SHOULD I RETAIN AN ATTORNEY OR A CPA?: THE ROLE OF EVIDENTIARY PRIVILEGES IN TAX LITIGATION

JENNIFER L. CHAPMAN*

I. INTRODUCTION

Following the Enron scandal, the passage of Sarbanes-Oxley, and the recent financial crisis, the number and type of tax-related cases permeating the U.S. court system increased. Moreover, in large part due to these events, litigants and their representatives have had to confront a number of tax issues that had been encountered only rarely in the past. Consequently, lawyers, accountants, and their clients are being forced to adapt their mindsets, tactics, and actions to suit a host of new legal issues. This article seeks to address one such issue – the role of evidentiary privileges in tax litigation.

Because tax litigation operates around the intersection of the law, accounting, and business, the assertion of evidentiary privileges creates unique problems for the courts and the parties alike. Nearly thirty years after the Supreme Court confirmed that there is no accountant-client privilege,[1] tax litigants continue to face situations in which the role of the professional who acted on their behalf may dictate which evidence can be introduced at trial. The recent addition to the Internal Revenue Code of the § 7525 privilege,[2] which protects communications between taxpayers and their federally authorized tax practitioner raised hopes in the late 1990s. However, its application has proven uneven. Finally, the ever-changing interpretation of the work product doctrine in tax cases has only added to the confusion.

This article seeks to bring some clarity to the current state of affairs and to offer suggested changes and improvements to the *status quo*. Part II provides a brief history of the various evidentiary privileges potentially applicable in tax litigation. Part III reviews three recent tax cases that have called into question the real role of those privileges in tax cases. In Part IV, the author asserts that the current application of evidentiary privileges in tax cases often leads to contrary results depending upon the tax professionals involved, causing litigants and their representatives unnecessary headaches and leading to unduly lengthy litigation as the courts struggle to apply the evidentiary privileges in this unique area of litigation. Finally, the author concludes with a few proposed changes and clarifications that need to be made in order to make tax litigation fairer and more efficient for all involved. An expansion of the work product doctrine in tax cases would go far

* J.D., C.P.A., Assistant Professor of Legal Studies & Accounting, Georgia Gwinnett College.

[1] United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984) ("[N]o confidential accountant-client privilege exists under federal law.").

[2] I.R.C. § 7525 (2010).

toward resolving the current state of uncertainty without unduly altering the traditional role of evidentiary privileges in general.

II. EVIDENTIARY PRIVILEGES IN TAX CASES

For centuries, courts have struggled to balance the need for the introduction of all evidence relevant at trial with the rights of the litigants to be secure in the knowledge that their relationship with the professionals they hire to represent them is not impaired. As aptly put by Judge Allegra in a recent case before the Court of Federal Claims:

> Balancing the interpenetrating factors involved in the assertion of privileges in our federal judicial system is a subtle and complicated process. The necessity for judicial accommodation between the intersecting pursuit of truth and the protection of confidences, though often expressed in terms of rules of certainty and simplicity, is often applied in a fashion that is neither certain or simple. Frequently, striking that balance requires a court to make close, factually intensive distinctions, particularly in the area of federal income taxation, in which business planning, tax return preparation, and legal advice tend to coalesce.[3]

This conundrum illustrates the need for a thorough understanding of the various privileges that may apply in a given tax case. A brief review of those privileges follows.

A. *Attorney-Client Privilege*

The oldest of the evidentiary privileges,[4] the attorney-client privilege is also the most familiar privilege to most people, lawyers and the general public alike. Succinctly put, the purpose of the attorney-client privilege is to encourage "full and frank communication between attorneys and their clients."[5] Generally, all confidential communications between an attorney and his or her client are protected from discovery and from introduction into evidence at trial.[6] A client will lose the

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[3] Evergreen Trading, LLC v. United States, 80 Fed. Cl. 122, 122 (2007)

[4] EDWARD W. CLEARY, MCCORMICK ON EVIDENCE § 87 (2d ed. 1972) (discussing the roots of the attorney-client privilege in ancient Roman law). The Federal Rules of Evidence explicitly recognize that the privilege is "governed by the principles of the common law as they may be interpreted by the courts . . . in the light of reason and experience." FED. R. EVID. 501. Some commentators have suggested that the federal law of privilege should be codified rather than relying on the current broad statement of privilege found in Rule 501 of the Federal Rules of Evidence, noting that the current case-by-case application of the privileges can lead to uneven results. *See generally* Kenneth S. Broun, *Giving Codification a Second Chance - Testimonial **Privileges** and the Federal Rules of Evidence,* 53 HASTINGS L.J. 769 (2002) (tracing the history of the current Rule 501 and advocating codification of the federal privileges).

[5] Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

[6] *Id.*

protection of the attorney-client privilege only in the event the client waives the privilege in some fashion.[7] Thus, this privilege serves to further the administration of justice by ensuring that clients feel free to share all relevant information with their attorney without the fear that their attorney may be forced later to use that confidential information at trial.[8] While its purpose seems clear, its application is not always as crystalline, especially where tax issues are involved.

First, the attorney-client privilege only attaches when the attorney is acting in his or her capacity as such. To quote Wigmore, the privilege applies, absent waiver, "[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."[9] Thus, for the privilege to apply, one must prove four elements: (1) a communication, (2) made in confidence, (3) by a client to an attorney, (4) who is acting in his or her capacity as an attorney.[10] The absence of any one of these factors will defeat the privilege.

Given the limited purpose of the attorney-client privilege – ensuring that an attorney and client may engage in open and frank communication in preparation for trial − the courts have traditionally construed the privilege in a very narrow fashion.[11] A client may affirmatively assert that a communication is confidential, or the expectation of confidentiality may simply arise from the context of the attorney-client relationship.[12] That relationship arises from the retention of an attorney by some species of legal advice or legal representation.[13] An attorney is acting in his or her legal capacity whenever legal, as opposed to accounting or business, advice is given. If an attorney is acting in any capacity other than his or her legal capacity, the privilege does not attach.[14] "The privilege applies only to the extent necessary to achieve its underlying goal of ensuring effective representation through open communication between lawyer and client."[15] Thus, where the privilege is raised, the courts will carefully review the communications to ensure that the privilege is needed in order to meet the purposes for which it was originally adopted. "Once the reason for the privilege ceases, the privilege ceases."[16] Given its narrow construction,

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[7] *See* Genetech, Inc. v. U. S. Int'l Trade Comm'n, 122 F.3d 1409, 1415 (Fed. Cir. 1997) (discussing waiver of attorney-client privilege).
[8] *See* Evergreen Trading, LLC, 80 Fed. Cl. at 128.
[9] 8 JOHN HENRY WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2292 (McNaughton rev. 1961).
[10] *See id.*
[11] United States v. Arthur Young & Co., 465 U.S. 805, 816 (1984); *see also In re* Grand Jury Subpoena, 274 F.3d 563, 571 (1st Cir. 2001) ("The privilege applies only to the extent necessary to achieve its underlying goal of ensuring effective representation through open communication between lawyer and client.").
[12] *See generally* WIGMORE, § 2292 (outlining the application of the attorney-client privilege).
[13] *Id.*
[14] *See id.* (noting that an attorney must be acting in his or her capacity as such before the privilege attaches).
[15] *In re* Grand Jury Subpoena, 274 F.3d 563, 571 (1st Cir. 2001); *see also* Wigmore, § 2192 (""The investigation of truth and the enforcement of testimonial duty demand the restriction, not the expansion of [the attorney-client privilege].").
[16] Ullmann v. United States, 350 U.S. 422, 507 (1956).

