

**PRIVILEGES:**

**THE PREROGATIVES OF PRIVILEGES—THE  
ETHICS OF PROTECTING OUR PLANNING  
CLIENTS, EVEN FROM THEMSELVES!**

**STEPHANIE LOOMIS-PRICE<sup>1</sup>**  
WINSTEAD PC  
600 Travis Street, Suite 5200  
Houston, Texas 77002  
713.650.2750  
*sloomisprice@winstead.com*

**Planned Giving Council of Houston**

**Houston, Texas**

**April 26, 2018**

---

<sup>1</sup> The author would like to thank and acknowledge Adam Mundt, Esq., for his significant contributions to this article.

## TABLE OF CONTENTS

I. INTRODUCTION .....	1
II. ANTICIPATE YOUR POTENTIAL AUDIENCE DURING PLANNING STAGE .....	1
A. Preparation for Transfer Tax Audit or Dispute Begins at Estate Planning Level .....	1
B. Understand IRS’s Broad Summons Power.....	1
C. Put Client in Position to Produce Correspondence or Documents in Files if in Client’s Best Interest to Do So.....	2
D. Understand and Preserve All Privileges .....	3
III. ATTORNEY-CLIENT PRIVILEGE .....	3
A. Definition.....	3
B. Two-Way Communications .....	3
C. Not Necessarily the Facts .....	4
D. Confidence.....	4
E. Bills and Invoices .....	4
F. Not Business Advice .....	5
G. Dual Purpose Advice.....	5
H. Fiduciaries.....	6
I. Loan Officer/Lawyer .....	7
J. Tax Opinions.....	7
K. Return Preparation May Not Be Privileged.....	7
L. Communications with an Entity .....	8
M. Crime/Fraud Exception.....	8
N. Beware Of Waiver .....	9
O. Inadvertent Waiver .....	10
IV. WORK PRODUCT DOCTRINE.....	12
A. Definition.....	13
B. Scope.....	13
C. Categories.....	13
D. Anticipation of Litigation .....	14
E. What About Proposed Transactions? .....	14
F. Protection Is Not Absolute.....	15
G. Audit or Tax Return Work Papers Generally Are Not Protected.....	15
H. “Because of” vs. Primary Purpose Test .....	15
V. PHYSICIAN-PATIENT PRIVILEGE .....	15
VI. TAX PRACTITIONER PRIVILEGE .....	16
A. Definitions .....	16
B. Limitations of Section 7525: Uncovered Return Preparers .....	17
VII. PRIVILEGES IN THE APPRAISAL PROCESS .....	18
A. Attorney to Hire Appraiser? .....	18
B. The Kovel Accountant: Solution? .....	20
C. Discussing Methodology Before Conclusions Are Memorialized .....	21

VIII. EFFECT OF ASSERTING ATTORNEY-CLIENT PRIVILEGE ON BURDEN OF PROOF IN DISPUTED CASES .....	21
A. Burden Shifts Where Taxpayer Produces Credible Evidence .....	21
IX. CONCLUSION.....	23

## **I. INTRODUCTION**

This article will provide practical tips with some discussion on recent developments in audits and case law related to privileges applicable to estate planning, with a particular focus on drafting audit responses related to transfer tax returns with closely held interests.

## **II. ANTICIPATE YOUR POTENTIAL AUDIENCE DURING PLANNING STAGE**

### **A. PREPARATION FOR TRANSFER TAX AUDIT OR DISPUTE BEGINS AT ESTATE PLANNING LEVEL**

The typical knee-jerk reaction to a request for documents or correspondence (particularly documents in a lawyer's file) is to assert all applicable privileges and refuse to produce the documents. However, the attorney-client privilege and the attorney work product doctrine may not protect all contents in the planner's file. More importantly, the production of carefully drafted estate planning correspondence or similar documents in response to such a request can actually help the taxpayer's case with the examiner or in litigation. With that goal in mind, when working on a client's estate plan, estate planners should assume that every document prepared by the lawyer, the client, the accountant, or any other person involved in the estate planning process may be reviewed by an IRS agent, appeals officer, district counsel, or ultimate finder of fact in litigation (sometimes a jury).

Preparation for the transfer tax dispute begins at the estate planning level. When writing letters or internal memoranda, estate planners should think about how each document will look to an IRS agent, an appeals officer, or the ultimate finder of fact in litigation. Have all relevant reasons for the transaction been discussed? Or only the estate and gift tax savings that might be achieved through the transaction? The client and the client's advisors, such as accountants or stockbrokers who are involved in the estate planning process, should be aware that their files may be subject to production in a tax audit or in litigation. And, in some circumstances, the client may wish to waive the relevant privileges and voluntarily produce those files.

### **B. UNDERSTAND IRS'S BROAD SUMMONS POWER**

The IRS has broad summons powers that can be used to require documents or compel testimony from a taxpayer, the taxpayer's representative, or a third party. For the purpose of "ascertaining the correctness of any return, making a return where none has been made, [or] determining the liability of any person for any internal revenue tax," the IRS is authorized to: (i) examine any books, papers, records, or other data that may be relevant or material to such an inquiry; and (ii) summons: the person liable for tax or required to perform the act; any officer or employee of such person; any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act; or any other person that the IRS may deem proper to produce such books, papers, records, or other data. I.R.C. § 7602(a).

Subject to any applicable privileges, the IRS can summons the taxpayer, the taxpayer's attorney, the taxpayer's accountants, and other third parties to produce books, papers, records, or other data and to testify on matters relevant or material to the IRS's inquiry. This summons power includes lawyers, accountants, and advisors involved in the planning process. It also includes doctors and other health care providers. The range of discoverable documents is also very broad and generally includes all documents in any form (including, for example, electronically stored information such as emails and voicemails).

