (9th Cir. 1954); United States v. Threlkeld, 241 F. Supp. 324, 327 (W.D. Tenn. 1965); In re Grand Jury Investigation, 842 F.2d 1223, 1225 (11th Cir. 1987); United States v. Lawless, 709 F.2d 485, 487-88 (7th Cir. 1983); see also United States v. Davis, 636 F.2d 1028, 1043 (5th Cir. 1981); Canaday v. United States, 354 F.2d 849, 857 n.7 (8th Cir. 1966).
49905 F.2d 1276 (9th Cir. 1990).
50Id. at 1284.
Since the officer was not part of the company’s legal department, the court paid particularly close attention to whether the memorandum of which the discovery was sought contained legal or non-legal advice. Although allowing discovery of portions of the memorandum described as intended for a third party, the court otherwise found that the memorandum embodied tax advice and was privileged, as were all but certain portions of two opinion letters from outside counsel.52

At the audit stage, the tax return is close at hand. The main privilege battleground during an audit is over testimony or documents sought by the Service relating to tax advice given regarding past and future conduct surrounding the subject matter of the audit. Until recently, there would not have been much dispute that representation of a taxpayer during a Service audit was considered legal advice even though there was no case squarely addressing the issue. In that vein, at least, was United States v. Cote,53 where the Service summoned work papers in the possession of the taxpayer’s attorney and accountant. The Eighth Circuit concluded that advising a taxpayer whether or not he should file an amended return during a Service audit was legal advice. If the attorney had simply prepared an amended return without the investigation pending, the attorney’s work would not have been considered legal advice.54 However, the case did not generally address the issue of characterizing representation relating to a Service investigation since the “legal advice” there related simply to the decision to file an amended return in face of the Service investigation. Under Cote, it would not be either at all aggressive or inconsistent to adopt the view that at least for an audit that raises questions about the legal treatment of an item (“was it deductible?”) as opposed to a mere “tallying” issue (“were all those claimed entertainment expenses really with clients?”), the attorney’s advice during such audit is legal advice that may be privileged.

Surprising then was United States v. Frederick,55 which squarely addressed the issue of representation in an audit. In the Seventh Circuit’s original April 15, 1999 opinion, Chief Judge Posner declared that an audit is “a stage in the determination of tax liability” and concluded that no privilege exists for communications between an individual taxpayer and his attorney during the course of a Service audit because those representing taxpayers during an audit are engaged in “accountant’s work.” Judge Posner noted, “[n]ormally, however, taxpayers in audit proceedings are represented by accountants, or not represented at all, rather than by lawyers; and so the principal effect of equating audits to litigation and thus throwing the cloak of privilege over the audit-related work of the taxpayer’s representative would be to create an accountant’s privilege usable only by lawyers.”56

52Id. at 12-13.
53456 F.2d 142 (8th Cir. 1972).
54See id. at 144. See also United States v. Willis, 565 F. Supp. 1186, 1191 (S.D. Iowa 1983) (stating that “a lawyer’s preparation of an amended tax return would probably not be viewed as falling outside the ambit of the tax return preparation function”).
55182 F.3d 496 (7th Cir. 1999).
56Id.

Tax Lawyer, Vol. 54, No. 3
Commentators were highly critical of this opinion and on May 18, 1999, the Seventh Circuit amended its opinion slightly. Judge Posner removed the sentence quoted above and added the following language:

[w]hen a revenue agent is merely verifying the accuracy of a return, often with the assistance of the taxpayer’s accountant, this is accountants’ work and it remains such even if the person rendering the assistance is a lawyer rather than an accountant. Throwing a cloak of privilege over this type of audit-related work of the taxpayer’s representative would create an accountant’s privilege usable only by lawyers. If, however, the taxpayer is accompanied to the audit by a lawyer who is there to deal with issues of statutory interpretation or case law that the revenue agent may have raised in connection with his examination of the taxpayer’s return, the lawyer is doing lawyer’s work and the attorney-client privilege may attach.

The amended opinion appears to be a return to the Wigmore formulation while offering the practical distinction between legal and accounting work during an audit as suggested by Cote. Although no case has addressed the matter in these terms, the very same distinction should apply to advice sought prior to or in connection with the preparation of an income tax return. Thus, where the attorney is providing legal advice (defined by Posner as the interpretation of cases and statutes), the privilege can apply. Nonetheless, it is fair to say that the law would appear to be settling if not settled around this distinction. Frederick is a vivid reminder of the frequent ambivalence, if not hostility, of courts to recognizing any privilege when a tax return is in the picture.

2. From a professional legal adviser in his capacity as such

Generally, the attorney-client privilege applies only to communications between a client and an attorney, and, now under section 7525, a non-attorney who is a “federally authorized tax practitioner.” However, particularly when the client is a corporation, in addition to attorneys there may be a considerable array of actors involved in a corporate transaction. As a result, the degree to which the attorney-client privilege may cover those other actors is critical. The guiding principle adopted by most courts is that the attorney-client privilege may cover those other actors is critical. The guiding principle adopted by most courts is that the attorney-client privilege extends to those assisting the attorney so long as the assistance is given ultimately to enable the attorney to provide legal advice. However, sometimes determining whether the non-attorney is truly assisting the attorney is not an easy task.

58182 F.3d 496, 502 (7th Cir. 1999).

Tax Lawyer, Vol. 54, No. 3
Since the origins of the attorney-client privilege, it has been held that the privilege extends to those who assist an attorney in a ministerial capacity such as secretary, assistant, file clerk, messenger, interpreter or other support personnel. The privilege can in fact extend beyond those providing ministerial services. The leading case defining the extension of the privilege beyond those providing such ministerial services is United States v. Kovel. In Kovel, an accountant employed by attorneys was held in contempt for claiming privilege when called to testify before a grand jury. On appeal, the Second Circuit held that an accountant assisting the attorney could not be forced to give testimony that would be protected if it had been the attorney that was being deposed. In often quoted but now quaint sounding language, Judge Friendly stated that “Accounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases.” The court recognized that the same reasons for protecting a client’s communications with his attorney also justify extending the privilege to all those assisting the attorney. Judge Friendly went on to state that the “complexities of modern existence prevent attorneys from effectively handling clients’ affairs without the help of others.”

Kovel also made it clear that who hired the non-lawyer and who was communicating with the non-lawyer was immaterial so long as the other elements of the Wigmore formulation were met. The Second Circuit used the non-controversial example of a foreign language interpreter to illustrate the contours of the privilege. Specifically, the court said communications could be privileged in situations where 1) the attorney provided the interpreter to help with communications between the attorney and the client, (2) the client brought the interpreter with him to consult with the attorney, (3) the attorney sent the client to an interpreter for the interpreter to make a literal translation of the client’s story, or (4) the attorney sent the client to an interpreter having given the interpreter instructions to interview the client. So long as the purpose of these transactions was to assist the attorney in providing legal advice (and the other elements of the privilege were met) the interpreter’s testimony could not be subpoenaed.

When accountants are involved in tax matters and privilege is claimed, the significance of Kovel and several cases that followed it is limited today insofar as the facts of those cases are concerned, as section 7525 generally has extended the privilege to accountants providing tax advice so long as the other elements of privilege are present. Thus, where an accountant is involved, the focus will be on whether the accountant is performing a task that is part of and needed for the purpose of delivering legal advice, whether that be legal advice of the

---

60See, e.g., Anderson, 2 Ch.D. at 649. The extension of the privilege to agents of the attorney has been codified in many jurisdictions. See supra note 23 (quoting N.Y. C.P.L.R. 4503(a)).
61296 F.2d 918 (2d Cir. 1961).
62Id. at 922.
63Id.
64Id. at 921.
65See supra Part II.C.
accountant or of a lawyer engaged on the same matter. However, *Kovel* and the cases that followed it where non-accountants or accountants who are clearly providing non-legal services are involved will still be of great significance.

Of particular importance are cases that delve into the purpose for engaging the non-attorney. For example, in *United States v. Bein*, the client, two attorneys and an accountant met to discuss the legality of certain proposed commodity transactions. At the meeting, the attorneys mentioned a case that apparently held that the type of transactions discussed were illegal. After the meeting, the accountant read the case and in a separate meeting recommended that the client not engage in that type of transaction. The court held that the accountant-client meeting was not privileged because it took place after the meetings with counsel where legal advice had already been obtained. Perhaps the court was swayed by the unsolicited nature of the advice in concluding that the accountant was functioning as the client’s accountant, not his professional legal advisor, thereby preventing any privilege from applying. The court concluded by saying that “[o]nly communications between a client and attorney are protected by the privilege, not discussions with non-lawyers concerning the same subject matter.”

Although section 7525 may change the result of *Bein* where the discussion was with a professional tax adviser and the subject matter of the advice was tax, the holding is highly relevant where the client may, apart from his or her discussions with counsel, discuss tax advice with a person to whom no privilege extends.

In contrast to *Bein*, in *In re Grand Jury* an accountant recommended to his client that the client hire an attorney. After the decision to hire the attorney was made, the accountant met with the client and discussed new information that related to the client’s tax returns. The client and the accountant later discussed the subject matter of the meeting, while driving together to the attorney’s office. The court recognized that “[s]tatements made while intending to employ a lawyer are privileged even though the lawyer is not employed.” The court then held that only communications that relate to future meetings with an attorney and that occur immediately prior to the meeting should be privileged, and therefore only the conversations in the car ride and not in the preceding meeting were privileged. The court reasoned that this would better ensure that the communications held privileged were to assist the client in dealing with the legal advice he received “rather than merely for the purpose of receiving accounting advice.”

---

66 See, e.g., *United States v. Frederick*, 182 F.3d 496, 502 (7th Cir. 1999) (finding that section 7525 is inapplicable where an accountant is “doing other than lawyers’ work . . .”).
67 See, e.g., *Segerstrom v. United States*, 2001 U.S. Dist. Lexis 2949, in which an attorney made notes summarizing a telephone conversation concerning estate planning issues. The conversation was between the lawyer, his client and the CFO of a partnership that managed a business owned by the client. The court held these notes were privileged because the CFO also “acted as a financial and tax adviser” to the client and that he was present to assist the client in obtaining legal advice.
68 728 F.2d 107 (2d Cir. 1984).
69 Id. at 113.
70 Id.
71 947 F.2d 1188 (4th Cir. 1991).
72 Id. at 1190 (citing *United States v. Dennis*, 843 F.2d 652, 656 (2d Cir. 1988)).
73 Id. at 1191.
Three important issues emerge under this rubric. The first, somewhat surprisingly, is the extent to which communications from attorney to client, and not just communication from client to attorney, are privileged. Although intuition would suggest, and some courts have held, that the attorney’s words to the client should have the same protection as the client’s words to the attorney,\(^7^4\) this is not necessarily true. In fact, most courts have held that communications to a client from an attorney are protected only if they contain information that would reveal confidential client communications.\(^7^5\) Without case law relating to any tax matter on this subject, it is hard to gauge the impact of this inherent limitation in the context of tax advice. Nonetheless, it is easy to imagine an unsympathetic set of facts in which a court would be tempted to hold that legal advice on a question of mixed law and fact is held not to be privileged because it mostly addresses nonconfidential facts.