the party asserting the privilege bears the burden of proving its elements are satisfied.[17] Finally, the courts have traditionally found that a communication ceases to be confidential when either the attorney or the client discusses the communication with a third party.[18] When an otherwise privileged communication is shared with a third party, both that particular communication and all communications related to the same subject matter lose the protection of the attorney-client privilege.[19]

1. Involvement of a CPA in Tax Matters

As one might expect in tax cases, very often information gathered either during the planning of a potentially taxable transaction or during the period leading up to litigation of a tax issue is shared with CPAs or other tax professionals. It is not uncommon for such information to include communications between an attorney and the taxpayer-client. Traditionally, the courts have treated this sharing of information as a waiver of the attorney-client privilege.[20] Though CPAs are governed by highly specific ethical guidelines and cannot generally share confidential information gathered from their clients without the client's permission, they do not have the same general duty of confidentiality as attorneys.[21] As a result, many courts have been reluctant to continue the application of the attorney-client privilege once an erstwhile confidential communication is shared with the client's CPA.

In spite of this general reluctance, some courts and commentators have acknowledged that an exception should exist where a third party is employed as an agent to assist an attorney in providing legal advice.[22] Most commonly, those agents include paralegals, administrative assistants, law partners, law clerks, and similar employees of the attorney's law firm along. The Second Circuit, in *United State v. Kovel*,[23] recognized that in certain instances a similar exception should be extended to CPAs. "The presence of an accountant, whether hired by the lawyer or the client, . . . ought not to destroy the privilege."[24] Very often in instances where a complex

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[17] *See, e.g., In re* Bonanno, 344 F.2d 830, 833 (2d Cir. 1965) (noting that the party asserting the privilege must prove its elements, a burden that is not satisfied by "mere conclusory" assertions.).

[18] Carter v. Gibbs, 909 F.2d 1450, 1451 (Fed Cir. 1990); *see also* Genetech, Inc. v. United States Int'l Trade Comm'n, 122 F.3d 1409, 1415 (Fed. Cir. 1997) (noting that disclosure to a third party waives the attorney-client privilege because any expectation of confidentiality is lost).

[19] Evergreen Trading, LLC v. United States, 80 Fed. Cl. 122, 130 (2007) (discussing the waiver of the attorney-client privilege in tax cases where the taxpayer shares legal advice with a third party).

[20] *See, e.g.,* United States v. Ackert, 169 F.3d 136, 139 (2d Cir. 1999) (noting that generally disclosure of attorney-client communications to a third party destroys the privilege).

[21] *See* AICPA CODE OF PROF'L CONDUCT R. 301 (2010) (explaining a CPA's duty of confidentiality and noting that the duty does not apply in the face of a valid subpoena or summons).

[22] 3 WEINSTEIN'S FEDERAL EVIDENCE §§ 503.12[3][a], [4][b] (J.M. McLaughlin, ed., 2d ed. 2002).

[23] 296 F.2d 918 (2d Cir. 1961).

[24] *Id.* at 922.

tax matter is at issue, "the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the [attorney-client] privilege is designed to permit."[25]

Most commonly, the attorney will hire the CPA in order to seek the CPA's advice on the underlying tax issue, particularly in situations where the attorney is not a tax law expert but is handling a tax case on a client's behalf. As a general rule, an attorney may share confidential communications from a client with the attorney's agents without endangering the attorney-client privilege. Where an attorney hires a CPA to perform work for the attorney on behalf of a client, include the CPA within that agency blanket. The rationale for this approach appears to center on the fact that the attorney is hiring the CPA to ensure that the attorney fully understands the legal contours of the tax issue at hand and is relying on the CPA to provide that expertise.[26] Therefore, the CPA is seen as acting as the attorney's agent to perform a service on the attorney's behalf, not on behalf of the client. In such a scenario, the expectation of confidentiality extends to the CPA, so that no waiver of the attorney-client privilege occurs.[27]

2. Attorney Acting in Another Capacity

Equally frustrating to many clients is the realization that confidential communications to an attorney who acts in something other than a legal capacity are not protected by the attorney-client privilege. This scenario is not uncommon in tax cases. For example, if a client hires an attorney as his or her legal counsel, the attorney-client privilege acts as a shield for all communications with that attorney related to legal advice. However, if the attorney also prepares the client's income tax return, any communications related to that tax return are not protected and may be discoverable by the IRS or other plaintiffs in the event of litigation.[28] To many clients, the fact the return itself is discoverable is not surprising; however, the fact that underlying supporting documentation, notes, and communications with the client may be discoverable often comes as a shock.[29] The client thought they were dealing with an attorney for a reason, after all.

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[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *See, e.g.,* United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999) (noting that the preparation of a tax return is seen as an accounting service and that the attorney-client privilege will not attach simply because the client hires "a lawyer to do the work that an accountant, or other tax preparer, or the taxpayer himself . . . normally would do."). Whether attorneys engage in tax return preparation appears to vary considerably across the country. In some states, the practice is common – both for income tax returns and estate tax and other tax returns. In other states, attorneys never wade into the tax return preparation pool. As discussed *supra* note *8*, the courts have united behind the belief that tax return preparation is an accounting function. *See also discussion infra* Part B. (noting that tax returns and accompanying workpapers are also not protected by the work product doctrine).
[29] *See* Claudine Pease-Wingenter, *Does the **Attorney-Client Privilege** Apply to **Tax** Lawyers?: An Examination of the Return Preparation Exception to Define the Parameters of **Privilege** in*

It is also not uncommon in tax cases for the attorney-client privilege to disappear due to an attorney's provision of business advice. As in the situation where an attorney provides accounting advice in the form of preparing a tax return, where the legal advice ends and the business advice begins is often a blurry line at best.[30] In complex business transactions, lawyers are often called in to handle every aspect of the deal. And, often these lawyers handle different aspects of the transaction, depending upon the attorneys' areas of expertise. Where one or more attorneys representing a client are involved in the tax law ramifications of the deal, often the attorney-client privilege that would otherwise attach to any communications between these attorneys and the client is lost, simply because the tax attorneys share their findings with business consultants, CPAs, and other experts. In such situations, the client's only hope for reprieve is the agency exception discussed previously.

In summary, where the attorney-client privilege applies, it is a powerful protector. However, given the peculiar nature of tax litigation, opportunities for the loss of the privilege abound. Not only does tax litigation sit at the intersection of legal, accounting, and business advice, but multiple professionals are often involved along the way, any one of whom may need information that, if provided, may cause the client to lose the privilege's protection. In addition, attorneys often play varying roles in tax transactions, providing both legal and other types of advice, meaning that traps for the unwary wait around every corner.

B. *Section 7525 Privilege*

In 1984, the Supreme Court confirmed that no accountant-client privilege exists under federal law.[31] It was not until 1998 that a form of evidentiary privilege for accountants and certain other tax preparers came about in the form of Section 7525 of the Internal Revenue Code (hereinafter the "§ 7525 privilege"). Touted as the equivalent of the attorney-client privilege, the § 7525 privilege applies to all practitioners authorized to practice before the Internal Revenue Service.[32] As one might expect, this privilege plays a starring role in many tax cases.