To enforce a summons, the IRS must demonstrate that the summons: (1) was issued for a legitimate purpose; (2) seeks information relevant to that purpose; (3) seeks information that is not already within the IRS's possession; and (4) satisfies all administrative steps required by the Internal Revenue Code. *United States v. Powell*, 379 U.S. 48, 57-58 (1964). However, the IRS's broad summons power remains subject to traditional privileges and limitations. *United States v. Euge*, 444 U.S. 707, 714 (1980). Thus, if the attorney-client privilege attaches to documents requested by the IRS, the IRS has no right to issue a summons to compel their production.

### **C. PUT CLIENT IN POSITION TO PRODUCE CORRESPONDENCE OR DOCUMENTS IN FILES IF IN CLIENT'S BEST INTEREST TO DO SO**

The assertion of privileges at the audit or Tax Court level may lead to an inference that the taxpayer is hiding something. Arguing that a document should be shielded from discovery by an examining agent or district counsel because it is either subject to the attorney-client privilege or was prepared in anticipation of litigation may have evidentiary implications. See, e.g., *Estate of Shoemaker v. Comm'r*, 47 T.C.M. (CCH) 1462, 1464 n.7 (1984) ("Prior to trial, respondent sought discovery of estate planning files of Mr. Parsons' law firm pertaining to decedent. The attorney-client privilege was asserted and sustained by us, although we invited attention to the possibility that an unfavorable inference could be drawn from this assertion of the privilege.").

In cases in which the IRS questions the motives or business purpose for forming a closely held entity, the best evidence of those motives can come from the contemporaneous correspondence prepared in connection with the transaction at issue. Well-drafted correspondence outlining the business and financial reasons (*i.e.*, the non-tax reasons) for the transaction can serve as wonderful evidence to rebut an argument from the IRS that an entity lacks business purpose or was created as "a device solely to avoid taxes." See, e.g., *John J. Wells, Inc. v. Comm'r*, 47 T.C.M. (CCH) 1114, 1116 (1984) ("While obviously the true facts can never be known with complete certainty by an outsider, . . . we base our conclusion upon our view of the spoken testimony and how that testimony, coupled with the documentary evidence, comports with human experience."). Of course, certain documents may be withheld from production due to one or more applicable privileges. Thus, every estate planner should have a solid understanding of the relevant privileges.

## **D. UNDERSTAND AND PRESERVE ALL PRIVILEGES**

Perhaps most importantly, the production of thoughtfully drafted estate planning correspondence or similar documents in response to an IRS request can actually help the taxpayer state his case with the examiner or in litigation. With that goal in mind, while a planner works on a client's estate plan, she should assume that every document prepared by the estate planning lawyer, the client, the accountant, or any other person involved in the estate planning process may be reviewed by an IRS agent, appeals officer, IRS counsel, or the finder of fact in tax litigation (perhaps a judge or even a jury).

Whether a privilege exists in the context of an IRS examination is a question of federal law. *Jaffee v. Redmond*, 518 U.S. 1 (1996); FED. R. EVID. 501. There are four privileges of which estate planners should be especially aware: (i) the attorney-client privilege; (ii) the attorney work product doctrine; (iii) the tax practitioner's privilege; and (iv) various medical privileges. Each is addressed in turn below.

## **III. ATTORNEY-CLIENT PRIVILEGE**

The attorney-client privilege exists to encourage the complete and truthful exchange of all sensitive information between a lawyer and her client, by ensuring that the confidential information will remain in confidence. Like the Fifth Amendment protection against compelled self-incrimination, the policy behind this privilege recognizes that encouraging complete and honest disclosures to a lawyer is more important than requiring lawyers to testify against their clients.

### **A. DEFINITION**

Professor Wigmore's definition of a communication covered by the attorney-client privilege is set forth in VIII Wigmore, Evidence § 2292:

1. Where legal advice of any kind is sought
2. from a professional legal advisor in his capacity as such and
3. the communication is made
  - a. in confidence
  - b. by the client
  - c. for the purpose of securing legal advice,

the communication will be protected from disclosure, subject only to waiver by the client.

### **B. TWO-WAY COMMUNICATIONS**

Arguably, the privilege also works in the other direction: it protects communications from the lawyer to the client. *Alexander v. Fed. Bureau of*

*Investigation*, 198 F.R.D. 306, 309 (D.D.C. 2000) (“The attorney-client privilege must protect ‘a client’s disclosures to an attorney,’ and ‘the federal courts extend the privilege also to an attorney’s . . . communications to a client, to ensure against inadvertent disclosure, either directly or by implication, of information which the client has previously confided to the attorney’s trust.”) (quoting *Coastal States Gas Corp. v. Dept. of Energy*, 617 F.2d 854, 862 (D.C. Cir. 1980)).

### **C. NOT NECESSARILY THE FACTS**

The privilege attaches to the communication but does not necessarily insulate the underlying facts against disclosure. *Rhone-Poulenc Rorer, Inc. v. Home Indem. Co.*, 32 F.3d 851, 862 (3d Cir. 1994) (holding while documents may be protected from disclosure if containing privileged confidential communications, protection may be inapplicable to underlying facts incorporated in communication).

### **D. CONFIDENCE**

Above all else, in order to be privileged, the communication must be made in confidence and must be intended to remain in confidence. A communication between a client and a lawyer may not be privileged if it is made “in the presence of a third party” who is outside of the privilege umbrella. *United States v. Evans*, 113 F.3d 1457, 1462 (7th Cir. 1997). Specifically, no privilege attaches to any letter that shows a “cc” or “bcc” to someone outside the attorney-client relationship or its extended protection. And, conversely, adding a “cc” to a lawyer extends no privilege to a letter to a third party. *Andritz Sprout-Bauer, Inc. v. Beazer E., Inc.*, 174 F.R.D. 609, 633 (M.D. Pa. 1997) (“What would otherwise be routine, non-privileged communications . . . do not attain privileged status solely because . . . counsel is ‘copied in’ on correspondence or memoranda.”); *United States v. Davis*, 636 F.2d 1028, 1041 (5th Cir. 1981) (“documents created outside the attorney-client relationship should not be held privileged in the hands of the attorney unless otherwise privileged in the hands of the client”). However, communications with third parties, such as accountants or financial advisors, made to “assist the attorney in rendering advice to the client” also are generally protected. See, e.g., *Segerstrom v. United States*, 2001 WL 283805 (N.D. Cal., Feb. 06, 2001). How to ensure that communications with third parties can be cloaked with the attorney-client privilege is discussed below.