The second set of issues relates to the extent to which written as well as oral communications can be privileged. Although there is no real question that written communication is eligible for the same degree of protection as oral communication,\(^7^6\) the question in practice can arise where there are multiple documents reflecting various communications from the client to the attorney or vice versa. The mere fact that all of the documents relate to a matter in which the client sought legal advice is not sufficient to cloak the documents in privilege. Thus courts generally reject a blanket claim of privilege\(^7^7\) and have held that trial judges can review documents that are claimed to be privileged and order production of the portions to which the privilege does not apply.\(^7^8\)

---

\(^7^4\)See, e.g., United States v. Amerada Hess Corp., 619 F.2d 980, 985-86 (3d Cir. 1980) (holding that legal advice and opinions from attorney to client are within the scope of the privilege); Sprague v. Thorn Americas, Inc., 129 F.3d 1355, 1370-71, (10th Cir. 1997); In re Grand Jury Subpoena, 765 F.2d 1014, 1018 (11th Cir. 1985); see also Paul R. Rice, Attorney-Client Privilege: Continuing Confusion About Attorney Communications, Drafts, Pre-Existing Documents, and the Source of the Facts Communicated, 48 AM. U. L. REV. 967, 974 (1999) (criticizing this expanded view of the privilege as “problematic in that it extends the privilege’s protection far beyond what is necessary to further its limited goal—to encourage open and candid communications from the client.”).

\(^7^5\)See United States v. Gray, 876 F.2d 1411, 1415 (9th Cir. 1989) (holding that an attorney’s testimony that he informed his client of the client’s sentencing date was not privileged because “[w]e apply the attorney-client privilege only when necessary to effectuate its limited purpose of encouraging complete disclosure by the client.” (internal citations omitted)); In re Air Crash Disaster at Sioux City, Iowa, 133 F.R.D. 515, 518 (N.D. Ill. 1990); Ohio-Sealy Mattress Mfg. Co. v. Kaplan, 90 F.R.D. 21, 28 (N.D. Ill. 1980).

\(^7^6\)See Colton v. United States, 306 F.2d 633, 639 (2d Cir. 1962).

\(^7^7\)See, e.g., Webster v. United States, 58 A.F.T.R.2d 86-5381 (C.D. Ill. 1986) (quoting United States v. Lawless, 709 F.2d 485, 487 (7th Cir. 1983)).

\(^7^8\)See Boca Investerings Partnership v. United States, 31 F. Supp.2d 9 (D.D.C. 1998) (holding the attorney-client privilege protects portions of an opinion letter that described a proposed transaction but made available the portions that reveal information that is publicly known, the attorney’s opinion with respect to such information and all references to transactions already completed); United States v. Adlman, 134 F.3d 1194 (2d Cir. 1998) (requiring disclosure only of the portions of the document not protected by the work-product privilege); United States v. United Technologies, 979 F. Supp. 108, 112 (D. Conn. 1997) (using a document-by-document review to determine which documents were privileged).

---

*Tax Lawyer*, Vol. 54, No. 3
For documents prepared by an attorney, the standard used is the same as that used for determining whether oral communications are protected by the attorney-client privilege. For example, in *United States v. (Under Seal)*, a client hired an attorney to prepare a proposed tax ruling. The court held that three letters from the attorney concerning the proposed tax ruling were not privileged because they either did “not reveal client communications or reveal[ed] communications on matters which were intended to be made public.”

Without expanding the scope of the attorney-client privilege beyond this conceptual boundary, at least one court has held that an attorney’s notes and draft agreements may be protected by the attorney-client privilege. Although these items are not communications and are, therefore, not squarely within the attorney-client privilege, the rationale for extending the privilege to these items is that disclosing them may reveal communications that are protected. Therefore, notes and draft documents may be protected by the attorney-client privilege to the extent disclosure of these documents would reveal confidential client communications.

The third set of issues relates to protection of the client’s identity. The law regarding when a client’s identity is within the privilege has undergone significant evolution. Typically, a client’s identity is not itself a communication and therefore is not privileged. However, a number of courts have held that the identity of a client may itself be privileged in appropriate circumstances. The Ninth Circuit case *Baird v. Koerner* is the earliest case in this area. In *Baird*, a taxpayer’s accountant went to an attorney to discuss underpayment of taxes in prior years. The taxpayer wished to minimize the repercussions that would follow a Service discovery of the deficiencies. It was decided that the best way to do so was for the attorney anonymously to pay on the taxpayer’s behalf the amount believed to be owed for the prior years. Upon receiving such payment, the Service sought the identity of the accountant and the taxpayer from the attorney. The Ninth Circuit found an exception to the general rule that a client’s identity is not privileged information and held that the identity of a client is privileged when “the name of the client is material only for the purpose of showing an acknowledgment of guilt on the part of such client of the very offenses on account of which the attorney was employed.” The applicability of *Baird* to federal tax controversies is somewhat questionable, however, because the court’s decision pre-dated the Federal Rules of Evidence and was based on California attorney-client privilege law. However, federal courts have recog-
nized the logic of *Baird* in cases following adoption of the Federal Rules of Evidence.

Subsequent to *Baird*, federal circuit courts have applied at least three different tests to determine if a client’s identity is privileged in both tax and non-tax cases.85 The least popular and now virtually discarded test has been described as the “last link” test. Courts applied it when “disclosure of the client’s identity by his attorney would . . . supply the last link in an existing chain of incriminating evidence likely to lead to the client’s indictment.”86 The second test which has been used by several circuits, but discarded by many of them, is the “legal advice” test.87 This test finds the client’s identity privileged where “disclosure of the information would implicate the client in the very matter for which legal advice was sought.”88

The third test is the “communication” test which has replaced the legal advice test as the most commonly used test. The first tax case to apply this standard was *Tillotson v. Boughner* in 1965.89 There, the Seventh Circuit addressed facts that were virtually identical to those of *Baird*. The court adopted the communication test, reasoning that disclosing the client’s identity would “lead ultimately to disclosure of the taxpayer’s motive for seeking legal advice,” and concluding that “motive of the taxpayer is subject to the privilege. . . .”90 Therefore, according to *Tillotson*, if disclosing a client’s identity would disclose the client’s motive for seeking legal advice, the client’s identity is privileged.91

Later, in *Osterhoudt v. United States*,92 the Ninth Circuit adopted the communication test. In doing so, it rejected the legal advice test which it had earlier adopted, and also rejected the rationale of *Baird*, while stating that the case would nonetheless have been decided the same way under the communication test. The court said that the client’s identity is privileged where disclosure “was in substance a disclosure of the confidential communication in the professional relationship between the client and the attorney.”93 The communication test was also used recently by the Fourth Circuit in *In re Grand Jury Subpoena*, a non-tax

---

86In re Grand Jury Proceedings, 680 F.2d 1026, 1027 (5th Cir. 1982) (en banc).
87See, e.g., *In re Grand Jury Subpoenas*, 906 F.2d 1485, 1488-89 (10th Cir. 1990); *In re Sealed Case*, 877 F.2d 976, 979-80 (D.C. Cir. 1989); *In re Grand Jury Investigation No. 83-2-35*, 723 F.2d 447, 452 (6th Cir. 1983); *In re Grand Jury Subpoenas Duces Tecum*, 695 F.2d 363, 365 (9th Cir. 1982); *In re Grand Jury Proceedings*, 641 F.2d 199, 204 (5th Cir. 1981); *In re Grand Jury Investigations*, 631 F.2d 17, 19 (3d Cir. 1980); *In re Walsh*, 623 F.2d 489, 495 (7th Cir 1980); United States v. Strahl, 590 F.2d 10, 11-12 (1st Cir. 1978).
87In re Grand Jury Subpoenas Duces Tecum, 695 F.2d at 365.
88350 F.2d 663 (7th Cir. 1965).
89Id. at 666.
90An earlier case, *Colton v. United States*, 306 F.2d 633, 637 (2d Cir. 1962), stated in apparent dicta that the identity of a client may be privileged in situations where revealing the client’s identity would “amount to the prejudicial disclosure of a confidential communication, as where the substance of a disclosure has already been revealed but not its source.” The Fourth Circuit adopted the communication test in an earlier non-tax case. See *N.L.R.B. v. Harvey*, 349 F.2d 900 (4th Cir. 1965).
91722 F.2d 591 (9th Cir. 1983).
92Id. at 593.

*Tax Lawyer*, Vol. 54, No. 3
case. There, a community organization retained an attorney who sent a letter to the record owner of a property that was known to be used for harboring drug activity. The letter threatened a lawsuit if the drug activity was not curtailed. The attorney for the organization received a letter back from an attorney who claimed to represent an individual (other than the record owner) stating the client wished to re-title the property and requested an opportunity to address the problem. The government later served a grand jury subpoena on the unidentified client’s attorney requesting, among other things, documents that identified the client. The Fourth Circuit applied the communication test, with counterintuitive results. The attorney claimed that his client’s identity was privileged because to reveal it would reveal his client’s motives. The court held that since the client’s motives were revealed in the letter, they were no longer confidential and therefore revealing the client’s identity would not reveal any confidential communications. Accordingly, the court held the client’s identity was not privileged. It is not at all clear that this reasoning would not have lead to a contrary result in Tillotson, which ostensibly applied the same test. Thus, while the articulation of the test may be relatively settled, its application by the courts is still somewhat unpredictable. While the scent of drugs surrounding the In re Grand Jury subpoena preceding may have influenced its result, it is always possible that a judge will find the aroma of tax avoidance no more inviting.

4. Made in Confidence

To invoke the attorney-client privilege, the communication must be intended to be confidential. Generally, information that will be transmitted to a third party cannot by its nature be said to be confidential and therefore is not privileged. A prime example of the type of communication that is denied any privilege because of this requirement is a corporation’s tax accrual work papers. In United States v. El Paso Company, the Service issued a summons for the El Paso Company’s tax accrual work papers. These papers were prepared by the company’s in-house counsel for disclosure to outside accountants to comply with the securities laws financial reporting requirements. The court concluded that because the tax accrual work papers were disclosed to independent accountants (in fact, they were created with the intention of disclosure), the confidentiality, and therefore the privilege, was destroyed.