1. Elements and Relationship to the Attorney-Client Privilege

The starting point for any analysis of a statute is the language of the statue itself. Section 7525 of the Internal Revenue Code explicitly states:

> [T]he same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and a federally authorized tax practitioner to the extent the communication would

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*the **Tax** Context*, 47 WASHBURN L.J. 699, 707-21 (2008) (providing an excellent analysis of the tax return preparation exception and noting that tax advice is not sought in a vacuum).

[30] *Id.*

[31] United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984).

[32] *See generally* I.R.C. § 7525 (2010) (outlining the requirements and applicability of the federally authorized tax practitioner privilege).

> be considered a privileged communication if it were between a taxpayer and an attorney.[33]

Thus, on its face, in order for the privilege to apply, several elements must be present: (a) a confidential communication; (b) that would be protected by the attorney-client privilege; and (c) a federally authorized tax practitioner. The first two elements are relatively straightforward to those familiar with the attorney-client privilege.[34] However, the third element must be explored. Again, the starting point is the Code itself.

Under Section 7525, a "federally authorized tax practitioner" is "any individual who is authorized to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code."[35] Thus, the Code section covers not only attorneys and CPAs but also enrolled agents and others who are authorized to practice before the IRS.[36] Moreover, the § 7525 privilege only applies in non-criminal matters.[37] Finally, the Code requires that the federally authorized tax practitioner be engaged in providing "tax advice" before the privilege will come into play.[38] Again, this limitation on the § 7525 privilege has clear roots in the attorney-client privilege. Only attorneys acting in their legal capacity are covered by that privilege,[39] so limiting the § 7525 privilege to tax advice merely adds to the correlation between the two privileges.

While the basis for the § 7525 privilege rests in the language of the Code, one cannot stop the analysis there. Rather, because the privilege is based on the attorney-client privilege, the case law underlying that privilege directly informs the application of the § 7525 privilege.[40] Indeed, the extent to which the § 7525 privilege is based on the attorney-client privilege can be seen in the Code section's legislative history. First, as with the attorney-client privilege, the § 7525 privilege is not applicable where the federally authorized tax practitioner is engaged in tax return preparation. As described in the House Conference Committee Report, in keeping with the common law, neither the attorney-client privilege nor the § 7525 privilege will "apply to communications and documents generated in the course of preparing [a tax] return."[41] Similarly, the § 7525 privilege will not apply in other situations

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[33] *Id.* § 7525(a)(1).
[34] *See* discussion *supra* Part II.A.
[35] I.R.C. § 7525(a)(3)(A).
[36] 31 U.S.C. § 330. Subsection (a) of Section 330 states in pertinent part that, "[T]he Secretary of the Treasury may . . . regulate the practice of representatives of persons before the Department of the Treasury." § 330(a)(1).
[37] I.R.C. § 7525(a)(2)(A).
[38] *Id.* § 7525(a)(3)(B) (providing that tax advice is "advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice described in [I.R.C. § 7525(a)(3)(A)].").
[39] *See supra* text accompanying notes 11-15.
[40] *See, e.g.,* United States v. BDO Seidman, 337 F.3d 802, 810 (7th Cir. 2003) ("[T]he scope of the [§ 7525] privilege depends on the scope of the common law protections of confidential attorney-client communications."); *see also* discussion *infra* Part III.C (discussing later appeal in the BDO Seidman litigation).
[41] H.R. CONF. REP. NO. 105-599, at 267 (1998).

where the practitioner is acting in other than a legal capacity.[42] Finally, actions that would waive the attorney-client privilege will likewise result in a waiver of the § 7525 privilege. Whenever a would-be confidential communication is passed along to a third-party, "[t]he privilege of confidentiality does not apply."[43] If a taxpayer or the taxpayer's federally authorized tax practitioner discloses the substance of a privileged communication to a third party, the privilege is considered waived "to the same extent and in the same manner as the privilege would be waived if the disclosure related to an attorney-client communication."[44]

2. The § 7525 Privilege v. the Attorney-Client Privilege: How They Differ

Clearly, the direct relationship between the § 7525 privilege and the common law attorney-client privilege is indisputable. However, the two privileges are not identical.[45] Specifically, Congress adopted a specific exception to the § 7525 privilege. Under this exception, any communications related to the promotion of a tax shelter are explicitly excluded from the protections of the § 7525 privilege. As stated in § 7525(b):

> The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in section 6662(d)(2)(C)(iii)).[46]

Under the plain language of the Code, the tax shelter exception applies to very narrow circumstances. Specifically, only written communications are included within the exception.[47] In addition, the communication must be between the federally authorized tax practitioner and a "director, shareholder,

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[42] *See id.* (noting that the § 7525 privilege applies in the same contexts as the attorney-client privilege).

[43] *Id.* The House Conference Committee Report explicitly states that "information that is communicated to an attorney for inclusion in a tax return is not privileged because it is communicated for disclosure." *Id.* This example mirrors the waiver of the attorney-client privilege that occurs when an attorney's tax advice is shared with a client's tax preparer for purposes of disclosing the information on the client's tax return.

[44] *Id.*, *see also* BDO Seidman, 337 F.3d at 810 ("[T]he § 7525 privilege is no broader than that of the attorney-client privilege.").

[45] As previously discussed, the § 7525 privilege does not apply to criminal matters. I.R.C. § 7525(a)(2)(A).

[46] I.R.C. § 7525(b). At least one author has posited that the present tax shelter rules encourage overdisclosure and has advocated a series of rules and penalties aimed at moving toward accurate and efficient detection of tax shelters. Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 UCLA L. REV. 1629 (2009).

[47] I.R.C. § 7525(b).

officer, or employee, agent, or representative of a corporation."[48] While this list may appear limited, the inclusion of agents and representatives makes it possible for the courts to include not only other tax professionals but a variety of consultants, effectively applying the exception to virtually any person with whom the federally authorized tax practitioner discusses a tax shelter. Finally, the exception applies wherever the communication relates to the promotion and direct or indirect participation of a corporation in a transaction that the IRS has deemed a tax shelter.[49]

Given the relative newness of § 7525, the courts are still actively working to define the tax shelter exception.[50] The precise scope of this exception and its interpretation by the courts are beyond the scope of this article. However, it is important to recognize that the exception exists and that, as a result of the exception and the other differences in application of the two privileges previously noted, the attorney-client privilege and the § 7525 privilege arguably are not, in fact, co-extensive. This divergence is broadened when one considers the current role of the work product doctrine in tax cases.