### **E. BILLS AND INVOICES**

Danger arises when IRS agents ask for invoices relating to all payables, and attorneys’ invoices describing all manner of confidential information are produced without thought given to privilege issues. Generally, the fact of receipt and payment of a lawyer’s bill is not privileged. *United States v. Ellis*, 90 F.3d 447, 450-51 (11th Cir. 1996) (“receipt of attorney’s fees normally [is] not [a] privileged matter”); *Chaudhry v. Gallerizzo*, 174 F.3d 394, 402 (4th Cir. 1999) (holding that attorney-client privilege does not typically extend to billing records and expense reports). However, descriptions in the invoices may very well (and usually do) reflect privileged communications – provided that privilege is not waived. *Clarke v. Am. Commerce Nat’l Bank*, 974 F.2d

127, 129 (9th Cir. 1992) (“[C]orrespondence, bills, ledgers, statements, and time records which also reveal the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided . . . fall within the privilege.”).

## F. NOT BUSINESS ADVICE

The attorney-client privilege only extends to communications relating to soliciting and receiving legal advice – as opposed to general business advice. *In re Grand Jury Subpoena Duces Tecum Dated Sept. 15, 1983*, 731 F.2d 1032, 1037 (2d Cir. 1984) (“[T]he privilege is triggered only by a client’s request for legal, as contrasted with business, advice.”); *Olender v. United States*, 210 F.2d 795, 806-07 (9th Cir. 1954) (holding communications with lawyer who merely fills out form deeds and deposits client’s money at bank not confidential attorney-client communications).

## G. DUAL PURPOSE ADVICE

What about dual purpose communications involving legal and business communications? The minority view is that any non-legal purpose precludes the privilege, but the more prevalent view looks to the dominant purpose of the advice to determine whether any privilege protects the communication from disclosure.<sup>2</sup> See, e.g., *Neuder v. Battelle Pac. Nw. Nat’l Lab.*, 194 F.R.D. 289, 292 (D.D.C. 2000) (“Where business and legal advice are intertwined, the legal advice must predominate for the communication to be protected.”); *Pippenger v. Gruppe*, 883 F. Supp. 1201, 1207 (S.D. Ind. 1994) (holding conversations conducted “primarily for the purpose of securing legal opinions and legal services” not subject to discovery).

There is, however, general consensus that if the advice is primarily legal, and the non-legal aspects are “integral to the legal assistance given, . . . both the client’s communications and the lawyer’s advice and assistance that reveals the substance of those communications will be afforded the protection of the privilege.” *Harrington v. Freedom of Info. Comm’n*, 323 Conn. 1, 17-20 (Conn. 2016). See also, e.g., *In re Vioxx Product Liability Litigation*, 501 F. Supp. 2d 789, 798 (E.D. La. 2007) (“When these non-legal services are mixed with legal services it does not render the legal services any less protected by the privilege. In fact, they both are protected when they are inextricably intertwined.”); *Kent Literary Club v. Wesleyan Univ.*, 2016 Conn. Super. LEXIS 815 (Conn. Super. Ct. Apr. 12, 2016) (“With regard to whether the communications at issue were ‘inextricably linked to the giving of legal advice,’ a

---

<sup>2</sup> See, e.g., 1 P. Rice, ATTORNEY-CLIENT PRIVILEGE IN THE UNITED STATES (2d Ed. Rev. 2010) § 7:6, p.7-78 (“there is general agreement that the protection of the privilege applies only if the primary or predominate purpose of the attorney-client consultation is to seek legal advice or assistance”); 24 C. Wright & K. Graham, FEDERAL PRACTICE AND PROCEDURE (1986) § 5490, p.444 (majority rule is “‘dominant purpose’ doctrine”); *Alomari v. Ohio Dep’t of Pub. Safety*, 626 Fed. Appx. 558, 570 (6th Cir. 2015); *Exxon Mobil Corp. v. Hill*, 751 F.3d 379, 382 (5th Cir. 2014); *In re Diagnostics Systems Corp.*, 328 Fed. Appx. 621, 622-23 (Fed. Cir. 2008); *Pritchard v. County of Erie (In re County of Erie)*, 473 F.3d 413, 422-23 (2d Cir. N.Y. 2007); *In re Buspirone Antitrust Litigation*, 211 F.R.D. 249, 252-53 (S.D.N.Y. 2002); *Cuno, Inc. v. Pall Corp.*, 121 F.R.D. 198, 204 (E.D.N.Y. 1988); *Barr Marine Products Co. v. Borg-Warner Corp.*, 84 F.R.D. 631, 634-35 (E.D. Pa. 1979); *Zenith Radio Corp. v. RCA*, 121 F. Supp. 792, 794-95 (D. Del. 1954). Cf. *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754, 758-60 (D.C. Cir. 2014) (in context of internal investigation, declining to apply single primary purpose and instead concluding that test is “whether obtaining or providing legal advice was one of the significant purposes of the attorney-client communication”).



determination must be made that the claimed privileged matter is so intertwined with non-privileged matter that it cannot be redacted or otherwise separated.”); *Marsh v. Safir*, Docket No. 99CIV.8605JGKMHD, 2000 U.S. Dist. LEXIS 5136, 2000 WL 460580, \*8 (S.D.N.Y. April 20, 2000) (“[I]f the protected and non-protected purposes of the communications are inextricably linked, thus precluding any separation of the communications into the privileged and non-privileged categories, the communications will be protected.”).