Similar reasoning applies to virtually any records or other information prepared for or used in connection with a tax return. Since the return itself represents a disclosure to the Service, the information developed for preparation of the return has necessarily been prepared with an intention to be disclosed rather
than remain confidential.99

5. By the Client

Since the attorney-client privilege only protects communications by “the client,” it must be determined who the client is. In the context of a corporate client, the corporation can communicate only through individuals. Before 1981, the question of which employees or agents of a corporation could make or receive privileged communications was subject to widely varying judicial approaches.100 Prevalent although not universal was the narrow “control group” test under which communications between a corporate employee and an attorney could not be privileged unless the employee was sufficiently high in the corporate hierarchy to be able to control corporate actions.101 In 1981, the Supreme Court in *Upjohn Co. v. United States*102 radically changed this focus. In this case, the Service summoned workpapers and communications prepared by or conveyed to in-house counsel during the course of an internal inquiry into alleged bribery by Upjohn employees. Without articulating any specific alternative, the Court rejected the control group test and held that the attorney’s communications with rank-and-file employees were eligible for the attorney-client privilege. The Court said the privilege should be applied on a case-by-case basis in situations where the facts are “consistent with the underlying goal of the privilege.” The Court identified five facts in the *Upjohn* case that warranted the use of the privilege. These facts included: (1) the communications were made to counsel at the direction of management to secure legal advice, (2) the information was not available from upper management, (3) the communications concerned matters within the employees’ corporate duties, (4) the employees were aware they were being questioned so the company could secure legal advice, and (5) the communications were kept confidential. The items on the list were not held out either as exclusive or required. As a result, post-Upjohn courts have struggled with the issue. Although courts have articulated somewhat different standards for determining which corporate employees can have privileged communications with attorneys,103 by

---

99Merrell, 303 F. Supp. at 492-93.
100See, e.g., Herbert v. Lando, 568 F.2d 974 (2d Cir. 1977) (holding that an in-house attorney was a member of the “control group” and therefore the communication was considered to be made by the client); United States v. United Shoe Machinery Corp., 89 F. Supp. 357 (D. Mass. 1950) (holding that the privilege applied to any employee).
101See Herbert, 568 F.2d at 974.
103See, e.g., Harper-Wyman Co. v. Connecticut General Life Ins. Co., No. 86 C 9595, 1991 U.S. Dist. LEXIS 5007 (N.D. Ill. 1991) (holding that the communication needed only to be within the communicator’s scope of employment); Thomas v. Pansy Ellen Products, Inc., 672 F. Supp. 237 (W.D.N.C. 1987) (holding that the communication needed to only be made at the direction of a corporate superior); Admiral Ins. Co. v. United States Dist. Court, 881 F.2d 1486 (9th Cir. 1989) (holding that the communication must be within the communicator’s scope of employment and the communicator must know that the communication is made for the purpose of obtaining legal advice); In re Alexander Grant & Co. Litigation, 110 F.R.D. 545 (S.D. Fla. 1986) (holding that the communication must be within the communicator’s scope of employment, at the direction of a corporate supervisor, and the communicator must know that the communication is made for the purpose of obtaining legal advice).
most any post-Upjohn standard an individual seeking tax advice on behalf of a corporation will be eligible.104

6. Are at this Instance Permanently Protected

This element of the attorney-client privilege has relatively little relevance in transactional tax matters. Generally, this element is cited for the proposition that it is the client who may invoke the privilege and not the attorney.105 It is also cited for the proposition that the privilege lasts indefinitely.106 Thus, for example, privileged communications with respect to a transaction will remain privileged even after any litigation regarding the transaction has concluded. This will be relevant when the particular issue is litigated but has significance in subsequent tax years.

7. From Disclosure by Himself or by the Legal Adviser

The traditional formulation of the attorney-client privilege would prevent compelled testimony by either the client or the lawyer about certain communications between the two. However, as discussed in Part III.A.2., the attorney-client privilege extends in certain cases to communications with non-attorneys who assist the attorney. The same logic that includes communications by the client or the attorney with these non-attorneys under the umbrella of privilege also prevents compelled testimony by these non-attorneys of the privileged communication.107

8. Except the Protection be Waived

a. Waiver in general. If a client waives the protection of the attorney-client privilege, justification for the privilege no longer exists and neither does the privilege. Waiver by the client can be either express or implied. There being no known case of a failed attempt at express waiver, all interpretive activity on the issue relates to determining what conduct of the client will constitute an implied waiver.

The principal manner in which an implied waiver can be made is communication of the privileged information to third parties.108 In so communicating the

104Upjohn interpreted Fed. R. Evid. 501, and so is binding only on federal courts. Following Upjohn, several state courts either adopted the control-group test, or reaffirmed it, thereby rejecting Upjohn. See e.g., Consolidation Coal Co. v. Bucyrus-Erie Co., 432 N.E.2d 250 (Ill. 1982) (refusing to follow Upjohn and reaffirming the control-group test); see also Samaritan Found. v. Goodfarb, 862 P.2d 870 (Ariz.1993) (adopting intermediate test, and legislatively overruling Arizona Revised Statutes §12-2234). Because the attorney-client privilege is a rule of evidence, the applicable test may depend on the jurisdiction. See note 17, supra.

105See United States v. Abrahams, 905 F.2d 1276 (9th Cir. 1990) (recognizing that the attorney may not assert the attorney-client privilege for himself when he was being investigated but allowing the privilege to be asserted because the attorney filed declarations of his clients wishing to invoke the privilege with respect to the documents in question).

106See Baldwin v. Commissioner, 125 F.2d 812, 814 (9th Cir. 1942).

107See Wigmore, supra note 5, § 2294, at 563.

information, the waiver generally is effective notwithstanding that the client may not have intended to waive the privilege. In *In re Grand Jury Subpoena*, discussed in Part III.A.3., it was acknowledged that a client’s identity could be privileged if disclosing it would reveal the client’s motive. Since the unidentified client in that case had written a letter to its adversary expressing his motive behind hiring the attorney, the court held that the client had waived the attorney-client privilege with respect to its motives and, therefore, the client’s identity was no longer privileged.

A very dramatic recent application of these principles occurred in *In re Pioneer Hi-Bred Int’l Inc.*, a case between private litigants for, among other things, patent infringement. Plaintiff Monsanto Corporation sought to have defendant Pioneer produce information relating to a merger transaction Pioneer had engaged in. The court found that disclosure in proxy materials with respect to the tax consequences of the merger “waived the attorney-client privilege with respect to all documents which formed the basis for the advice, all documents considered by counsel in rendering that advice, and all reasonably contemporaneous documents reflecting discussions by counsel or others concerning that advice.”

b. The Common Interest Doctrine. The so-called common interest doctrine protects in certain circumstances an otherwise privileged communication that is disclosed to another party where the disclosure ordinarily would waive any privilege. One typical situation in which the common interest doctrine might be applied is that of two different clients who retain a single lawyer in a single matter. More relevant to transactional tax practice is another typical situation where two parties are separately represented by different attorneys. For example, in *United States v. Schwimmer*, a criminal prosecution, the court held that the common interest doctrine protected a client communication made to the other party’s attorney. Additionally, the court held that the client’s attorney did not need to be present when the communication was made for the client to invoke the attorney-client privilege.

Courts have also held that the common interest doctrine can apply in a transactional setting where the parties are represented by different attorneys. In *United

---


110In re Grand Jury Subpoena, 204 F.3d 516 (4th Cir. 2000).

111338 F.3d 1370 (Fed. Cir. 2001).

112Id.

113Id. at 1374-75. In contrast, disclosure to a party whose role is to assist the client in obtaining legal advice will not constitute a waiver. See supra Part III.A.2.

114See, e.g., Baldwin v. Commissioner, 125 F.2d 812 (9th Cir. 1942); Hodges, Grant & Kaufman v. United States, 768 F.2d 719 (5th Cir. 1985).


116Id.
States v. United Technologies Corp., the Service had sought discovery of documents relating to consultations and negotiations, the goals of which were to minimize the tax consequences relating to the formation of a jointly owned company of which United Technologies was to be one of several owners. The Service contended that:

the consortium members shared only a common business interest, and the discussions regarding the structure of [the joint venture] were more in the nature of negotiations between adverse parties than consultations among collaborators.

In rejecting the Service’s contention, the court recognized that “all members shared a common legal interest in structuring [the joint venture] in such a way as to minimize their tax liability” and that “the attorneys for each of the [joint venture’s] collaborators advised the other members and coordinated their legal efforts.” The court then held that:

although, in the area of taxation, it is often difficult to determine where business ends and the law begins, the court finds that nearly all the documents pertain to the development of a common legal strategy regarding the tax structure of [the joint venture]. In formulating this strategy, the members acted not as adversaries negotiating at arms length but as collaborators, legally committed to a cooperative venture and seeking to make that venture maximally profitable.

B. Work-Product Privilege

The Federal Rules of Civil Procedure recognize two types of privileged work product: fact work product, or attorney work that develops factual information, and opinion work product, or the mental impressions, conclusions, opinions, or legal theories of an attorney. Discovery of fact work product is permitted upon demonstration of a “substantial need” for the material and the unavailability without “undue hardship” of the substantial equivalent of the material. Opinion work product is discoverable only in rare circumstances.

Whether fact or opinion work product, the materials at issue must have been prepared in anticipation of litigation in order to be protected. Courts have
interpreted litigation to include governmental investigations,\textsuperscript{124} grand jury subpoenas,\textsuperscript{125} and arbitrations and negotiations,\textsuperscript{126} as well as judicial proceedings. While litigation would certainly include tax litigation, no case has addressed whether a Service audit is a “governmental investigation.” For a corporation under continuous audit, it would be relatively easy to maintain a claim of anticipated audit. However, if an audit is not considered to be a governmental investigation for this purpose, then only the prospect of actual litigation would be relevant.

As the law relating to the application of the anticipation of litigation standard has developed largely in non-tax cases, there is considerable uncertainty about work product prepared in connection with a transaction. Although litigation need not have begun when the materials at issue were produced, courts have not been consistent in applying any particular standard. In the past, courts used a variety of strict standards. One court stated that the threat of litigation must be “real and imminent.”\textsuperscript{127} Another stated that there must be a “substantial probability that litigation will occur and that commencement of such litigation is imminent.”\textsuperscript{128} Another stated that the prospect of litigation must be “identifiable.”\textsuperscript{129} Others required that the “primary motivating purpose” behind the creation of the document is to aid in possible future litigation.\textsuperscript{130} If a mere audit were considered to be a governmental investigation, any of these standards would be met easily by a typical large corporation. However, insofar as tax litigation is concerned, it would be a very special transaction where the attorney work product created in execution or planning the transaction would meet any of these standards. Nevertheless, the standard has evolved and has been liberalized considerably. Courts today generally hold that work product is prepared in anticipation of litigation if it was prepared “because of” litigation.\textsuperscript{131} This test was first articulated in the Wright, Miller & Marcus treatise, which states the following with regard to the anticipation of litigation standard:


\textsuperscript{130}See United States v. Davis, 636 F.2d 1028, 1039-40 (5th Cir. 1981); United States v. The El Paso Co., 682 F.2d 530, 542 (5th Cir. 1982).