C. *Work Product Doctrine*

In very general terms, the work product doctrine acts to protect written statements, memoranda, personal recollections, and similar documents prepared or formed by a client's legal counsel.[51] During the Congressional debates over the adoption of § 7525, many wondered whether the section would, in fact, turn into an extension of the work product doctrine. The legislative history ends any debate on this issue. Specifically, the Senate Finance Committee rejected this option by specifically limiting the scope of § 7525 to "communications" and thereby effectively turning § 7525 privilege into a privilege akin to the attorney-client privilege rather than an extension of the work product doctrine.[52] In light of this history, the courts have uniformly found that § 7525 "does not protect work product."[53] Given that Congress deliberately opted not to apply § 7525 to an tax practitioner's work product, the courts have faced the task of determining if and how the work product doctrine applies in tax litigation where tax professionals who are

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[48] *Id.*
[49] *Id.*
[50] *See, e.g.,* BDO Seidman, LLP v. United States, 492 F.3d 496, 822-28 (7th Cir. 2007) (examining contours of Section 7525 privilege); *see also generally* Countryside Ltd. P'ship v. Comm'r, 132 T.C. No. 17 (2009) (examining the scope of the tax shelter exception and, in particular, the promotion of tax shelters).
[51] Hickman v. Taylor, 329 U.S. 495, 510 (1947).
[52] H.R. 2676 (Apr. 22, 1998) (as reported by the S. Fin. Comm. with an amendment); *see also* H.R. REP. NO. 105-599, at 268 (1998) ("This provision relates only to matters of privileged communications.").
[53] United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999) ; *see also* BDO Seidman, LLP 492 F.3d at 827 ("[T]he tax practitioner privilege is limited to communications that would be privileged if they had been made to an attorney."); United States v. Bisanti, 414 F.3d 168, 170 n.1 (1st Cir. 2005) (noting that the tax practitioner privilege protects communications that would be protected by the attorney-client privilege if made between a client and an attorney).

not attorneys are involved.[54] Before discussing the most recent applications of the work product doctrine in tax cases, a brief review of the doctrine and its traditional scope is in order.

The work product doctrine was created in the seminal case of *Hickman v. Taylor*.[55] As explained by the Supreme Court, the doctrine's role is to ensure that an attorney can rest assured that his or her thoughts and work would enjoy an appropriate degree of privacy, thereby allowing the attorney fully and adequately prepare for trial without fear of that work being discovered by opposing counsel.[56] Following the reiteration of the doctrine's importance by the Supreme Court,[57] the work product doctrine was formally adopted into the Federal Rules of Civil Procedure as Rule 26(b)(3).

Rule 26(b)(3) states that documents "prepared in anticipation of litigation or for trial" are discoverable only upon a showing of "substantial need" for the materials and "undue hardship."[58] Importantly, even where a party seeking to discover work product can show substantial need or undue hardship, Rule 26(b)(3) explicitly provides that the court "shall protect against disclosure of the mental impressions, conclusions, opinion, or legal theories of an attorney or other representative of a party concerning litigation."[59] Thus, an attorney's own thought processes, impressions, and theories remain the attorney's. They are not shared with opposing counsel, even under the explicit exception to Rule 26(b)(3). In light of the policy concerns underlying the creation of the work product doctrine, this protection for attorneys is well-reasoned. However, in spite of the seemingly clear language of Rule 26(b)(3), the work product doctrine is not without its ambiguities, even outside the tax litigation context.

The application of Rule 26(b)(3) to a particular document is often called into question due to the failure of the drafters of the rule to include a timing provision. "Rule 26(b)(3) does not in so many words address the temporal scope of the work product immunity."[60] The lack of a timing provision means that the courts have had to determine when the privilege attaches. In spite of a lack of explicit guidelines, the courts have developed a specific set of rules in this regard. Specifically, the courts are in almost universal accord that "litigation need not have already commenced or be imminent; rather, litigation must merely be a real possibility at the time the documents in question are prepared."[61] Importantly, proceedings before

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[54] *See infra* Part III (suggesting that either Congress or the courts should revisit the application of the work product doctrine under the § 7525 privilege).
[55] 329 U.S. 495 (1947).
[56] *Id.* at 510-11. Justice Murphy, writing in *Hickman*, noted that "[i]nefficiency, unfairness, and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial" without the work product doctrine. *Id.* at 511.
[57] *See, e.g.*, Upjohn v. United States, 449 U.S. 383, 398 (1981) (outlining the elements of the federal work product doctrine); United States v. Nobles, 422, U.S. 225, 236-40 (1975) (acknowledging the existence of a federal work product doctrine).
[58] F.R.C.P. 26(b)(3).
[59] *Id.*
[60] Fed. Trade Comm'n v. Grolier, Inc., 462 U.S. 19, 26 (1983).
[61] Evergreen Trading, LLC v. United States, 80 Fed.Cl. 122, 132 (2007) (citing AAB Joint Venture v. United States, 75 Fed.Cl. 432, 445 (2007); Energy Capital Corp. v. United States,

administrative agencies have traditionally been included within the definition of "litigation."[62] However, it is equally clear that documents prepared in the "ordinary course of business" or related to requirements unrelated to litigation, such as requirements of the Securities and Exchange Commission, are not covered by the work product doctrine.[63]

While these concepts are accepted by courts and litigants alike, the work product doctrine continues to create controversies where documents that are not prepared as part of an administrative proceeding or in response to another public requirement are involved. In these instances, the courts continue to struggle with whether the documents were prepared "in anticipation of litigation."[64] After much debate among the circuits, two tests now predominate. First, the Fifth Circuit employs the "primary purpose" test.[65] Under this test, documents are deemed prepared in anticipation of litigation "as long as the primary motivating purpose behind the creation of a document was to aid in possible future litigation."[66] On the other hand, several circuits, most notably the First Circuit, have adopted a simple causation test.[67] Under this view, the court's inquiry focuses purely upon whether a given document was prepared or otherwise obtained "because of" the prospect of litigation.[68] These two tests, though widely accepted do not necessarily suit tax litigation and are often unevenly applied in tax cases.

III. THE ROLE OF EVIDENTIARY PRIVILEGES IN RECENT TAX CASES

Nowhere is the role of evidentiary privileges subject to more debate than in tax litigation. In spite of the well-developed history of the attorney-client privilege and the work product doctrine, these privileges, as well as the newer § 7525 privilege, continue to evolve within the context of tax litigation. As a result, litigants, attorneys, other tax professionals, and the courts operate in a land of confusion. Over the past few years, the number of published opinions involving the nuances of evidentiary privileges in tax cases has increased. A review of several of those recent cases illustrates the extent to which the application of one or more evidentiary privileges in each case is subject to extensive interpretation and highlights the need for a standard privilege to be applied in all tax cases.

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45 Fed.Cl. 481, 485 (2000); Senate of Puerto Rico v. U.S. Dept. of Justice, 823 F.2d 574, 586 n.42 (D.C. Cir. 1987)).

[62] *See* S. Union Co. v. Sw. Gas Corp., 205 F.R.D. 542, 549 (D. Ariz. 2002) (citing United States v. Am. Telephone & Telegraph Co., 86 F.R.D. 603, 627 (D. D.C. 1979) (advocating view that privilege applies both in court and before administrative agencies).

[63] *See* F.R.C.P. 26(b)(3) advisory comm. notes (1970).

[64] *See* F.R.C.P. 26(b)(3). There is very little dispute over when documents are prepared for trial, since litigation has clearly commenced at that point. *See id.*

[65] United States v. El Paso Co., 682 F.2d 530, 542-44 (5th Cir. 1982).

[66] *Id.* at 542.

[67] Maine v. Dept. of the Interior, 298 F.3d 60, 68 (1st Cir. 2002).

[68] *See id.* (discussing causation analysis and rejecting primary purpose test).

A. *Textron, Inc.*

The First Circuit recently delved into the question of whether the work product doctrine protects tax accrual workpapers prepared as part of the audit of a public company, Textron, Inc.[69] The court engaged in an extensive analysis of the work product doctrine in tax cases before ultimately concluding that the workpapers were not protected as work product.[70] While that ruling is not earth-shattering, the court's analysis illustrates many of the difficulties faced when applying the evidentiary privileges in tax cases.