On the other hand, when the legal aspects of the communication are incidental or subject to separation, the proponent of the privilege may be entitled to redact those portions of the communication. See, e.g., *In re County of Erie*, 473 F.3d at 421 n.8 (“redaction is available for documents [that] contain legal advice [ ] incidental to the non-legal advice that is the predominant purpose of the communication”); *Hercules, Inc. v. Exxon Corp.*, 434 F. Supp. 136, 147 (D. Del. 1977) (“The problem remains . . . of separating out business from legal advice. . . . [B]usiness and legal advice may often be inextricably interwoven. A single proposed course of conduct . . . will have both legal and business ramifications, and the lawyer may advise as to both in a single communication. . . . [N]onetheless, it is necessary to separate out the two, in the interest of preserving the integrity of the privilege itself . . . .”); G. Sisk & P. Abbate, *THE DYNAMIC ATTORNEY-CLIENT PRIVILEGE*, 23 *GEO. J. LEGAL ETHICS* 201, 223 n.121 (2010) (“The exacting and detailed segregation of privileged from unprivileged portions of an otherwise integrated communication and the redaction of the privileged sections while disclosing the remainder is a process that generally should be reserved to the situation in which the overwhelming purpose of the communication was non-legal and thus the legal advice is an incidental element of the communication.”).

In short, practitioners should be cognizant of governing precedent on this issue in their respective jurisdictions.

## **H. FIDUCIARIES**

The attorney-client privilege extends to the fiduciary role, not necessarily to the person serving as a fiduciary. What happens when a fiduciary is removed and a successor fiduciary is appointed? The former fiduciary must provide the successor fiduciary with all of its files related to the estate or trust. But what if the former fiduciary sought legal advice regarding possible personal liability for its conduct as fiduciary? Unless the former fiduciary has taken affirmative steps to preserve its right to rely upon the attorney-client privilege as the basis for withholding from any successor fiduciary confidential documents maintained in the estate or trust’s legal files, the privilege may not protect the former fiduciary’s communications with counsel. See *Fiduciary Trust International of California v. Klein*, 9 Cal. App. 5th 1184 (2017). In *Fiduciary Trust*, the court analyzed the purpose of the attorney-client relationship, not the purpose of the individual communication in question and whether, at the time the legal advice was sought, the purpose for obtaining the legal advice was, on the one hand, for protection against personal liability or, on the other, the administration of the trust or estate in order to determine whether communications were protected by privilege. *Id.* at 1202.

## **I. LOAN OFFICER/LAWYER**

A rebuttable presumption may arise where the lawyer works in the General Counsel's office, as opposed to in management. *Boca Investering's P'ship v. United States*, 31 F. Supp. 2d 9, 12 (D.D.C. 1998) ("There is a presumption that a lawyer in the legal department or working for the general counsel is most often giving legal advice, while the opposite presumption applies to a lawyer . . . who works for the Financial Group or some other seemingly management or business side of the house.").

## **J. TAX OPINIONS**

Tax advice and tax opinions by counsel are arguably privileged. *United States v. Tel. & Data Sys, Inc.*, No. 02C0030, 2002 WL 2023767, at \*3 (W.D. Wis. Jul. 16, 2002); *Wojdak v. First W. Gov't Sec.*, No. 83-1076, 1991 WL 160249, at \*1 (E.D. Pa. Aug. 16, 1991) (finding that draft tax opinions were protected by attorney-client privilege because they "were for the purpose of giving legal advice to a client, and were expressly treated by the sender and the recipient as confidential"). However, when the client seeks to rely on the Section 6664 defense to penalties (reasonable cause and good faith reliance on advice of tax professional), the tax opinion may be the very piece of evidence necessary to show the client's reliance. See, e.g., *In re G-I Holdings, Inc.*, 218 F.R.D. 428 (D.N.J. 2003) (holding that privilege is waived in its entirety by raising "reliance upon tax counsel" as "reasonable cause" penalty defense under I.R.C. § 6664).

## **K. RETURN PREPARATION MAY NOT BE PRIVILEGED**

In many cases, lawyers may serve as the preparer of tax returns. A question arises as to what extent the work performed by the lawyer/preparer may fall under the attorney-client privilege. Courts have disagreed on whether tax return preparation by a lawyer is privileged.

1. Return Preparation Not Legal Advice? Some courts have held that the preparation of a tax return is not the rendering of legal advice. See *United States v. Richey*, 632 F.3d 559, 567 (9<sup>th</sup> Cir. 2011); *In re Grand Jury Investigation (Schroeder)*, 842 F.2d 1223 (11<sup>th</sup> Cir. 1987); *United States v. Davis*, 636 F.2d 1028 (5<sup>th</sup> Cir. 1981); *United States v. Gurtner*, 474 F.2d 297 (9<sup>th</sup> Cir. 1973); *Canaday v. United States*, 354 F.2d 849 (8<sup>th</sup> Cir. 1966). But see *Colton v. United States*, 306 F.2d 633, 637 (2<sup>d</sup> Cir. 1962) ("There can, of course, be no question that the giving of tax advice and the preparation of tax returns . . . are basically matters sufficiently within the professional competence of an attorney to make them prima facie subject to the attorney-client privilege.").

2. Return Preparation as Confidential? Other courts have held such information privileged. Although the IRS has argued that information provided to an attorney for the purpose of preparing tax returns is outside the scope of the privilege, various courts of appeal have rejected this contention, holding that material provided in the context of return preparation may also have been for the rendition of legal advice and may be protected by the privilege. See, e.g., *United*

*States v. Abrahams*, 905 F.2d 1276, 1282-83 (9th Cir. 1990), *partially overruled on other grounds*, *United States v. Jose*, 131 F.3d 1325, 1329 (9th Cir. 1997); *United States v. Bornstein*, 977 F.2d 112, 116-17 (4th Cir. 1992); *United States v. Davis*, 636 F.2d 1028, 1043 (5th Cir. 1981).

Yet other courts acknowledge an element of legal advice in the preparation of a return, but deny privilege based on a lack of expectation of confidentiality or a waiver. *United States v. Lawless*, 709 F.2d 485, 487 (7th Cir. 1983) (noting no expectation of confidentiality in information to be included on return); *In Re Grand Jury Subpoena Duces Tecum (Dorokee)*, 697 F.2d 277, 280 (10th Cir. 1983) (holding that even where privilege might protect communications related to preparation of income tax returns, privilege did not apply to documents given to attorney for inclusion in income tax return because information was not intended to remain confidential due to inclusion in tax return); *United States v. Cote*, 456 F.2d 142 (8th Cir. 1972) (holding disclosure waives privilege not only as to disclosed data but also as to details underlying information on return); *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982) (holding waiver by inclusion on return).