Some pre-1970 cases attributed significance to whether a document was created or obtained before or after litigation was commenced, but this cannot be sound. Prudent parties anticipate litigation, and begin preparation prior to the time suit is formally commenced. Thus the test should be whether, in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation.132

Two relatively recent opinions focus on the anticipation of litigation standard in tax cases. Both cases involved large corporations. Neither corporation appeared to argue that their anticipated audits were governmental investigations that would be sufficient to invoke the work-product privilege. Rather, the courts focused solely on the degree to which actual tax litigation was anticipated. Looking only to potential tax litigation, whether work product prepared in a transaction setting meets the “because of” standard is a function of imponderables such as how likely audit or discovery in audit is and how aggressive one estimates the Service to be. Thus, it is not too surprising that the courts, purporting to apply the same standard, have approached comparable facts quite differently. In United States v. Adlman,133 the Second Circuit followed several other circuits134 by adopting the “prepared because of litigation” standard. In Adlman, the Service summoned documents prepared for Sequa Corporation by an attorney who worked for an accounting firm.135 Sequa was contemplating a merger of two subsidiaries that would result in a tax loss that it expected would be challenged by the Service. Sequa requested the accounting firm to evaluate the tax implications of the transaction. The lawyer for the accounting firm prepared a memorandum that analyzed the positions likely to be taken by the Service, proposed possible legal theories or strategies for Sequa to adopt in response, recommended preferred methods of structuring the transaction, and made predictions about the likely outcome of litigation. In holding the memorandum privileged, the Second Circuit recognized not only that this document was prepared solely, or even primarily, to aid in litigation, but also that litigation was “virtually certain” to result from the transaction.

In contrast, the anticipation of litigation standard was found not to be met in United States v. Ackert.136 In this case, an investment bank approached a corporation with an investment proposal that would produce significant tax benefits. At issue were conversations between the corporation’s attorney tax director and a representative of the investment bank whose assistance the tax director solicited following the initial presentation of the transaction. With the benefit of

133134 F.3d 1194, 1194-95 (2d Cir. 1998).
135See supra note 128.
136The tax years involved preceded the effective date of § 7525. The possibility of privilege existed on the grounds that the work was commissioned to assist Sequa’s tax director, who was an attorney, to provide legal advice to Sequa. See supra text accompanying notes 52-60.
hindsight, the transaction that was underlying Ackert must have been at least as aggressive as whatever the subject transactions were in Adlman, which never were revealed. Nonetheless, the court in Ackert reached a different conclusion than the Adlman court, although it was not clear whether it was applying the “because of” or a stricter standard. Specifically, the court held the anticipation of litigation standard was not met with respect to conversations between the in-house corporate counsel and the banker. The court reasoned that “the conversations took place in connection with a proposed investment, not an impending lawsuit.”

Because the approaches in Adlman and Ackert are so fundamentally different, one has to regard the state of the law on this subject as unsettled.

A document that otherwise would be protected work product may still be discoverable if the privilege is waived. Like the attorney-client privilege, waiver may be express or implied. Unlike the attorney-client privilege, however, disclosure of work product to a third party will not necessarily constitute a waiver of the privilege. If the disclosure is intentional, the privilege is waived only if there is a substantial risk that the document would be revealed to an adversary. However, if the disclosure was unintentional, courts engage in a multi-factor balancing test, the ultimate goal of which is fundamental fairness. The common interest doctrine applies to prevent waiver of the work-product privilege in a manner similar to its application to the attorney-client privilege.

IV. APPLICATION OF THE ATTORNEY-CLIENT AND WORK-PRODUCT PRIVILEGES IN COMMON TRANSACTIONAL SETTINGS

A. The Acquisition

A typical corporate acquisition will, one hopes, involve considerable work for tax professionals. Communications between lawyers will abound, enough to warm the heart of any telecom executive. Participants will include various employees of the client corporation, lawyers in the same firm representing the same client, lawyers in other law firms representing the same client, representatives of non-law firms (such as investment banks) retained by the client to provide non-legal services, and all of the same sorts of people playing the same roles for the other party to the acquisition. The lawyer who participates in these discussions believing that everything he or she says or hears is privileged is likely to have overestimated the breadth of the privilege. The following sections attempt to dissect the activities of a tax lawyer acting for acquiring company A in connec-

\[137\text{Id. at 227 (emphasis added).}
\[139\text{The factors considered include (1) whether the party seeking discovery was misled by the unintentional disclosure, or relied on the disclosure to its detriment, (2) whether the party claiming the privilege took precautions to prevent accidental disclosure, (3) how long it took that party to notice its error, and (4) the overriding interest of fairness and justice. See James W.M. Moore, 6 Moore’s Federal Practice § 26.70[6][c] (3d ed.).}
\[140\text{Burlington Indus. v. Exxon Corp., 65 F.R.D. 26 (D. Md. 1974).}

*Tax Lawyer*, Vol. 54, No. 3
tion with a friendly, negotiated acquisition of target T, and to analyze the application of the attorney-client and work-product privileges to these various activities.

1. In the Beginning

At some point, a tax lawyer learns of the contemplated acquisition. The lawyer is debriefed about the identity of A and T, overall non-tax issues and whatever preliminary thoughts may have surfaced about structure. The debriefing may come initially from another lawyer in the tax lawyer’s firm or from a representative of A. This will be one of the last clearly privileged communications that take place in connection with the acquisition. Alas, seldom would any part of the conversation at this stage be of great interest to the Service.

Now the tax lawyer really goes to work. The next conversations often are with tax professionals employed by A. These professionals may or may not be attorneys, but it is safe for purposes of this discussion to assume they are either attorneys or practitioners eligible to receive or convey privileged communications under section 7525. This round of conversations will focus on the general configuration and tax position of A along with what is known about T, and on the relative merits of alternative acquisition structures from a tax point of view. The tax lawyer takes notes. These discussions will contain the first bits of potentially sensitive information for which claims of privilege may be important. For example, there may be discussion of net operating loss preservation for either T or A and of legal theories on which use of the losses may be impaired by reason of the acquisition.

The contents of the conversations are most likely protected by the attorney-client privilege. The tax lawyer is being consulted ostensibly to advise what structure will be most tax efficient. Certainly, elements of the tax attorney’s involvement relate to straightforward legal questions. “Can we do the following consistent with tax-free treatment of the transaction?” So far so good. With regard to this aspect of the involvement, the tax lawyer is still engaged in providing legal advice. However, these conversations begin to approach the border between privileged legal advice and non-privileged business advice.

Seldom is the tax lawyer’s role limited to advice on sterile legal questions. “What other structures should we be thinking about?” is something that the tax lawyer is likely to hear. So too, “What are the pros and cons of the possible structures?” The request is not necessarily a request for and the answer not necessarily the provision of legal advice. A summary of pros and cons may

---

141Although the definition of “tax shelter,” advice on which nullifies any ability to claim the privilege under section 7525, is very broad, it is assumed that the circumstances and planning for A’s acquisition of T are relatively routine, and the acquisition would not be so treated.

142At this stage other elements of the privilege are routinely present. The A employees involved in the conversations will almost by the very fact that they are having the conversations qualify under Upjohn as among those who can conduct privileged communications on behalf of A. 449 U.S. at 401. The communications are intended to be confidential and not revealed in any other context, such as tax return or other regulatory filings.

*Tax Lawyer, Vol. 54, No. 3*
include large doses of non-legal considerations. Even the manner in which tax issues are addressed may resemble accounting as the quantitative results of the legal advice are presented. For example, when a schedule depicting net operating loss availability is created, there certainly is an element of accounting. Yet in order to perform the accounting there may well have been significant elements of legal interpretation. This presents squarely the issues that Willis and other cases addressed in a relatively unsophisticated manner. One can hope that in the context of an acquisition involving significant dollar amounts, a court will be willing to presume the need for an existence of greater legal input than in an individual income tax return. Thus, while one could subject conversations in this vein to a hard look and maybe not see clear answers about the application of the privilege, at this stage there most likely would be no truly compromising statement in the conversation that would not represent the provision of legal advice. “If you did the following, it would call into question the tax free status of the acquisition,” is something the Service might want to hear, but this statement at least is one conveying legal advice. Nonetheless, the vague border looms.

The lawyer’s notes deserve some special mention. There is no general doctrine of sanctity for a lawyer’s notes. The notes are available under a section 7602 summons unless all of the elements of either the attorney-client or work-product privilege are available. Even in this relatively innocuous situation, it will not be entirely clear that either privilege will be available to the notes in their entirety. To the extent they memorialize or otherwise would reveal a communication from the client, they are protected by the attorney-client privilege. Beyond that, the notes may be protected only if the work-product privilege applies. Notes are prototypical work product of an attorney. Nonetheless, in the context of the initial stage discussion of at least a relatively routine acquisition, it would be quite difficult to maintain that the anticipation of litigation standard is met. Clearly the consultation and effort at this stage is to determine what structure is most efficient. One might argue that where the stakes are high enough, there always will be a prospect of litigation. However, no court has adopted so cynical a view in articulating an anticipation of litigation standard. Since the notes will not satisfy even the weak “because of the prospect of litigation” standard, there should be no expectation of privilege for any notes that go beyond the mere recording of or expanding on client communications.

2. **Engaging with T**

After these preliminary activities, the tax lawyer will begin engaging with representatives of T. At this point, many more parties will be involved. In particular, outside financial advisors and accountants for A and T are likely to

---

143 See supra text accompanying notes 44-49.
144 For example, the tax lawyer’s notes may indicate that certain conduct or intentions may be inconsistent with a desired result or merely contain a reminder to review a particular line of authority.
145 See supra text accompanying notes 128-34.
have a role. The activities are a little less predictable in terms of who may communicate with the tax lawyer, and a great deal more sensitive information may surface. Application of the attorney-client and work-product privileges similarly is less predictable. The activities in this phase have three distinct but related segments. First are discussions aimed at finalizing a structure. Second is tax related due diligence by or on behalf of A. And third is negotiation and execution of the transaction documents. Each of these activities poses different privilege issues.

a. **Finalizing structure.** The first prominent challenge to the availability of any privilege is the introduction of A’s financial adviser to the conversations. Intuitively, one is tempted to think that the financial adviser’s participation in discussions should not affect the availability of any privilege. After all he or she is on the “same team.” Moreover, it is perfectly legitimate if not important for the client’s ultimate goal for the financial adviser to be involved in these discussions since looming tax considerations will affect structure and strategy going forward. Nonetheless, the financial adviser’s participation at this juncture in any communication would appear to violate one or more of the requirements of the attorney-client privilege and render it inapplicable.\(^{146}\)

There are, however, certain theories under which communications that include the financial adviser could be privileged, at least on the right facts. First, it may be inquired whether the financial adviser is acting to assist the tax lawyer in providing legal advice. In most cases though, it would be quite unlikely that the financial adviser in these conversations would be said to be plying his or her specialty to assist the lawyer in interpreting the client’s communications. Rather, the financial adviser is more likely to be acting like any other “team member” to facilitate negotiation and execution of the transaction, making it unlikely that the requirements of *Kovel* would be satisfied. A better argument in favor of the conversations being privileged is that the financial adviser is acting as a form of agent for the client A in these circumstances. Arguably then, he or she should be considered to be the client equivalent, entitled to engage in privileged communications with either inside or outside counsel. One court has been presented with the argument that someone not actually in the employ of a corporate client can be considered to be the client. In *In re Bieter Co.*,\(^{147}\) the court held that an independent consultant hired by client was the functional equivalent of client’s employee for purposes of applying the attorney-client privilege, when the consultant had been intimately involved in the client’s unsuccessful development and had been the client’s sole representative at meetings with potential tenants and with local officials. The argument is an appealing one given the reality that

\(^{146}\)The two most obvious requirements that are not met are that the communication be between the client and the lawyer and that the communication is confidential. Since the financial advisor is not the client, the former obviously is not satisfied. And since anything the client disclosed to the attorney in the presence of the financial adviser was obviously not presented in confidence to the attorney, the latter is not satisfied. *See supra* text accompanying notes 97-100.