Textron, Inc. is a publicly traded conglomerate.[71] In 2005, the IRS issued a summons seeking Textron's tax accrual workpapers for the 2001 tax year.[72] As a public company, Textron is required to undergo an independent audit, and the workpapers were produced as part of the preparations for that audit. The IRS summons related to that agency's audit of a number of sales-in, lease-out transactions entered into by one of Textron's subsidiaries, Textron Financial Corporation.[73] The IRS had previously classified this type of transaction as a "listed transaction" so that the transactions were subjected to added scrutiny to ensure they were not entered into for the purpose of tax avoidance.[74] Textron refused to comply with the summons, asserting, *inter alia*, that the workpapers were privileged.[75] The

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[69] United States v. Textron, Inc., 577 F.3d 21 (1st Cir. 2009) (*en banc*). For a complete discussion of the District Court of Rhode Island's decision in the *Textron* case, which led to the appellate decision discussed in this article, see Claudine Pease-Wingenter, *The Application of the Attorney-Client Privilege to Tax Accrual Workpapers: The Real Legacy of* United States v. Textron*,* 8 HOUS. BUS. & TAX. L.J. 337, 342-53 (2008). *See generally* Paul McCord, *Circling Sharks: Toward a Better Understanding of the Tax Lawyer's Role Under Circular 230, Fin 48 and the Work-Product Doctrine*, 34 MICH. TAX L. 26, 29-30 (2008) (discussing district court opinion in *Textron*). *But see* Dennis J. Ventry, Jr., *Protecting Abusive Tax Avoidance*, 120 TAX NOTES 857 (2008) (criticizing the district court opinion in *Textron*).

[70] Textron, Inc., 577 F.3d at 31-32.

[71] *Id.* at 22.

[72] *Id.* at 24. Specifically, the summons sought "all of the Tax Accrual Workpapers" for Textron's 2001 tax year and defined "Tax Accrual Workpapers" to include:

> [A]ll accrual and other financial workpapers or documents created or assembled by the Taxpayer, an accountant for the Taxpayer, or the Taxpayer's independent auditor relating to any tax reserve for current, deferred, and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to any footnotes disclosing reserves or contingent liabilities on audited financial statements. They include, but are not limited to, any and all analyses, computations, opinions, notes, summaries, discussions, and other documents relating to such reserves and any footnotes.

United States v. Textron, Inc., 507 F. Supp. 2d. 138, 142 (D.R.I. 2007).

[73] Textron, Inc., 577 F.3d at 23-24.

[74] *Id.*

[75] *Id.* at 24.

District Court noted that, in 2001 and 2002, Textron's tax department included six attorneys along with several CPAs, while Textron Financial Corporation's tax department consistently solely of CPAs.[76] Since Textron Financial Corporation had no attorneys in its tax department, its CPAs met with outside legal counsel to discuss the tax accrual workpapers, and then met with a Textron tax attorney to finalize the workpapers.[77] Thus, in-house attorneys, in-house CPAs, and outside attorneys were involved in the preparation of the workpapers. In addition, Textron's external auditors would have no doubt had access to the workpapers during their examination of Textron's financial statements.

On appeal, the First Circuit ultimately vacated the District Court's decision and remanded the case for further proceedings.[78] The First Circuit's *en banc* opinion in the *Textron* case focused exclusively on the role of the work product doctrine in tax litigation. Its analysis highlights the difficulties faced by every court analyzing the application of this privilege in a tax case. Moreover, the opinion illustrates the need to develop a concrete set of standards for when information will be deemed privileged as work product in a tax case.

Central to the First Circuit's decision was the fact that Textron was required to prepare the tax accrual workpapers as part of its independent audit requirements.[79] Tracing the issue of the work product doctrine from its origins in *Hickman* through to the 1970 adoption of Rule 26(b)(3) of the Federal Rules of Civil Procedure, the First Circuit honed in on the reasons the tax accrual workpapers were created.[80] Because the work product doctrine only protects documents prepared in anticipation of litigation or for trial, the court was faced with deciding whether this standard was met by Textron. The District Court had found that Textron wanted to be "adequately reserved" in the event the IRS disputed the sales-in, lease-out transactions, and an adjustment to Textron's tax liability resulted.[81] While acknowledging this possibility, the Court of Appeals rejected this position, going so far as to explicitly state that the District Court Judge would have committed clear error if he had found that the workpapers were prepared "for use" in possible litigation.[82] Rather, the Court of Appeals noted, "[t]hat the purpose of the work papers was to make book entries, prepare financial statements and obtain a clean audit cannot be disputed."[83] As such, the Court of Appeals found the work product doctrine inapplicable, stating:

> It is not enough to trigger work product protection that the *subject matter* of a document relates to a subject that might conceivably be litigated. . . . Nor is it enough that the materials were prepared by lawyers or represent legal thinking. Much corporate material

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[76] Textron, Inc., 507 F. Supp. 2d at 141.
[77] *Id.*
[78] Textron, Inc., 577 F.3d at 31-32.
[79] *Id.* at 27-28.
[80] *See id.* at 29 (tracing history of work product doctrine).
[81] See i*d.* at 27 ("The district court first said (paraphrasing a Textron witness) the work papers were prepared to assure that Textron was 'adequately reserved with respect to any potential disputes or litigation' over its returns.") (parentheses in original).
[82] *Id.*
[83] *Id.*

> prepared in law offices or reviewed by lawyers falls in that vast category. It is only work done in anticipation of or for trial that is protected.[84]

The Court of Appeals also noted that only two circuits, the First Circuit and the Fifth Circuit, have squarely addressed the issue of work product protection for tax accrual work papers.[85] Both Circuits had found that the papers were not protected by the work product doctrine, and the Court in *Textron* was bound by its previous decision in *Maine v. Department of the Interior.*[86] However, the Court also noted in passing that there remained the possibility that documents, potentially including audit work papers, could enjoy work product protection where the documents were "prepared for potential use in litigation if and when it should arise."[87] No such evidence was present in the *Textron* case. As such, the Court found that no danger existed that attorneys would not be able to adequately prepare for a law suit because of the production of work papers under the circumstances before it in *Textron.*[88] However, the Court refused to issue a blanket statement covering all tax accrual work papers, noting that "[t]he danger may exist in other kinds of cases."[89]

B. *Valero Energy Corporation*

Another recent case, this one coming out of the Seventh Circuit, further informs the discussion of evidentiary privileges in the tax context. Unlike the *Textron* case, in *Valero Energy Corporation v. United States*, the central issue was whether the § 7525 privilege applied to a series of documents received from the company's tax advisors.[90] The Court was forced to evaluate each item of evidence on an individual basis, resulting in a mixed bag of rulings.