In light of the inconsistency among jurisdictions, advisors should consider whether to *separate* files for a given client based on whether the primary purpose of the engagement is for tax preparation or for legal advice.

#### **L. COMMUNICATIONS WITH AN ENTITY**

Special problems arise when the client is an entity, as a divergence exists between federal law and the law of some states. Since the Supreme Court's holding in *Upjohn Co. v. United States*, 449 U.S. 383, 392-97 (1981), counsel's communications with any corporation employees (though not shareholders) may be privileged under federal law, while some states still limit the privilege to those between counsel and the company's "control group" of employees. Even communications between counsel and former employees of the corporate client may be treated as privileged. *In re Allen*, 106 F.3d 582, 605-06 (4th Cir. 1997). And communications between counsel for the corporate parent and counsel for the subsidiary are generally privileged. *In re Westinghouse Elec. Corp. Uranium Contracts Litig.*, 76 F.R.D. 47, 58 (W.D. Pa. 1977).

Beware that disclosure of privileged corporation communications to shareholders may constitute a waiver. *Cf.*, *Garner v. Wolfinbarger*, 430 F.2d 1093, 1103-04 (5th Cir. 1970). By contrast, communications with and disclosures to the general partners of a partnership client are generally privileged. *Abbott v. Equity Group*, 1988 WL 86826 (E.D. La. 1988).

#### **M. CRIME/FRAUD EXCEPTION**

The privilege attaches to communications relating to completed crimes, but not to ongoing or future crimes and frauds. This "crime-fraud" exception to the privilege requires a prima facie showing (as opposed to mere suspicion) that (i) the client is in the

process of planning or committing a crime or civil fraud, and (ii) the attorney-client communication furthers that crime or fraud, generally by giving direction to it. *In re Grand Jury Subpoena*, 223 F.3d 213, 217 (3d Cir. 2000). Note that the exception applies even if the lawyer doesn't know about the crime or fraud. *In re Grand Jury Proceedings*, 604 F.2d 798, 802 (3d Cir. 1979).

#### **N. BEWARE OF WAIVER**

Any action inconsistent with the maintenance of a privilege may constitute waiver, and that waiver may extend to the entire subject matter. *In re Sealed Case*, 676 F.2d 793, 818 (D.C. Cir. 1982). *But see, e.g., Long-Term Capital Holdings v. United States*, 2003 WL 1548770 (D. Conn. 2003) (finding disclosure of gist of “more-likely-than-not” tax opinion to auditors did not constitute waiver as to entire opinion); *In re von Bulow*, 828 F.2d 94 (2d Cir. 1987) (holding subject matter waiver occurs where privileged information is disclosed to mislead/gain advantage); FED. R. EVID. 502(a) (providing that subject matter waiver occurs only if waiver was intentional; disclosed and undisclosed information concerned same subject; and disclosed and undisclosed information should, in fairness, be considered together).

At least in the Tax Court, the party asserting the privilege bears the burden of proving that he has not waived it. *Hartz Mountain Indus., Inc. v. Comm’r*, 93 T.C. 521, 525 (1989). Under the precedent of the D.C. Circuit – which governed evidentiary rulings in Tax Court cases up until December 16, 2015 – even an inadvertent waiver by the lawyer (or the *Kovel* CPA) could constitute an enforceable waiver. *In re Sealed Case*, 676 F.2d at 807. Thus, even though the privilege always belongs to the client and the lawyer is not free to waive it without her client’s authorization, a third party may be entitled to enforce a waiver based on the actions of that same lawyer as an agent with apparent authority. *Id.*

Also beware of “witness waiver.” Adverse parties may be entitled to inspect anything shown to a witness at any time to refresh his recollection for the purpose of testifying. FED. R. EVID. 612; FED. R. CIV. P. 26; *Nutramax Labs., Inc. v. Twin Labs, Inc.*, 183 F.R.D. 458, 468-72 (D. Md. 1998); *Bailey v. Meister Brau, Inc.*, 57 F.R.D. 11, 13 (N.D. Ill. 1972); *In re Pioneer Hi-Bred Int’l Inc.*, 238 F.3d 1370, 1375 (Fed. Cir. 2001) (“[D]ocuments and information disclosed to a testifying expert in connection with his testimony are discoverable by the opposing party, whether or not the expert relies on the documents and information in preparing his report.”). *But see* FED. R. EVID. 26(b)(4)(C), (D) (protecting communications with consulting experts, as well as communications with trial expert, as long as not relied on by trial expert in forming opinion).

Furthermore, the advice of counsel cannot be used as a sword and then cloaked with a privilege. *Columbia Pictures Television, Inc. v. Krypton Broad. of Birmingham, Inc.*, 259 F.3d 1186, 1196 (9th Cir. 2001) (“The privilege which protects attorney-client communications may not be used both as a sword and a shield. Where a party raises a claim which in fairness requires disclosure of the protected communication, the privilege may be implicitly waived.”); *In re G-I Holdings, Inc.*, 218 F.R.D. 428 (D.N.J. 2003)

(holding that privilege is waived in its entirety by raising “reliance upon tax counsel” as “reasonable cause” penalty defense under I.R.C. § 6664).

Finally, the client may wish to waive privileges in order to assert the defense that any underpayment of tax was made in good faith and due to reasonable cause. Reliance on the advice of tax advisors constitutes reasonable cause and good faith if, under all circumstances, such reliance was reasonable and the taxpayer acted in good faith. In order to demonstrate reasonable reliance, the taxpayer may need to disclose what might otherwise have been privileged information. Accordingly, each case should be viewed individually to determine whether the client might benefit from disclosure. This disclosure could include producing to the IRS all of the client’s advisors’ legal opinions and correspondence – a possibility that few lawyers may consider when preparing opinion letters or other correspondence.