\(^{147}\)16 F.3d 929 (8th Cir. 1994).
employees of the financial adviser often are serving the role of a temporary SWAT team working on behalf of A to consummate the proposed transaction. The question of whether the financial adviser is a functional equivalent of an employee obviously will depend entirely on the circumstances of the financial adviser’s involvement.

At this stage there is also a fair amount of dialogue between A and T. For example, the common discussion about whether an acquisition will be a stock acquisition or an asset acquisition (or if there is to be a stock acquisition, whether a section 338(h)(10) election is to be made) necessarily results in discussion and quantification of the relative costs and benefits to the parties. During these conversations, T may reveal certain facts about its tax position or prior transactions. For example, it may reveal that it engaged in certain transactions that would call into question the availability of an otherwise desirable section 338(h)(10) election. Would the discussions in which such a revelation was made be privileged?

Much of what representatives of T have stated to representatives of A and A’s lawyers are facts about T’s history. In general, corporate records of prior transactions and the facts reflected therein are not privileged, as there is no communication of legal advice embodied therein. If the Service requested information about the subject transaction or prior transactions, T would provide all relevant documentation relating to that transaction from which the facts, no matter how deeply buried, in theory could be derived. A and T naturally would prefer that the contents of this conversation be privileged, however, since the conversation highlights particular facts and associates potential adverse consequences to them. Although the Service may well figure out there was an issue to assert, the Service would have an easier time of it if after the acquisition, A had to respond to a request for a summary of conversations between A and T relating to matters that could adversely affect the tax position A asserts.

There is only a tenuous basis for claiming this conversation is privileged. A may be acting through internal or external lawyers, but T is neither the client nor someone whose assistance, other than in providing otherwise discoverable facts, is necessary to assist A’s attorneys in rendering legal advice. Hence, nothing in the traditional attorney-client privilege, as it may be asserted by A, will protect these conversations. Insofar as T is concerned, it is providing information to one or more people who may be lawyers, but those lawyers are not in any event its lawyers. T is not seeking legal advice from the people who are being given the information. Thus, it would appear T has no basis on which to assert the attorney-client privilege either. Although development of facts by A’s attorney is a form of attorney work product, failure to meet the anticipation of litigation test would prevent the privilege from applying. In any event, although the work-product privilege would prevent A’s attorney from being required to divulge the information, there would be no such protection for the T employees with whom the attorney spoke.

148See, e.g., United States v. El Paso Co., 682 F.2d 530 (5th Cir. 1982).
The best opportunity A and T may have to salvage any privilege may be under the common interest doctrine. Arguably, A and T have a common goal at this juncture, a mutually satisfactory consummation of the transaction, with minimization of current and future corporate or shareholder tax liabilities. Communications between A and T, with or without their respective attorneys’ direct involvement, could potentially be privileged on this basis. The basic fact pattern bears some resemblance to that in United Technologies, discussed in Part III.A.8. In United Technologies, the court held that communications between separately represented clients and their respective attorneys, as well as their counterpart’s attorneys, were privileged where they had a common legal interest in structuring a transaction to minimize the tax liability. An acquisition, however, can be distinguished from the joint venture in United Technologies. In a joint venture, the parties’ interests are more aligned than in a sale and purchase type transaction. In a joint venture, the consortium members presumably receive a portion of every dollar the venture saves on an ongoing basis. Conversely, in a sale context, the parties interests are in some respects, for example with respect to price, directly at odds. Although not always presented in concrete terms, either one party or the other will bear certain tax liabilities, resulting in no alignment of interest with respect to that liability. However, at least in some cases the parties can claim that their interests are aligned. For example, if there is an explicit agreement to split the benefit of any tax savings in the purchase price to be paid, there is clear alignment of interests.

b. Due diligence. Either simultaneously with determining a structure, or after having done so, A ordinarily undertakes routine tax due diligence. The purpose of this exercise is to evaluate the existence of potential adverse adjustments to T’s prior years’ tax liabilities. A’s fervor in pursuing this exercise may be a function of the quality of the indemnity (both in scope and credit quality) it may receive from the sellers for adjustments to prior year tax liabilities. Assuming that the indemnity is expected to be a poor one, however, the due diligence exercise may resemble a mini-Service audit of T’s open tax years. A may request tax reserve work papers, tax returns for open years and any and all material information in T’s files.

For the most part, the question of privilege is irrelevant to this exercise. Much of what A is examining are materials that the Service could and would obtain in a routine audit. However, in theory, the due diligence exercise can give A access to more information than the Service could gather in an audit in two different ways. The first is information relating to transactions that the Service would not choose to examine closely. Second are materials that ordinarily would be privileged in the hands of T. The analysis of the availability of any privilege is different in these two situations.

150See supra text accompanying notes 114-116.
Suppose following completion of the acquisition, in an audit of A the Service requests A to provide a list of documents turned over to A during the due diligence phase. A claims that the list is privileged. It would assert that the list was prepared by its attorney (assuming this were true) for the purpose of rendering legal advice to A. This is plausible enough, but that law/business border looms large. A is searching for contingent tax liabilities that T may have. The mere search for contingent tax liabilities in fact resembles a Service audit that has been held generally not to involve legal advice,151 and would not appear to be predominantly a legal exercise. In evaluating specific matters, A may request specific legal advice (“was the asbestos removal cost deductible?”) but the list was not prepared in order for that specific advice to be sought. Where the legal advice is not the predominant purpose of the exercise, the attorney-client privilege has been held not to exist.152 More of a link to a specific legal issue is probably required for documents prepared in the due diligence phase to qualify for the attorney-client privilege.

An assertion by A of work-product privilege also is problematic. Like notes made in the initial conversations, the main difficulty is satisfying that anticipation of litigation standard. However slim the prospects of satisfying the standard may be in the former case, they are all but nonexistent in this situation. Due diligence is by its nature a fishing expedition. It is not credible to assert that a list of items that once examined may reveal the possibility of future litigation was itself prepared “because of” or with any other articulated causal relationship to any particular litigation. Similarly, work product embodying an analysis of particular issues that surface in the due diligence phase are unlikely to meet the standard even if they appear to be traditional legal analysis. Although the essence of the analysis may embody legal advice that will be protected by the attorney-client privilege, the mere inquiry about the subject matter belies any possible assertion that the analysis was prepared in anticipation of litigation. It is possible to envision a situation where A is aware of an issue in T’s tax history that is particularly pregnant with the possibility of litigation. In this limited situation, the work-product privilege could apply to materials prepared to investigate this specific issue. Accordingly, the work-product privilege has a very limited role.

In the second situation, the principal question that arises is whether sharing either the documents embodying the privileged advice or their contents waives the privilege that theretofore attached. Say T engaged in some aggressive corporate tax shelter and had a privileged opinion relating to that transaction. As a practical matter, T will either hand that opinion over to A if A asks for it or more often, mistakenly thinking that it makes a difference, discuss its contents with A. While there is some possibility of preserving the privilege under the common interest doctrine,153 it is likely that turning over or discussing the opinion will waive any privilege that attached to it.

151United States v. Frederick, 182 F.3d 496 (7th Cir. 1999).
153See supra text accompanying notes 111-116.

Tax Lawyer, Vol. 54, No. 3
c. Execution. Additional issues of privilege can arise in the execution phase of the acquisition. In this phase, the final documentation, including tax indemnities, will be resolved and final substantive advice will be rendered orally or in writing about any risks that may have been identified and undertaken. It is entirely possible, for example, that in the course of negotiating a tax indemnity, there will be open discussions about carving out specific substantive risks, which quite possibly might not have surfaced in the due diligence. Assuming that A agrees to assume those identified risks, we are all obviously clever enough to describe what is being carved out in generic enough terms that no specific transaction necessarily is implicated. Have we accomplished anything with this camouflage though? Can the Service elicit an answer to the question “Did you have any discussions about what would not be indemnified for and if so, what?” from either the lawyers for A or T or from employees of A or T?

T’s revealing particular substantive issues in this phase raises no different issues than those raised by much the same revelation during the due diligence phase. Thus, the more interesting question is whether the substance of A’s conversations with its lawyer about the indemnity negotiations are protected by the attorney-client privilege. The first question one may ask is whether discussions concerning the negotiation of an indemnity constitute legal advice. Most indemnity negotiations in which the author has participated have focused more on “what is typical in these indemnities?” and “what does someone in these circumstances give/get?” than any substantive legal advice. This is purely business advice about market responses to allocating theoretical risks. Thus, if the specifics of a particular risk (not otherwise discoverable) are revealed to A’s lawyer for advice about the likelihood of receiving an indemnity but not for an evaluation of the risk, application of the attorney-client privilege to that conversation might be questioned.

Carrying the proposition further, suppose A’s lawyer produces a memorandum that is intended to memorialize the thinking behind accepting certain risks in the indemnity negotiation and evaluating the risks accepted. Can the Service obtain this memorandum? Clearly, portions of the memorandum contain the communication of legal advice. However, the Service could well argue that the portions of the memorandum that simply identify the risks that are being examined is not privileged and that it should be entitled to receive the memorandum. To the extent the memorandum also provided legal advice that would reveal confidential communications by the client, those portions could be redacted. Of course, since merely identifying the issues that could be raised is what the battle is about, the ability to redact the lawyer’s handicapping of the risk is of no consolation to A. Although the work-product privilege has not appeared to have much vitality in the context of an acquisition so far, this is one circumstance to

---

154Legal advice in connection with the negotiation of a tax indemnity is not altogether absent, but it is relatively mundane. For example, interpretation of draft language with one’s client would constitute legal advice. (“Does this language cover the situation when . . .?”).


Tax Lawyer, Vol. 54, No. 3
which it arguably could apply. By definition, the tax indemnity is prepared to address the consequences of a Service challenge to T’s tax returns. Accordingly, the memorandum arguably is prepared because of possible litigation. The question on which the availability of the privilege will turn, and on which courts appear to have taken conflicting approaches, is whether the theoretical possibility of Service challenge is sufficient to invoke the work-product privilege or whether there must be some specific reason to believe there will be a challenge.156

3. Post-closing

Certain activities following the closing of an acquisition can raise issues of privilege. In particular, these activities involve sharing of information relating to the pre-acquisition tax activities of T between tax professionals representing A and tax professionals who worked on the affairs of T prior to the acquisition. One situation that may arise is finalizing results for a short pre-closing period of T (where T was a former member of a consolidated group). Another situation is the solicitation of friendly assistance from those who formerly worked on T’s tax matters (perhaps members of the tax department of T’s former parent) in connection with a subsequent audit of T after the acquisition. In the first situation, the former parent of T may be contractually obligated to cooperate. In the latter situation, friends in a relatively small community may try to help each other out.