Valero Energy Corporation markets oil products and is actively involved in crude oil refining.[91] In December 2001, Valero merged with Ultramar Diamond Shamrock Corporation, an oil company that owned several Canadian subsidiaries.[92] Valero ultimately entered into the merger for both business and tax reasons.[93] Prior to the merger, both Valero and Ultramar engaged their outside CPA firms to review the proposed merger and to offer tax advice regarding the proper structure and financing for the transaction.[94] Following the merger and as a result of the tax advice it garnered up front, Valero realized a $105 million, tax-deductible, foreign currency

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[84] *Id.* at 29-30.
[85] *See* i*d. at* 30 (discussing prior precedent).
[86] *See id.* (citing Maine v. Dep't of Interior, 298 F.3d 60, 70 (1st Cir. 2002)).
[87] *Id.* at 30.
[88] *Id.* at 30-31.
[89] *Id.* at 31.
[90] Valero Energy Corp. v. United States, 569 F.3d 626, 628 (7th Cir. 2009).
[91] *Id.*
[92] *Id.*
[93] *See id.* (noting the merger expanded the company's reach as well as providing tax benefits).
[94] *Id.*

loss.[95] That loss led to an IRS investigation, and during that investigation, the IRS issued a summons to Valero's CPA firm, Arthur Andersen.[96] The summons sought any and all documentation related to:

> tax planning, tax research, or tax analysis, by or for, Ultramar Diamond Shamrock (including any of its subsidiaries or partnerships, both domestic and foreign) and Valero Energy Corporation (including any of its subsidiaries or partnerships, both domestic and foreign) in connection with their 2001, 2002 and 2003 Canadian and U.S. income taxes.[97]

Valero, as a third party, moved to quash the summons, claiming it was overbroad and that the information sought was protected by either the work product doctrine or the § 7525 privilege.[98] The District Court found the summons was not overbroad and refused to apply the work product doctrine to the materials.[99] However, the District Court engaged in a document-by-document, *in camera* review of the documents at issue, and ultimately sustained Valero's § 7525 privilege as to the documents withheld on that basis.[100] Ultimately, a second round of document production followed, resulting in the opinion at issue. During this second round, the District Court again undertook a document-by-document review of the materials before deeming some of the documents privileged under § 7525, while finding others did not warrant the protection of the privilege.[101]

After noting that the § 7525 privilege protects communications to the same extent those communications would be protected if they occurred between an attorney and a client, the Seventh Circuit focused on the denotation between legal advice and accounting advice.[102] Only communications related to legal advice is protected by the attorney-client privilege; thus, only legal advice is protected by the § 7525 privilege.[103] As noted by the Court, all agree that tax return preparation is an accounting function that does not enjoy the protection of the privilege, while communications about legal questions raised during or in anticipation of litigation are privileged.[104] However, the *Valero* case involved neither of these easy cases. Rather, the documents at issue fell squarely within the gray area so often encountered by courts in tax litigation.

The Court first dealt with the documents that were used for both preparing Valero's income tax returns and for litigation. "[T]o the extent documents are used or both preparing tax returns and litigation, they are not protected from the

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[95] *Id.*
[96] *Id.*
[97] *Id.*
[98] *Id.*
[99] *Id.* at 629.
[100] *Id.*
[101] *Id.*
[102] *Id.* at 630.
[103] *Id.*
[104] *See id.* at 631. (noting that documents produced in conjunction with return preparation are not privileged).

government's grasp."[105] This finding is in line both with other courts that have ruled on the issue as well as with the narrow reading of the attorney-client privilege upon which the § 7525 privilege is based. Thus, it offers little analytical difficulty. As to the other documents, the Court refused to second-guess the District Court and, under a very deferential standard of review, found the documents were not privileged because Valero failed to carry its burden of proving otherwise.[106] In dicta, the Court of Appeals notes that "there is no general privilege between a federal tax practitioner and her client – it's not enough that the communications raised federal tax topics."[107] While it is beyond dispute that there is no accountant-client privilege and that both the attorney-client and § 7525 privileges are narrowly construed, it does not necessarily follow that all communications related to federal tax topics are accounting advice related to return preparation. However, the Seventh Circuit was, in essence, forced to adopt this view because Valero failed to offer sufficient proof to the District Court that the communications at issue should be privileged.[108]

The Valero case illustrates the confusion surrounding the assertion of the § 7525 privilege. In addition, it shows the inefficiencies intrinsic in the present system. In order to garner the protection of the § 7525 privilege, the taxpayer must show the communication related solely to legal advice and that the communication was not used in the preparation of the taxpayer's income tax return. While seemingly straightforward, Valero is just one example of where that standard is more easily stated than met in practice. Moreover, the level of review necessary at the District Court level and the length of time that review takes, calls into question whether a the courts' resources could be better used in something other than in camera review of tax documents.

C. *BDO Seidman*

The issue before the Seventh Circuit in *United States v. BDO Seidman*[109] revolved around the applicability of the attorney-client and § 7525 privileges.[110] However, in this case, the defendant was not the taxpayer, but the public accounting firm that offered the underlying tax advice, BDO Seidman, LLP.[111] Here, the IRS issued a series of administrative summonses to BDO Seidman, as part of a compliance investigation into whether the accounting firm had promoted and then failed to disclose potentially abusive tax shelters.[112] When BDO refused to comply

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[105] *Id.*
[106] *See id.* at 631-32 (discussing Valero's failed attempt to meet its burden of proof).
[107] *Id.* at 631.
[108] *Id.*
[109] 492 F.3d 806. This case has endured a long journey through the courts, including three appeals to the Seventh Circuit to-date. This discussion will focus only on the third opinion published by the Seventh Circuit.
[110] *See* 492 F.3d at 814 (describing issues on appeal).
[111] *Id.* at 809. A number of BDO's clients later intervened in the case, asserting separate claims of privilege. *Id.* at 810-12. These claims are not materially different from those in *Textron* and *Valero* and are not discussed for that reason.
[112] *Id.* at 809.

with the summonses, the IRS petitioned the United States District Court for the Northern District of Illinois for enforcement.[113]

The IRS investigation of BDO centered on various proposed transactions that BDO marketed to its tax clients.[114] Several of these transactions had set off alarm bells within the IRS as potential tax shelters. As such, the IRS sought a large number of documents from BDO related to these transactions.[115] The District Court engaged in an *in camera* review of all of the produced documents to determined which were privileged.[116] By the time the case went up to the Seventh Circuit the third time, after another *in camera* review by the trial court, the focus was limited to a relatively small number of documents still in dispute.[117] Relevant to the current discussion, one document, a memorandum created by BDO's in-house counsel and referred to by the Court as the "Kerkedes Memorandum," was divulged to the firm's outside counsel.[118] The IRS claimed that the Kerkedes Memorandum fell within the crime-fraud exception and, even if not, its disclosure waived any privilege that might otherwise attach to the document.[119] Meanwhile, BDO asserted that the document was protected under the attorney-client privilege and that any waiver was inadvertent.[120]

The Court of Appeals upheld the trial court's ruling that the Kerkedes Memorandum was protected by the attorney-client privilege under the common interest doctrine.[121] The common interest doctrine is, in essence, an exception to the exception in that when it applies, the fact that a privileged document has been shared with a third party does not result in a waiver of the attorney-client privilege.[122] The exception holds true even where litigation is not imminent.[123]

The IRS argued that the common interest doctrine was inapplicable because the memorandum was not produced for the benefit of a particular client or clients.[124] Thus, though BDO and its outside counsel often shared clients, the memorandum did not represent material that served the two firm's common interest, i.e., serving their common clients. Rather, the IRS asserted, the memorandum was more properly characterized as advice from BDO's in-house counsel to BDO that was shared with a third party, thus waiving any privilege that might attach.[125]