Note, however, that waiver of the attorney-client privilege does not necessarily waive the work product doctrine. See *Rhone-Poulenc Rorer*, 32 F.3d at 866.

#### **O. INADVERTENT WAIVER**

Under relatively recent amendments to Rule 502 of the Federal Rules of Evidence, inadvertent disclosure will not waive the attorney-client privilege where the disclosure was inadvertent, where the holder of the privilege took reasonable steps to prevent disclosure, and where the holder promptly took steps to rectify the error, including following Federal Rule of Civil Procedure 26(b)(5)(B), if applicable. FED. R. EVID. 502(b).

But how does inadvertent waiver apply in the technological world in which we practice law today? In *Harleysville Ins. Co. v. Holding Funeral Home*, No. 1:15-cv-00057 (W.D. Va. Feb. 9, 2017) (mem. op.) (slip copy), an investigator for an insurance company (“Harleysville”) uploaded a video showing surveillance footage of a fire at a funeral home to an internet-based electronic file-sharing service operated by Box, Inc. The investigator then sent an email with a hyperlink to the shared file to a third party. *Id.* at \*2-3. The hyperlinked email included a confidentiality notice, which stated (in summary) that the e-mail contained information that was privileged and confidential. *Id.* at \*3. However, the hyperlink was not password protected. *Id.* Months later, the investigator uploaded all of his files about the fire incident to this same hyperlink and sent an email containing the hyperlink to Harleysville’s legal counsel. *Id.* at \*4. Counsel for the funeral home (“Holding”) sent a subpoena duces tecum to the third party requesting the third party’s entire file related to the fire incident. *Id.* The third party provided the requested documents, including a copy of the email received from the insurance company investigator. *Id.* Upon receipt of the investigator’s email, Holding’s legal counsel, without the knowledge or permission of Harleysville’s counsel, accessed the link, and downloaded and reviewed all the investigator’s documents. *Id.* at \*4-5. Harleysville was never notified and did not find out about this access until Holding sent a discovery response referring to files uploaded by the investigator to the hyperlink. *Id.* at \*5. Four days later, Harleysville’s counsel contacted Holding’s counsel and requested the files be destroyed. *Id.* Harleysville also then disabled the hyperlink. *Id.*

at \*6. Harleysville filed a motion requesting the disqualification of Holding's counsel for their improper access to privileged documents. *Id.* In response, Holding's counsel argued Harleysville waived any claim of privilege or confidentiality because the privileged documents were uploaded to the hyperlink where it could be accessed by anyone who knew where to look for it. *Id.*

A magistrate judge noted that application of the attorney-client privilege was a matter of state law because federal jurisdiction was based on diversity of citizenship and the claims raised by Harleysville were state law claims, but that the work product doctrine was a qualified immunity and governed by federal law. *Id.* at \*6-7. The Magistrate, following a Virginia Supreme Court seminal case on attorney-client privilege, opined that the disclosure in this case was inadvertent because Harleysville provided access to information by failing to implement sufficient precautions to maintain its confidentiality. *Id.* at \*10. The Magistrate then applied a three-factor test to determine whether Harley waived the privilege, took reasonable steps to prevent disclosure, and took steps to rectify the error. *Id.* at \*10-11. The Magistrate concluded that Harleysville had waived the attorney-client privilege because it did not take any precautions to prevent disclosure, their investigator intentionally uploaded the documents to the hyperlink, their investigator knew or should have known that documents on the hyperlink were not protected and could be accessed by anyone who knew of the hyperlink, the documents remained accessible for six months after they were uploaded, and no action was taken by Harleysville's counsel even after counsel accessed the files and knew or should have known the information was easily and readily accessible. *Id.* at \*11-13.

The Magistrate went on to analyze whether Harleysville could make any claim under the work product doctrine, concluding that the work product doctrine had also been waived. *Id.* at \*14-17. The Magistrate noted that under federal law, for the disclosure to be inadvertent, the act of disclosure must be unintentional. In this case, however, the investigator uploaded the documents intentionally. *Id.* at \*16-17. Ultimately, the Magistrate judge denied the motion for disqualification. *Id.* at \*23. Meanwhile, the Magistrate ordered monetary sanctions against Holding for Harleysville's attorney's fees and costs because Holding's counsel disregarded the confidentiality notice contained in the email with the hyperlink and did not disclose to Harleysville that it accessed the documents. *Id.* at \*22-23.

Both sides filed objections to the Magistrate's decision and a new evidentiary hearing was held in district court. *See Harleysville Ins. Co. v. Holding Funeral Home, Inc.*, No. 1:15-cv-00057, (W.D. Va. Oct. 2, 2017). The District Court agreed with the Magistrate that the disclosure of documents was inadvertent for purposes of attorney-client privilege. *Id.* at \*14-16. However, the judge concluded that disclosure in this manner was not a waiver of such privilege. *Id.* at \*24. The District Court determined that Harleysville took reasonable precautions to prevent disclosure, noting that the hyperlink was not searchable by Google or any other search engine and the hyperlink contained 32 randomly-generated alphanumeric characters, both of which together provided inherent security. *Id.* at \*18-19. The District Court was persuaded that the investigator believed that the hyperlink was a unique link and that it expired several days after being sent. *Id.* at \*20. The court opined that the confidentiality notice in the

e-mail and the fact that the documents were identified as privileged and confidential reflected reasonable precautions taken by Harleysville to prevent disclosure. *Id.* at \*21. The District Court further pointed out that counsel for Harleysville took action within four days of discovering that the documents had been disclosed, which weighed against a finding of waiver because Harleysville attempted to rectify the error in such a short time after discovery of disclosure. *Id.* at \*22.

The District Court did not agree that counsel for Harleysville should have known that the documents were not protected simply because they continued to be able to readily access the documents. *Id.* Finally, the District Court pointed out that counsel for Holding was the only party to whom the documents were disclosed; the Court did not believe Harleysville was responsible for any subsequent disclosures. *Id.* at \*23-24. Therefore, the District Court determined that the attorney-client privilege had not been waived. *Id.* at \*24.