Any surprises revealed at this stage about questionable tax positions in the short pre-closing period would bear no greater privilege protection than the same revelation would have if made prior to closing. As discussed above, that revelation is protected, if at all, under the common interest doctrine. Following the close of the transaction, it is that much harder to apply the doctrine. Although a contractual obligation to cooperate in supplying tax information for the relevant period provides some basis for claiming continued application of the doctrine if it would have applied prior to closing, the argument at this stage is strained at best. Thus, it is safe to assume that statements questioning certain positions that appear in the relevant period, or documented legal advice concerning those questionable positions, are not privileged when shared with A. A fortiori, there is no basis to claim any privilege for the substance of friendly assistance rendered in connection with a later audit.

B. The Corporate Tax Shelter

The lifecycle of a corporate tax shelter will present several situations in which a privilege may become relevant. The unique and often ambiguous role of the ubiquitous “tax shelter promoter,” in whatever form he or she may appear, presents some different perspectives for determining whether a privilege exists. This section will walk through the various stages of the development, marketing and execution of a corporate tax shelter and examine the issues of privilege that

156See supra text accompanying notes 120-137.
may arise at each stage.

1. Development

The development stage might begin with a conversation between a banker and a lawyer about a potential “opportunity.” Sometimes the banker may call the lawyer first to broach the opportunity. Other times the lawyer may call the banker first. The initial conversation may start with a statement to the effect, “I think there is a glitch in the xyz regulations and there may be a way to design a transaction to exploit it.” One or more sessions of collaborative transaction design will follow, punctuated by sessions of legal research by the law firm, and non-legal research and other development work by the banker. The result of these activities might be a “pitchbook” that explains the transaction and its intended tax consequences. The pitchbook may or may not contain an opinion from the lawyer.

Two variations on this scenario are worth examining as well. The first is the development of a transaction in its entirety either by an accounting firm or a law firm. In this case, there are no communications between any client and lawyer retained by the client. Rather, one or more tax professionals, all lawyers in the case of the law firm and many of whom will be lawyers in the case of the accounting firm, work collaboratively within their firm to reach the same pitchbook stage as the banker-lawyer team. The second is development of a transaction upon the instigation of a lawyer contacting the chief tax officer of a regular corporate client or vice versa. Here, the corporation’s internal non-legal resources may be used to perform the non-legal functions that the banker otherwise may have. Ultimately, there is no pitchbook, but there may be some other document meant to serve the function of an internal blueprint or game plan.

a. Lawyer-Banker Collaboration. What communications and documents in these series of events can be protected from Service discovery? Starting with the initial conversation between banker and lawyer, the answers are not so clear. If the banker calls the lawyer, there is a presumption that an attorney-client relationship exists. The initial questions are about tax law and are intended to be confidential. This is the more or less classic case that the confidentiality privilege is intended to apply to. So far, so good.

What about the conversation that is instigated by the lawyer? At least up to a point, the communications that occur arguably are intended to remain confidential and are made for the purpose of securing and communicating legal advice. Nonetheless, there are two important differences distinguishing this conversation from the normal case to which the attorney-client privilege applies.

157The term banker is used here generically to refer to someone who is employed by some form of financial institution and whose charge is to develop, market and execute “tax products” on behalf of the employer. There may or may not be any work customarily associated with banking involved in any particular transaction.

158In the case of the accounting firm, there is more likely to be some amount of non-legal work as well.

159Diversified Industries v. Meredith, 572 F.2d 596 (8th Cir. 1977) (en banc).
First, the legal advice conveyed was not solicited by the recipient. The classic articulation of the privilege presupposes a client who seeks legal advice.\textsuperscript{160} Nonetheless, we can presume that there is little cold calling by lawyers with tax shelter ideas. Thus, it is safe to assume there is a preexisting, if only social, relationship between the lawyer and the banker. There may already be an attorney-client relationship and even ongoing unrelated representations of the bank by the lawyer’s firm. It may be implied in the existing relationship that the banker has invited the lawyer to provide him or her with any and all legal advice that is relevant to the banker’s business with an understanding that the communications are to remain confidential. Thus, one cannot entirely dismiss the possibility that the attorney-client privilege will apply to the initial conversation where instigated by the lawyer. However, the client would likely have to bear the burden based on past practice or conversations that the factual premises supporting the privilege are met.\textsuperscript{161} There will come a point, however, after the initial conversations where the relationship becomes a more traditional one of client seeking legal advice from lawyer, rather than lawyer foisting unsolicited (but probably welcome) legal advice on the client.

The second difference is that the desire for confidentiality in the first instance is the lawyer’s, not the client’s. The lawyer may intend this initial conversation to remain confidential and may be very explicit about that intention. There appears to be no authority elaborating on whose intention of confidentiality is relevant but no case law appears to focus on anything other than the client’s intention.\textsuperscript{162} Moreover, given the often articulated purpose of the confidentiality privilege, it is doubtful that the lawyer’s purpose is particularly relevant. All told, although there is a confidential communication of legal advice between lawyer and client, it is unlikely in the end that the initial conversations are privileged.

b. Internal Law/Accounting Firm Development. The attorney-client privilege and work-product privilege both presume the existence of an attorney-client relationship. The attorney-client privilege does so by its very nature. If there were no attorney from whom the client sought confidential legal advice and none was communicated by any such attorney, there simply could not be any privilege. The existence of a client similarly is critical to the availability of the work-product privilege. It would be a bit far-fetched to consider work to be in anticipation of litigation where neither the potential plaintiff nor the potential defendant could be identified.

Thus, where development of the transaction occurs entirely by either a law firm or an accounting firm, availability of any privilege with respect to conversations or materials produced in the development of a “product” prior to any other attorney-client relationship being established will turn in the first instance

\textsuperscript{160}Although the Wigmore formulation uses the passive voice, and does not explicitly state that the client sought the legal advice, any other construction would be absurd.

\textsuperscript{161}See Weil v. Investment/Indicators, Research & Management, 647 F.2d 18, 25 (9th Cir. 1980).

\textsuperscript{162}See supra text accompanying notes 97-100.
on whether an attorney-client relationship exists or can be implied. An overly simple answer that would preclude the application of any privilege might be that the firm is either the client or the attorney but not both. Nonetheless, an attorney can represent himself, and arguably that is what is happening when the law firm or accounting firm is developing a product. Given the absence of any reported instance of the Service seeking all files relating to the development of a product from a law firm or accounting firm sponsor, it may be inferred that the Service places some credence in this argument. Assuming then that some attorney-client relationship exists, one must then inquire which communications or work product may be privileged. Even if we view the firm as both attorney and client, however, it is clear that only the attorney-client and not the work-product privilege can apply. Although work may be done in anticipation of litigation that may follow, that litigation would involve the potential customers of the product and not the firm itself as plaintiff or defendant.163 Accordingly, individual communications must be examined against the standards for the attorney-client privilege only.

The first issue to address is which individuals within the firm should be considered to be the client. Under Upjohn, the client equivalent may be any person within an organization so long as protection of that person’s confidential communications with counsel would serve the purposes of the attorney-client privilege, as applied to the corporate client. A sensible approach is to view each professional involved in the effort himself as the client, represented pro se, or to the extent that the effort is collaborative, within the firm, that the collaborating individuals are both the attorneys and clients. Viewed in this manner, all communications within this working group are eligible for protection to the extent the other relevant requirements are met. It is debatable whether the intention to remain confidential is met, however. Although the firm intends confidentiality up to a point, the ultimate goal of the exercise is marketing of the product outside the firm. Thus, like communication of a product idea from a lawyer to a client, the confidentiality requirement may be lacking altogether.

Even if the confidentiality requirement were met, however, not all of the communications are likely to qualify for the privilege. Although much of the communication will involve traditional legal analysis—“does the product ‘work’?”—there is a point at which the communications no longer relate to legal advice. In this arena, the line between law and business is quickly crossed, and there is no privilege. The obvious breakpoint is where marketing enters the picture. Research, strategy discussions and materials prepared for the purpose of marketing most certainly will fail to involve primarily legal advice and will not be privileged. Accordingly, the limiting factor on the Service’s ability to gain access to the materials in the development files of a law firm or accounting firm

---

163One would hope that a court would not take seriously an argument to the effect that a shelter was so aggressive that the firm expected itself to be a party to litigation, either because the Service was likely to assert penalties against the firm (as it may under section 6701) or because the customer ultimately may sue the firm.
beyond the basic materials embodying legal advice is only the inherent limits on the Service’s power to obtain information from third parties.164

c. Law Firm/Corporate Client Collaboration. Where the development of the transaction begins as a result of an initial conversation between the attorney and an officer of the corporate client, claims of privilege are the strongest. There is a pre-existing attorney-client relationship and the client will have an expectation that the communication will remain confidential (if only based on the attorney’s obligation to maintain confidentiality under the Rules of Conduct). Here, and to a lesser extent where development is made jointly between the lawyer and the banker and the privilege is held to apply in the first instance, questions can arise going forward about whether the privilege is waived or whether there are circumstances that limit the privilege.

Invariably, non-lawyers will be consulted on various aspects of a corporate tax shelter transaction. Those non-lawyers may include the corporation’s internal finance professionals and accountants as well as external bankers and accountants. Every conversation relating to the contemplated transaction raises the possibility of the privilege being waived. A few examples can illustrate the issues. Assume in each case that the corporation’s tax director conducts the conversations alone or together with an outside lawyer. The central issue is whether the tax director is conducting the conversations for the purpose of rendering legal advice (“does the transaction ‘work’?”). Certain conversations that relate to non-tax matters can be privileged, but many of the conversations can be expected to take place will not be.

For example, the tax director may consult an outside accountant about the accounting ramifications of the contemplated transaction. This conversation arguably is within the holding of Kovel. However, given Kovel’s emphasis on the interpretation of client communication, there are several circumstances where the Kovel doctrine will most likely not apply. First is where the tax director may already know the answer to the legal question. For example, the legal analysis has already been concluded and a comfort level with the availability of the desired tax result determined. The accounting advice is sought not for the purpose of refining the legal advice, but for the purpose of determining whether the transaction will be economically and operationally feasible from a corporate perspective. That is, the corporation may gladly pursue the transaction for the contemplated tax benefit, but not if it results in significant additional debt on its balance sheet or any immediate adverse affect on earnings. Anything the tax

164The Code grants the Service the authority to summon documents and testimony and grants the district courts the authority to enforce such summons. I.R.C. §§ 7602, 7604. Furthermore, § 7608 authorizes the Service to designate agents to, among other things, “execute and serve search warrants” and “carry firearms” (which will certainly be helpful in getting documents from law or accounting firms). The Service has used this power rather infamously to order a major investment firm to turn over documents with confidential client information. Jonathan M. Moses, Judge Removes Roof From Merrill Lynch Tax Shelter, WALL ST. J., Jan. 26, 1993, at C1. Jonathan M. Moses, Merrill Lynch Battling IRS to Maintain Confidentiality of its Client Records, WALL ST. J., Dec. 30, 1992, at 13.
director reveals in these conversations is likely not to be privileged. These conversations could, however, be considered relevant to the tax result if, for example, they reflect on the corporation's intentions in entering into a transaction with a series of steps.