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[113] *Id.*
[114] *Id.*
[115] *Id.*
[116] *Id.* at 809-10.
[117] *Id.* at 812-13.
[118] *Id.* at 813 (describing the Kerkedes Memorandum and the uncertainty surrounding its divulgence to the outside law firm).
[119] *Id.* at 813-14.
[120] *Id.* at 813.
[121] *Id.* at 814, 817.
[122] *Id.* at 815.
[123] *See id.* at 816 (noting that "communications need not be made in anticipation of litigation").
[124] *Id.* at 817.
[125] *Id.*

The Seventh Circuit sided with BDO, finding that the Kerkedes Memorandum was fully protected by the attorney-client privilege.[126] The Court reasoned that BDO and the outside law firm were engaged in common efforts to provide tax advice to a number of current and potential shared clients. As a result, the two firms shared a common interest, and the Kerkedes Memorandum represented general legal advice applicable to all of those clients.[127] Therefore, by sharing the memorandum with its outside counsel, BDO was acting in the two firms' common interest and did not waive the attorney-client privilege.[128]

IV. DISCUSSION AND ANALYSIS

Application of evidentiary privileges, standing alone, often proves a thorny issue. Application of those privileges in a tax litigation setting only compounds the complexities involved. As illustrated by the string of recent decisions discussed in the previous section, the need for clarification and simplification is overwhelming. All parties involved − the courts, the attorneys, and the litigants – would benefit. A single set of standards to determine whether a professional is acting in a legal capacity, a business capacity, or an accounting capacity would be helpful for all involved for purposes of determining whether a particular piece of evidence is protected by a privilege. Given the narrow construction traditionally applied to the attorney-client privilege and the newness of the § 7525 privilege, the work product doctrine seems the most likely candidate to ensure fairness and equality across tax cases. Either Congress or the courts should revisit its application in cases involving the § 7525 privilege.

The IRS and the courts have explicitly acknowledged that the § 7525 privilege has essentially the same scope as the attorney-client privilege in tax litigation.[129] Thus, the § 7525 privilege, on its face, should extend to protect confidential communications between a taxpayer at his or her federally authorized tax practitioner. However, as discussed above, the courts have applied the privilege unevenly.[130] Unlike the duty of confidentiality an attorney owes his or her clients, the duty of confidentiality under the AICPA Code of Professional Conduct specifically excludes compliance with a valid subpoena or summons.[131] In other words, a CPA may not refuse to disclose materials related to his or her accounting functions based on confidentiality where faced with a subpoena or summons.

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[126] *See id.* (finding the district court's ruling that the common interest doctrine applied was not clearly erroneous).
[127] *Id*. at 816.
[128] *Id.* at 816-17. Because the Court found that the common interest doctrine protected the Kerkedes Memorandum, it did not need to address the district court's alternative holding that any disclosure was inadvertent. *Id.* at 817 n.8.
[129] *See* United States v. BDO Seidman, 337 F.3d 802, 810 (7th Cir. 2003) ("[T]he scope of the [§ 7525] privilege depends on the scope of the common law protections of confidential attorney-client communications."); *see also* H.R. CONF. REP. NO. 105-599, at 267 (1998) (noting that the § 7525 privilege applies in the same contexts as the attorney-client privilege).
[130] *See supra* Part II.B. (discussing the elements and application of the § 7525 privilege).
[131] AICPA CODE OF PROF'L CONDUCT R. 301 (2010).

Further complicating the issue, most clients expect a high level of confidentiality from a CPA, but the § 7525 privilege covers other tax preparers as well.[132] Many, if not most, of these tax preparers are not bound by strict ethical guidelines like CPAs. While the IRS has recently announced its intention to begin requiring that tax preparers who are not CPAs or attorneys pass an examination and meet other requirements in order to be paid for their tax preparation services, [133] these changes will not change the fact that these tax preparers will not be held to task by a professional licensing board, like a State Bar or State Board of Accountancy.

Even if one does not consider the varying levels of confidentiality, the § 7525 privilege still falls short of filling the need for a fair, easy-to-apply evidentiary privilege in tax cases. Courts, attorneys, and tax preparers alike have traditionally considered the preparation of tax returns as an accounting function. Thus, even if the § 7525 was read to be co-extensive with the attorney-client privilege, neither a tax return nor the documentation and calculations underlying the preparation of that tax return would be privileged.

Because tax return preparation is an accounting function, the current state of the attorney-client privilege and the § 7525 privilege do no harm to the taxpayer or to the IRS as to information on or relating to a tax return. In other words, the taxpayer is not put at a disadvantage in the event of litigation as a result of hiring a CPA or other tax professional rather than an attorney to prepare a tax return. However, very often tax litigation includes evidence related to tax planning, including both the structuring of transactions and the preparation of tax accrual workpapers. Here, taxpayers face the potential for inequity depending upon the professional hired, the structure of the relationship among the taxpayer and multiple professionals, and the court who hears the taxpayer's case.

Given the manifest differences between the attorney-client relationship and the relationship between a client and a CPA or, to a greater extent, between a client and a non-CPA tax preparer, direct modifications to the § 7525 privilege would fail to honor those differences in ways that would damage traditional notions of fairness. Moreover, public policy would require that the differences in these various relationships remain in place so that the public's perceptions match reality. Therefore, in order to introduce a level playing field in tax litigation, attention should focus upon the work product doctrine.

The work product doctrine, though not as youthful as the § 7525 privilege, is a relatively new and, in many ways, still-evolving privilege. Given the special place tax litigation occupies at the intersection of legal, accounting, and business advice, the work product privilege could be adapted to suit the needs of the taxpayer and the IRS without running afoul of public policy or traditional views of client-professional relationships. As revealed in the above review of recent tax cases,[134] the courts have also focused their efforts upon the work product doctrine. However, these efforts have, to date, not resulted in a consistent approach across the board.

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[132] *See supra* text accompanying notes 33-36.

[133] I.R.S. Publication 4832 (Rev. 12-2009), *available at* http://www.irs.gov/pub/irs-pdf/p4832.pdf.

[134] *See supra* Part III. (discussing a recent string of tax cases involving evidentiary privilege issues and the often blurry lines drawn by the courts in such cases).

As originally constructed in *Hickman v. Taylor*,[135] and later codified in Rule 26(b) of the Federal Rules of Civil Procedure,[136] the work product doctrine protects evidence that was created for purposes of preparing for litigation.[137] In a personal injury case or contract dispute, that basic rule is fairly easy to apply and, more to the point, the only professionals that are normally involved in trial preparation are attorneys. Due to the nature of tax litigation, few attorneys – especially attorneys who have not pursued additional education such as an LLM or a CPA certification − handle a tax case without assistance from either a tax attorney or, more commonly, a CPA or other tax professional. Moreover, clients very often turn first to their CPA when the IRS contacts them, and it is not unusual for CPAs to represent clients in front of the IRS, up to and including, IRS Appeals. It is only when all avenues within the IRS have been exhausted that an attorney is required. And, it is only at this point that most taxpayers turn to an attorney to continue their representation.

Given the unique interaction between attorneys, CPAs, and other tax professionals in tax litigation, the work product of each professional should be protected by the work product doctrine. Courts have struggled with whether and when that work product is produced in anticipation of or because of litigation. By explicitly expanding the work product doctrine to apply to the § 7525 privilege, any work done either: (1) specifically related to the tax issues involved in planning a transaction, or (2) specifically related to responding to an IRS Notice should be presumed to be in anticipation of, or because of, potential litigation. The IRS could overcome the presumption by showing the work product had been shared with a third party other than another professional (e.g., attorney or CPA) involved in the tax planning or hired to assist with the response to the IRS, thereby waiving the privilege, or by showing that the work product related to planning the tax ramifications of a transaction was later relied upon by the tax preparer when preparing a client's tax return.