With regard to the claim for work product protection, the District Court overturned the Magistrate's decision holding that Harleysville intended and attempted to maintain the confidentiality of the documents, even though it failed to do so, and was not aware the documents were accessible by anyone other than its own counsel. *Id.* at \*27-29. The District Court then concluded that there was no waiver of the work product doctrine's protection. *Id.* at \*29. The District Court vacated the monetary sanctions, instead imposing evidentiary sanctions by ruling that the privileged documents (or any information derived from the privileged documents) could not be used by Holding in the case at hand or in any other civil litigation matter. *Id.* at \*47-49.

Clearly, this case reflects a constantly changing area of the law. Practitioners should always be on the lookout, playing it safe when it comes to sharing privileged documents and information by dropbox or other potentially unsecure methods.

#### **IV. WORK PRODUCT DOCTRINE**

The work product of an attorney or her staff in anticipation of litigation is protected from disclosure. *Hickman v. Taylor*, 329 U.S. 495 (1947); FED. R. CRIM. P. 16(b)(2); FED. R. CIV. P. 26(b)(3). In fact, the attorney work product doctrine is not a privilege, although some courts (and many practitioners) refer to it as one. Unlike the attorney-client privilege, its purpose does not lie in protecting confidential communications; its purpose is to encourage lawyers to thoroughly prepare for litigation (whether or not actually pending) through investigation of the good and the bad, without fear of being forced to aid their adversaries at the expense of their clients. In addition to its focus on anticipated litigation, this doctrine also differs from the attorney-client privilege in that its protection can be pierced (in very limited circumstances) through no fault of the lawyer or her client.

## A. DEFINITION

The doctrine is defined by the narrow scope of its exception in this passage from the Federal Rules of Civil Procedure:

[A] party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent). But, subject to Rule 26(b)(4), those materials may be discovered if: (i) they are otherwise discoverable under Rule 26(b)(1); and (ii) the party shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means. If the court orders discovery of those materials, it must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation.

FED. R. CIV. P. 26(b)(3)(A).

## B. SCOPE

Note that the protection extends beyond just the work prepared by the attorney to work prepared by the client and the client's employees, agents, etc., at the direction of the lawyer. *In re Perrigo Co.*, 128 F.3d 430, 437 (6th Cir. 1997).

## C. CATEGORIES

The rule contemplates two types of work product: (i) factual and (ii) opinion or "core" work product. Under unusual circumstances, factual work product is discoverable as described in the above-quoted Rule. *See also In re Allen*, 106 F.3d 582, 607 (4th Cir. 1997). By comparison, opinion work product "enjoys a nearly absolute immunity and can be discovered only in very rare and extraordinary circumstances." *Cox v. Adm'r U.S. Steel & Carnegie*, 17 F.3d 1386, 1422 (quoting *In re Murphy*, 560 F.2d 326, 336 (8th Cir. 1977) (11th Cir. 1994), *modified on reh'g* by 30 F.3d 1347 (11th Cir. 1994)). In very rare and extraordinary circumstances, core or "opinion work product" is discoverable. For example, at least one court has found that if legal opinions and observations made by counsel are at issue in the case, and such information is needed by opposing counsel to substantiate the defense, the work product is discoverable. *See, e.g., Bird v. Penn Cent. Co.*, 61 F.R.D. 43, 46 (E.D. Pa. 1973) ("Since the relevant inquiry is into what plaintiffs knew or should have known concerning grounds for their rescission action, only through discovery of information in the hands of plaintiffs, and their agents, can defendants substantiate their defense.").

Some courts have gone so far as to decline to declare opinion work product to be absolutely immune from disclosure. *See, e.g., Duplan Corp. v. Moulinage et Retorderie de Chavanoz*, 509 F.2d 730 (4th Cir. 1974); *United States v. Leggett & Platt, Inc.*, 542 F.2d 655 (6th Cir. 1976). Others have demurred, indicating that there may be



circumstances (as yet unseen) that would call for production of even opinion work product. See, e.g., *In re Murphy*, 560 F.2d 326, 336 (8<sup>th</sup> Cir. 1977); *Bio-Rad Labs, Inc. v. Pharmacia, Inc.*, 130 F.R.D. 116, 121 (N.D. Cal. 1990) (“The Supreme Court declined to rule whether opinion work product was absolutely protected.”), citing *Upjohn Co. v. United States*, 449 U.S. 383, 401 (1981). A more conservative rule, thus, may be that opinion work product may be discoverable “where such information is directly at issue and the need for production is compelling,” see *Bio-Rad Labs, Inc.*, 130 F.R.D. at 122, or where the party waives work product protection by disclosing some or all of a document otherwise protected by the work product doctrine. See, e.g., *Am. Family Life Assur. Co. v. Intervice*, 560 Fed. Appx. 931 (M.D. Ga. 2010); *In Re EchoStar Communs. Corp.*, 448 F.3d 1294 (Fed. Cir. 2006).

Note, however, that the subject-matter waiver doctrine does not extend to materials protected by core work product doctrine where the work product is core, rather than factual. See *Cox*, 17 F.3d at 1422 (“subject-matter waiver doctrine does not extend to materials protected by the opinion work product privilege”).