There will be other conversations that the tax director conducts arguably for a purpose other than rendering legal advice. Some of these conversations will relate to matters of commercial feasibility. “Is financing of a particular type available in the capital markets?” “Can a particular kind of derivative be obtained?” Whether these conversations are with internal treasury professionals or outside bankers, they are at the very least not so clearly conducted for the purpose of giving legal advice, but rather for conducting the business of the corporation. While the quotation at the beginning of the article is apt in many situations, the line has clearly been crossed here. Ironically, the business of the corporation here is reducing its tax liability.

Other conversations may go to the heart of whether a particular transaction works; specifically, what is its business purpose? In the typical situation, there is a certain circularity to the process insofar as analysis of availability of the privilege is concerned. The tax director must determine whether there is a valid business purpose to evaluate the efficacy of the contemplated transaction and provide privileged legal advice. In the purest case, there should be no question that the attorney-client privilege covers a conversation between the tax director and some other corporate employee in which the latter simply articulates the corporation’s business purpose in undertaking a transaction.

It would be unusual that circumstances were so clear-cut, however. Most corporate tax shelters are transactions desperately seeking a business purpose. The conversations about business purpose are more likely to be iterative ones in which potential business purposes are stated and the transaction redesigned to cater to more meaningful business objectives. As the tax director reacts to articulated business purposes and suggests means of redesigning the contemplated transaction to cater to business purposes that are considered more likely to allow for a favorable tax result, he or she is performing two functions. One is a pure legal function. As each variation of a potential transaction is discussed, the tax director is evaluating the availability of the desired tax benefits, clearly an exercise in providing legal advice. The other is a business function, where changes to a transaction are suggested that would further stated business objectives. The difficulty from the perspective of evaluating the availability of the privilege is that the two activities are conducted simultaneously and are inextricably intertwined.

2. Marketing by a Financial Institution

“Have I got a deal for you!” the conversation might begin. “It will add three cents to your earnings per share.” This does not sound like a conversation in which legal advice is being sought or offered. In fact, when a banker says something like this to a chief financial officer, legal analysis is most likely viewed as mere detail to be addressed later. It is fair to assume that nothing in
this conversation is privileged. It is also fair to assume that a cavalier attitude at this stage toward the developing law of tax-motivated transactions will result in a paragraph or two in a Tax Court opinion.

The initial conversation will be followed by a formal presentation that is likely to include the CFO, various financial or operational personnel from the company, the company’s tax director and inside or outside counsel. A pitchbook is likely to be presented at this meeting, which would outline the contemplated transaction and contain some explanation of the intended tax benefits. A detailed opinion letter from the financial institution’s counsel may be included. None of the conversations in this meeting are likely to be privileged. The company may argue that the presence of the company’s tax director (assumed to be an attorney) is for the purpose of allowing him or her to render legal advice. However, the attorney-client privilege is intended to protect the client’s communication. Here the purpose of the meeting is for the financial institution to present a proposed transaction to the company. The company is communicating nothing to its lawyers. If desperate, the company could argue that it has designated the financial institution as its agent to impart the information to the attorney. This would be a strained interpretation of the facts, however. It also would be strange for the company to argue that it has asked the tax director to supply it with legal advice on subject matter of which it had no knowledge. Ironically, there is a possibility that the legal opinion presented with the pitchbook could be privileged. As discussed below, the assistance provided to the tax director in providing legal advice may be eligible for the privilege, and the opinion ostensibly is for that purpose. However, like the conversations, delivered before the subject matter of the legal advice is known, the opinion delivered at this stage is likely to be considered to be something other than a communication with an attorney for the company to assist in the rendering of legal advice and hence is not privileged.

The battleground for the availability of the privilege is really in what follows this initial meeting. If interested in proceeding, the CFO will likely ask the company’s tax director to examine the proposed transaction more closely. The tax director most likely will have conversations with the presenting banker, lawyers from the firm that worked with the financial institution in developing the transaction, an outside lawyer retained by the company, and the company’s inside and outside accountants. The availability of any privilege largely will follow the analysis described in the preceding section, “Law Firm/Corporate Client Collaboration.” However, by the very nature of the addition of an extra party, the financial institution, there are additional situations to analyze.

First, there will be additional conversations between representatives of the corporation and of the financial institution. In United States v. Ackert, the assistance provided to the tax director in providing legal advice may be eligible for the privilege, and the opinion ostensibly is for that purpose. However, like the conversations, delivered before the subject matter of the legal advice is known, the opinion delivered at this stage is likely to be considered to be something other than a communication with an attorney for the company to assist in the rendering of legal advice and hence is not privileged.

165 If there is a privilege, it could be asserted only by the company. By delivering the opinion to the company the financial institution would have waived any privilege that it may have claimed as the client of the opinion’s author.

166 United States v. Ackert, 169 F.3d 136 (2d Cir. 1999).
Second Circuit addressed precisely such a situation. Ackert was a representative of an investment bank that proposed a transaction to a corporation. The corporation’s tax director, an attorney, engaged in several conversations with Ackert after the initial presentation, all for the purpose of gaining a better understanding of the details of the transaction so that he could render appropriate legal advice to the corporation. The purpose of the conversations was not in controversy. The corporation asserted that the *Kovel* doctrine applied and that these conversations were privileged.

The Second Circuit disagreed. Citing *Hickman* and *Colton* for the proposition that communication between an attorney and a third party is not privileged merely because the communication proves important to the attorney’s ability to represent the client, the court made an all important distinction between consultation of an outside party to interpret communications from the client, and consultation with an outside party to gather information not otherwise known to the client. On the facts of the case, the court held that Ackert was not being consulted for the purpose of interpreting any particular facts, but simply to supply them. Since the discussions in question were primarily for the latter purpose, they would not as a general matter be protected by the attorney-client privilege. The court did leave open the possibility that certain parts of the conversations in question could be privileged, however, when the traditional requirements are met. On remand, the district court in *Ackert* found none of the conversations privileged. The world had grown in sophistication since *Kovel*. It is indeed hard to see very many circumstances where the explanations of outside parties to a knowledgeable tax director will be able to meet the *Kovel* standard.

One type of discussion between the tax director and third party that may be eligible for protection of the attorney-client privilege, however, would involve the investment bank’s tax lawyer. Where the tax director engages with the investment bank’s tax lawyer for the purpose of understanding the pure legal analysis of the transaction, the conversations would appear to be privileged except to the extent they stray into the territory of elucidating facts as in *Ackert*, a place where the lawyer easily could go. The only authorities addressing circumstances involving conversations between two attorneys representing different clients has been in the context of the common interest doctrine, which would not appear to apply in these circumstances. However, if the *Kovel* doctrine is intended to prevent the purpose of the attorney-client privilege from being frustrated where an attorney needs expert assistance in addressing a legal situation, it would be ironic indeed to provide the privilege to a conversation between an

---

168*Colton v. United States*, 306 F.2d 633 (2d Cir. 1962).
169*Ackert*, 169 F.3d at 139. See supra Part III.A.2. for discussion on attorney-client privilege as it relates to third parties assisting attorneys.
170*United States v. Ackert*, 76 F.Supp. 2d 222 (D. Conn. 1999). The court also found that the work-product privilege was unavailable. See supra text accompanying notes 133-34.

*Tax Lawyer*, Vol. 54, No. 3
attorney and a lay person, but not to a conversation between an attorney and another attorney who is held out as expert in the legal matters being addressed.\textsuperscript{171} Accordingly, consistent with the boundaries set by Ackert, these conversations should be privileged so long as the focus remains legal analysis.

Like the private conversations with the financial institution’s tax attorney, the written work of the same attorney provided to the company’s tax director is likely to be privileged if supplied at this stage and not in connection with the initial marketing of the transaction. Those materials will have the same intent as the later private conversations, assisting the corporation in understanding the legal analysis of the transaction. Thus, the attorney-client privilege may attach based on Kovel, as applied in Ackert. Moreover, so long as the contemplated transaction was sufficiently aggressive, the work-product privilege also may protect the opinion.\textsuperscript{172}

3. Execution

Implementation of an elaborate corporate tax shelter transaction presents numerous situations where routine conversations between attorney and client may not be privileged. In addition, many other communications among participants in the transaction may take place that can shed light on the tax analysis of the transaction, yet will not be protected by any privilege despite the fact that they are communications from attorneys of legal advice bearing directly on the tax analysis of the contemplated transaction. Two situations merit examination.

a. Non-Privileged Attorney-Client Communication. During the implementation of a tax shelter transaction, there may be numerous opportunities for the creative, proactive tax lawyer to overstep the boundary between law and business to render communications non-privileged. Once a decision has been made to proceed with a transaction, the charge to the legal team will be “to get the deal done.” Only the subtext—“in a way that gets us that opinion”—imports any legal content into the mix. That subtext cannot be ignored of course, and one of the tax lawyer’s charges will be to mind details to assure that the actual facts of the transaction remain consistent with the legal premises that furnished the basis for proceeding.

Nonetheless, the transaction does not unfold in so tidy a fashion as to allow a legal question to be put to the tax attorney, have the question answered and the next one asked all in a tidy timeline. More likely will be the discovery of some perhaps unexpected business obstacle that must be addressed. When the tax adviser suggests an alternative business solution that is consistent with the tax objective (hero!), the question is whether legal advice or business advice has just been rendered. To be fair, the answer in this case probably is equal parts of both

\textsuperscript{171} See United States v. Adlman, 134 F.3d 1194 (2d Cir. 1998) (holding that attorney tax director could have privileged conversations with outside accountants, acting solely as a tax adviser).

\textsuperscript{172} Id. The fact that the attorney whose written work product is supplied is not paid by the corporation should not affect the conclusion. See Robinson v. Magovern 83 F.R.D. 79 (D.C. Pa 1979).
at the same time, but there is more than enough justification for a court to strip away any privilege if it so chose. It is easy to imagine other situations where the tax adviser more clearly is on the wrong side of the law/business line.

b. Non-privileged legal advice from attorneys. While no one disputes the virtues of friendship, it can be said that friendship and the attorney-client privilege will not always mix. Where a company decides to proceed with a transaction marketed by a financial institution, the two will be separately represented. As discussed in Part IV.B.2., above, there is a fair degree of latitude under Kovel for the company’s attorney to seek assistance from the financial institution’s attorney. But what about conversations initiated by the financial institution’s attorney in connection with execution of the transaction? If the conversation begins “I know you didn’t ask, but what I see in document X is inconsistent with our tax analysis and should be changed as follows . . . ,” the argument for protecting the conversation under Kovel is strained. The company might argue that there has been a standing invitation for assistance to the company’s attorney since the initial marketing of the transaction, but this is probably wishful thinking absent a direct statement to this effect. Even in the event that such a statement is made, to accept it at face value is to admit that the financial institution’s attorney is conducting a dual representation in connection with execution, something that they have probably taken some measures to deny. With friends like these . . .