The rationale for such an expansion of the work product doctrine is relatively straightforward. Tax planning is not generally undertaken solely for purposes of preparing a tax return. Rather, planning begins as a way of evaluating the most likely tax implications of a transaction, so that a client may ascertain whether the transaction can and should be structured in a manner that reduces tax liability. Such planning is not done where the tax implications of a transaction are readily apparent or straightforward. In those cases, the taxpayer usually completes the transaction and tells his tax advisors about it later, at which point, the advisor, usually the CPA, simply records the transaction on the taxpayer's tax return.[138] Therefore, it follows that where a client hires a CPA or attorney to help plan a transaction so as to minimize income taxes, that planning is done because all involved are aware that the

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[135] 329 U.S. 495 (1947).
[136] F.R.C.P. 26(b).
[137] *Id.*
[138] Very often this is true of transactions that are disastrous from a tax prospective as well, lending credence to the idea that tax planning is usually only done where the taxpayer is aware that a planned transaction may have adverse tax consequences that are significant result to warrant the expense of hiring a CPA or tax attorney to give advice about those consequences.

IRS may challenge the transaction if it is not structured properly and that litigation is at least one possible, if not probable, result.

The courts that have found to the contrary appear not to have considered the fact that most taxpayers, regardless of their sophistication, do not structure a transaction purely for tax purposes. Rather, business purposes usually override all other considerations. Therefore, it is incongruent to effectively punish a taxpayer who does seek tax advice by allowing the work produced by the advisor to be introduced against the taxpayer at trial. Moreover, as in the *BDO Seidman* case,[139] multiple professionals are often working on behalf of a single client. In such an instance, either the common interest doctrine must apply across the board, or the professionals' work should collectively be privileged, regardless of whether an attorney or CPA created the document in question.

Where a tax advisor is responding to an IRS Notice on behalf of a client, any failure to protect that advisor's work under the work product doctrine is even more incongruous. Even if it could be argued that tax planning is not in anticipation of potential litigation, responding to an IRS Notice should be considered in anticipation of litigation. And, correspondingly, the work performed by any tax professional, attorney or CPA, should be protected by the work product doctrine. Clearly, a taxpayer who receives an IRS Notice is aware that litigation is possible (or even probable, depending on the circumstances). Therefore, the work product of that taxpayer's chosen professional falls squarely within the intended reach of the work product doctrine and should enjoy the protection of that doctrine. The identity of that professional as an attorney or CPA should not control the outcome; rather, the situation itself should be sufficient to warrant protection. Drawing a line in the sand at the point where the response to an IRS Notice begins provides a clear, easy-to-apply guideline for courts, professionals, the IRS, and taxpayers alike.

Finally, the protection of the work product doctrine should not depend upon whether the CPA was hired by the client or by an attorney to assist that attorney in representing a client. As discussed in the previous section, courts have been more willing to find a CPA's work product privileged where that CPA was hired by an attorney on behalf of a client. In the more common scenario, where a client hires a CPA first and relies upon that CPA's advice until it becomes necessary to go to court – and thus necessary to hire an attorney in order to proceed – the work produced by the CPA is fair game for discovery by the IRS. In other words, the client is put at a disadvantage in terms of what evidence may be produced during litigation by hiring a CPA first. Moreover, in order to potentially gain the protection of the work product doctrine, a client who retains an attorney in addition to his or her regular CPA may bear the additional cost of paying a second CPA to assist the attorney in preparation for trail. The work of the client's regular CPA, even if created at the attorney's request to help the attorney in his or her trial preparation, may or may not enjoy a similar level of protection simply because that CPA was involved prior to the commencement of litigation. The inequity of that result is patently obvious. Therefore, the work product doctrine should be applied consistently, regardless of whether the client continues to use his or her regular CPA through the litigation

[139] *See supra* Part III.C.

process[140] or whether an attorney retains a CPA after litigation commences, whether or not the client had a CPA prior to that time.

In summary, the work product doctrine stands as the most viable method for ensuring consistency in evidentiary privileges across tax cases. The courts should apply the doctrine so that the discoverability and admissibility of a professional's work product does not depend upon whether that professional is an attorney or CPA. The central question, instead, should revolve around whether the work product relates to tax return preparation, in which case it would not be protected, or whether the work product is prepared because of a valid dispute over the tax law, in which case, the work product doctrine should apply. This approach, unlike the expansion of the attorney-client privilege or the expansion of the common interest doctrine to that privilege, seems to more closely follow the spirit of the evidentiary privileges. The work product doctrine, as a creature of case law without the history of the attorney-client privilege, could be applied fairly and efficiently to work product produced by both attorneys and CPAs without a radical change to the attorney-client privilege or the § 7525 privilege. Rather, by the explicit expansion of the work product doctrine to the § 7525 privilege, Congress would do much to ensure that privilege is truly equivalent to the attorney-client privilege, as intended. Given that the expansion of the work product doctrine was discussed when § 7525 was originally enacted, fixing the problems faced by litigants in tax litigation should prove doable. Not only would such action complete the process of equalizing the attorney-client and § 7525 privileges, but it would ease the burden on the courts in tax litigation and provide a greater degree of equity and certainty to taxpayers and the IRS when faced with evidentiary privilege issues.

V. CONCLUSION

In conclusion, the application of evidentiary privileges has been and remains one of the most difficult areas of the law. Nowhere is that more true than in tax litigation, where courts are faced with deciphering a complex mix of legal, accounting, and business advice to determine whether a privilege applies and, if so, to what extent. Traditionally, the attorney-client privilege has protected only confidential communications between an attorney and his or her client. Given its narrow scope, this privilege has limited application in tax cases. Likewise, the relatively new § 7525 privilege is limited in scope and exact contours are still being shaped, not only by the courts but also by the IRS itself. As a result, the courts have rightly refused to extend its reach beyond its explicit bounds. Due to the constraints on these privileges, the work product doctrine stands alone as the equalizer in tax cases. Unfortunately, the doctrine has been applied unevenly to date. In order to level the playing field and ensure that all taxpayers are treated consistently in litigation, application of the work product doctrine should be expanded to apply

[140] Note that the work of the client's CPA directly related to preparing the client's income tax return would not be privileged under this rule, in keeping with the present view that tax return preparation is an accounting function. In contrast, a CPA who is responding to an IRS Notice on a client's behalf or assisting an attorney in drafting such a response is interpreting the tax law, a legal function.

under the § 7525 privilege to the same extent it does where the attorney-client privilege is at issue. The doctrine should apply to all work product created after the receipt of an IRS Notice, whether produced by an attorney or by a CPA. Moreover, the doctrine should apply regardless of whether the CPA was hired by the client or the attorney and regardless of whether the CPA was hired prior to or after the receipt of the IRS Notice. Through these modifications, the courts, attorneys, and the litigants will have a clearly defined point in time at which the work product doctrine comes into play. Finally, taxpayers will rest easy in the knowledge that their existing CPA can continue to assist them without the potential that the CPA's work product may be used against the taxpayer at trial.