4. Compliance with the Tax Shelter Regulations

Recently issued regulations aimed at abusive tax shelters raise attorney-client privilege issues. These regulations require promoters of a “confidential corporate tax shelter”173 to register the shelter by submitting a Form 8264 to the Service.174 The regulations also require organizers of a “potentially abusive tax shelter”175 to maintain a list of each investor in the shelter. The list must be made available to the Service upon its request. Because the definitions of tax shelter, promoter and organizer are extremely broad,176 an unsuspecting and generally innocent lawyer can find himself or herself needing to pay attention to these rules.177

Information required to be included on Form 8264 includes the name, address, telephone number, and identifying number of the tax shelter and the tax shelter organizer; the type of business organization; the principal and secondary

---

173A confidential corporate tax shelter is defined as an investment offered under conditions of confidentiality where a significant purpose is to avoid income taxes. Reg. § 301.6111-2T(a)(2). Transactions structured for avoidance of income taxes include certain types of transactions identified in various Service pronouncements, transactions “lacking economic substance,” and transactions where “the tax benefits constitute an important part of the intended results of the transaction.” Reg. § 301.6111-2T(b)(3)-(4).
174Reg. § 301.6111-1T A-1.
175Reg. § 301.6112-1T A-4.
176Reg. §§ 301.6112-1T A-4; 301.6111-2T(a)(1); 301.6111-2T(f); 301.6111-1T A-26.
177See Reg. § 301.6112-1T A-5.

*Tax Lawyer, Vol. 54, No. 3*
business activity codes; the principal asset of the shelter and whether the asset was acquired from a related party; the cost to the tax shelter and whether it is located in a foreign country; the means of the acquisition; the date acquired; the accounting method of the shelter; the registration number of other tax shelters which the person filing participated; and the date the investment was first offered for sale. These items are holdovers from the scheme in place before the recent focus. Additional information required by the recent regulations includes a detailed description of the tax shelter and the expected tax benefits, along with any written materials that are given to potential investors.\textsuperscript{178} Information required to be included on the investor list includes the name, registration number and TIN of the shelter; the name, address, and TIN of each investor and in some circumstances indirect corporate participants; the number of units acquired by each investor; the date each interest was acquired; the amount invested by each investor; a description of the structure and tax benefits of the shelter; copies of any written materials provided to potential participants (excluding those never possessed by the organizer or seller); and various other information.\textsuperscript{179}

The tax shelter regulations address the possibility that registration of a tax shelter may require an attorney to reveal confidential client communications.\textsuperscript{180} Although the regulations still require the attorney to submit Form 8264 in such a situation, the attorney may omit any information from the form that would reveal a confidential communication. However, the attorney must submit a statement that identifies each document or category of information omitted and that states the privilege with respect to the omitted information has not been waived. The regulations similarly address the possibility that disclosure of the investor list upon request by the Service may be subject to claims of privilege.\textsuperscript{181} Thus, the regulations state that if an attorney believes disclosing the client’s identity would violate the attorney-client privilege, the client’s identity may be withheld if the attorney submits a signed statement similar to the type required for a claim of privilege for registration of a confidential corporate tax shelter.\textsuperscript{182} Curiously, the regulations do not allow for claims of privilege with respect to the written materials or information other than the client’s identity.

Much of the information required on Form 8264 is of a nature that would not be privileged. In general, information about the identity of the tax shelter entity, its assets and activities do not by themselves represent a confidential communication with an attorney. Information relating to the tax shelter’s identity may be privileged under \textit{Baird}, \textit{Tillotson}, and \textit{Osterhoudt},\textsuperscript{183} however, where disclosure of the tax shelter’s identity would itself reveal a confidential communication

\textsuperscript{178}Reg. § 301.6111-2T(e)(2)(ii).
\textsuperscript{179}Reg. § 301.6112-1T A-17(a).
\textsuperscript{180}Reg. § 301.6111-2T(e)(3).
\textsuperscript{181}Reg. § 301.6112-1T A-17(b).
\textsuperscript{182}Reg. § 301.6112-1T A-17(b).
\textsuperscript{183}See supra text accompanying notes 83-96.
between client and attorney. Because the nature of the advice sought from the attorney is by definition with respect to a form of tax-motivated transaction, revealing the name of the client would be tantamount to revealing that the entity engaged in a tax-motivated transaction. This is a sympathetic case for applying the privilege.

The availability of the privilege depends nonetheless on the context of the required registration. First, the attorney must have an attorney-client relationship with the entity whose identity is to be disclosed. This will not necessarily be the case, particularly where the attorney is required to register because another party acting more in the traditional promoter role failed to do so. Second, even if there is an entity involved with respect to which there is an attorney-client relationship, that entity will have waived the privilege if the tax planning or benefits involved are revealed to prospective investors or customers.

Similar issues arise with respect to the required detailed explanation and written materials. Only in the simplest case, involving an attorney who has a pre-existing relationship with a client, will any privilege be available. Otherwise, where the attorney is required to register because of another party’s failure to do so, it is very likely that there will have been sufficient communication between the client and the promoter for the required information either not to be considered confidential or to have been revealed to a third party in such a manner that any privilege would have been waived. Finally, when the attorney is representing the promoter, the fact that the promoter has intended to and did market the plan, and presumably the attorney’s advice, would belie any claim of an intention to keep the information confidential and eliminate any privilege.

A claim of privilege with respect to a client’s identity on the investor list is more likely to occur in practice than other possible claims of privilege. The analysis here is much the same as with respect to the identifying information on the Form 8264. Thus, provided that an attorney-client relationship exists with the person or entity whose name is to be disclosed, and there has not been sufficient disclosure of the matters relating to the shelter for a waiver to have occurred, a claim of privilege for the investor’s name should be upheld. More in the way of commentary on the tax shelter regulations than on the availability of any privilege, as a practical matter, the Service, without knowing the identity of the client in the face of a claim of privilege, will not be in a position to dispute the claim. As a result, it is clear that the Service will be relying more on the good faith of practitioners claiming the privilege than on the remote chance of punishment of those who falsely claim that a client’s identity is privileged.

V. PRIVILEGE RECONSIDERED

Courts, and so far this article, have unfailingly and without question applied the attorney-client and work-product privileges to tax-related matters in the same manner as the privileges would apply in non-tax matters. It is fair to ask, however, whether there are not differences between tax and non-tax law that would merit application of the privileges differently. In particular, one may ask whether the purposes of the privileges are served equally in tax law and non-tax law.
matters? From the other side of the telescope, one may inquire whether particular underpinnings of the tax law are frustrated by the privileges.

The work-product privilege can be disposed of summarily. As a litigant, the Service is no different from any other party. There can be little debate that the work-product privilege fosters the same goals in tax litigation as in other litigation matters.

Real debate can take place with respect to the attorney-client privilege, however. One fairly can ask whether a client’s ability to disclose facts fully to an attorney matters should be available in a tax matter as much as, for example, an antitrust or an environmental matter. There are some important differences between tax and other areas of law that can make one pause before answering in the affirmative. First, and most importantly, most other areas of law have a variety of rules either mandating or prohibiting specified conduct under pain of penalty. Aside from a few relatively trivial items like return filing requirements, tax law does not have many prescriptions or proscriptions. Tax law simply ascribes a tax consequence (taxable vs. nontaxable; deductible vs. nondeductible; benefit available vs. unavailable) to taxpayer conduct. Second, tax law is far more pervasive than any other area of law in the sense that it necessarily will affect virtually every individual and business enterprise in the country. And third, there is the close connection between tax law and accounting. Although tax law will necessitate the interpretation of statutes, the ultimate objective is to correctly tally a taxpayer’s income tax liability, just the issue that has caused the courts to struggle for some time.

The purpose of the attorney-client privilege is expressed almost universally as promoting compliance with the law. Yet compliance is not a particularly relevant concept in the tax law (save for a number of ministerial activities). A taxpayer’s objective in addressing tax law matters is permissible tax minimization, not compliance. Recognizing that the attorney’s duty to uphold the law is no different in tax law matters than others, the tax attorney’s professional charge is more slanted to advocacy against the system than most other disciplines. This can be dismissed as merely a difference in degree since other lawyers frequently will be asked “what is the least I can do to be in compliance?” Still, the client’s charge to the antitrust or environmental lawyer, for example, is to assure that there is no antitrust violation with its large civil or criminal penalties, or no environmental violation with similar threats attached. The larger social interest in facilitating compliance with law in a wide array of disciplines is not so clearly present when it comes to tax. Indeed it is rather difficult to articulate what may be the social interest in tax minimization.

The other differences between tax law and other areas of law are less important, but nonetheless to some extent militate against making the attorney-client privilege available. The fact that tax law touches the economic affairs of just about every single person and business enterprise in the country creates the

---


_Tax Lawyer_, Vol. 54, No. 3
specter of far more claims of privilege than in other areas of law. A privilege is sensibly conferred only after balancing the competing societal interests in access-to-truth and integrity-of-the-system. The sheer bulk of information that the Service is charged with processing and the resulting disadvantage at which it is placed, adds weight to the access-to-truth side of the scale. At the same time, except in respect of criminal matters (where the attorney-client privilege must be retained even in tax matters) the societal interest in permitting the self-assessment system to allow for the hiding of a few balls does not appear that great.

Finally, there is the ongoing confusion between tax law and income tax accounting. Although courts seemed to have struggled their way to a sensible distinction, *viz.*, the interpretation of statutes versus the tallying of numbers, 185 it is likely that situations will arise that arguably fall somewhere in between. There will probably be some additional case law on this subject before we are through which could be avoided if application of the attorney-client privilege to tax matters were reconsidered.

On the flip side of the ledger, some of the underpinnings of the tax system itself arguably are inconsistent with the idea of privileged communications. Our tax system is widely considered to be a self-assessment system. Aided by a large dose of wage withholding, the system depends on voluntary compliance. The audit process is a relatively unique feature of the tax law, where outside of the context of suspected wrongdoing, the government agency charged with enforcement is by statute given broadside access to information. Obviously, the attorney-client privilege is a limitation on that access, but just about the only one. Unfortunately, it is a very outsized limitation. The privilege essentially protects private communications about motives, mistakes and misfeasance in the face of a regime created to provide access to information. Privilege thus protects what arguably is the most important information for the Service to know and the most difficult for it to obtain.

If elimination altogether of the attorney-client privilege in tax matters is simply too dramatic, a partial approach may be considered. Like the approach taken in creating section 7525, the privilege can be denied in a matter involving a “tax shelter.” There is something to this approach as a compromise since the access-to-truth interest is greater and integrity-of-the-system interest is weaker in tax transactions, which are predominately tax-motivated. One problem with this approach, though, is its inherent circularity. Subjective motive is part of the definition of a tax shelter. Thus discovery of communications about motive may be necessary to determine whether an arrangement is a tax shelter. Discovery of those communications would only be deemed improper after the fact if no tax shelter were found, a clearly unsuitable approach.

VI. CONCLUSION

The issue of privilege in tax matters has created a body of law practically as large if not larger than any other single issue in the tax law. It is still evolving.

185 See United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999).
While we may despair of the prospect of true tax simplification in our lifetimes, there are meaningful steps that can be taken in that direction. Elimination of the attorney-client privilege in all but criminal tax matters would be one such step. The work-product privilege can be retained, but in a lesser blow for simplification, the “anticipation of litigation” standard can be clarified to include only situations where litigation actually has been threatened or otherwise is imminent, so that no work product produced in connection with planning or execution of a transaction would qualify.