#### **D. ANTICIPATION OF LITIGATION**

To qualify for work product protection, work need not be done after litigation has been filed; indeed, the *certainty* of litigation need not even exist. Rather, litigation must be only *anticipated*. And the required level of anticipation varies by jurisdiction. See, e.g., *ServiceMaster of Salina, Inc., et al., v. United States*, 2012 U.S. Dist. LEXIS 53399, at \*8 (D. Kan. Apr. 17, 2012) (holding “neither the audit nor the IRS investigation processes make litigation imminent”); *Energy Capital Corp. v. United States*, 45 Fed. Cl. 481, 485 (2000) (“Litigation must at least be a real possibility at the time of preparation.”); *United States v. Frederick*, 182 F.3d 496, 502 (7<sup>th</sup> Cir. 1999) (“An audit is both a stage in the determination of tax liability... and a possible antechamber to litigation.”); *A. Michael’s Piano, Inc. v. Fed. Trade Comm.*, 18 F.3d 138, 146 (2d Cir. 1994) (holding that document must be created “with an eye toward litigation”); *Schiller v. N.L.R.B.*, 964 F.2d 1205, 1208 (D.C. Cir. 1992) (holding that document must be created “in anticipation of foreseeable litigation”); *United States v. Rockwell Int’l*, 897 F.2d 1255, 1266 (3d Cir. 1990) (holding that document must be created “because of the prospect of litigation”); *Binks Mfg. Co. v. Nat’l Presto Indus., Inc.*, 709 F.2d 1109, 1119-20 (7<sup>th</sup> Cir. 1983) (stating that party asserting work product protection must show that “some articulable claim, likely to lead to litigation, [has] arisen”); *United States v. Davis*, 636 F.2d 1028 (5<sup>th</sup> Cir. 1981) (holding doctrine applied where document was created “to aid in possible future litigation”).

#### **E. WHAT ABOUT PROPOSED TRANSACTIONS?**

The fact that the work product relates to a proposed transaction is just one factor that suggests it was not prepared in anticipation of litigation and is not, in and of itself, dispositive. *United States v. Adlman*, 68 F.3d 1495, 1500-01 (2d Cir. 1995) (finding that corporate officer obtained tax memorandum regarding proposed reorganization from accountant/lawyer).

## **F. PROTECTION IS NOT ABSOLUTE**

Work product is not absolutely immune from disclosure, and some work product may be obtained by an adverse party upon a showing of substantial need. *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

## **G. AUDIT OR TAX RETURN WORK PAPERS GENERALLY ARE NOT PROTECTED**

Historically, an accountant's work papers and work product were not protected. Under current law, however, while an accountant's tax return preparation materials may remain the subject of discovery, a tax practitioner's advice to a taxpayer may be protected from discovery under the moderately new (and fairly limited) tax practitioner privilege protection found in I.R.C. § 7525. See full discussion in Section VI below.

## **H. "BECAUSE OF" VS. PRIMARY PURPOSE TEST**

Litigation need not be imminent or even the primary reason that protected documents were prepared in order for the work product doctrine to apply. As long as the facts demonstrate that the documents were prepared "because of" anticipated litigation, the doctrine should attach. *United States v. Adlman*, 134 F.3d 1194, 1203-05 (2d Cir. 1995).

Transactional lawyers should be aware that their work product may qualify for privilege protections as well; it is not necessary that litigation be certain. The required level of anticipation varies by court, but it is clear that in many jurisdictions, a court action need not be imminent. For example, courts have extended work-product doctrine protection even to proposed transactions. One found that the work product doctrine applied to tax accrual work papers of a company, as the company's counsel believed that certain transactions entered into by the company would eventually be challenged by the IRS. *United States v. Textron*, 507 F. Supp. 2d 138 (D.R.I. 2007). However, the district court was reversed. *United States v. Textron*, 577 F.3d 21 (1<sup>st</sup> Cir. 2009). This issue continues to be the subject of litigation, however. See, e.g., *Schaeffler v. United States*, 22 F. Supp. 3d 319 (S.D.N.Y. 2014), *vacated and remanded*, 806 F.3d 34 (2d Cir. 2015).

## **V. PHYSICIAN-PATIENT PRIVILEGE**

IRS requests for information increasingly seek access to medical records of a decedent and interviews with treating physicians. Under state law, a doctor-patient privilege often protects such information. However, where the IRS is seeking to enforce a summons issued under federal statutory authority, federal privilege rules generally apply. See, e.g., *United States v. Moore*, 970 F.2d 48, 50 (5th Cir. 1992).<sup>3</sup> The Fifth

---

<sup>3</sup> When Congress adopted the final version of the Federal Rules Evidence in 1975, it rejected the nine enunciated privileges in the proposed rules (which included a physician-patient privilege) in favor of a single rule authorizing federal courts to apply "the principles of common law. . . in the light of reason and experience" in determining whether a privilege exists under the common law. Const. Rep. No. 93-1597, Statement by House Subcommittee Chairman, Dec. 18, 1974, as reprinted in 1974 U.S.C.C.A.N. 7108, 7110. The Senate Report accompanying the adoption of the Rules indicates that Rule 501 "should be understood as reflecting the view that the recognition of a privilege based on

Circuit has held that there is no physician-patient privilege under federal law. *Id.* No other circuit has adopted such a privilege. Although the Supreme Court has not yet directly addressed the issue, our highest Court has determined that federal courts should recognize a psychotherapist-patient privilege under Federal Rule of Evidence 501. *Jaffee v. Redmond*, 518 U.S. 1, 10 (1996). In *Jaffee*, the Supreme Court held that confidential communications between a licensed psychotherapist and a patient in the course of diagnosis or treatment are protected from compelled disclosure under Rule 501. In reaching its holding, however, the Court noted that:

Like the spousal and attorney-client privileges, the psychotherapist-patient privilege is 'rooted in the imperative need for confidence and trust.' [ ] Treatment by a physician for physical ailments can often proceed successfully on the basis of a physical examination, objective information supplied by the patient, and the results of diagnostic tests. Effective psychotherapy, by contrast, depends upon an atmosphere of confidence and trust in which the patient is willing to make a frank and complete disclosure of facts, emotions, memories, and fears. Because of the sensitive nature of the problems for which individuals consult psychotherapists, disclosure of confidential communications made during counseling sessions may cause embarrassment or disgrace.

*Id.* While the *Jaffee* Court did not rule on the applicability of a physician-patient privilege, the cited language indicates that medical records based primarily upon physical examination and other objective information supplied by the patient or that result from diagnostic tests may not be considered privileged.

## VI. TAX PRACTITIONER PRIVILEGE

Section 7525(a)(1), enacted in 1998, extends the same common law protection of confidentiality to a communication between a taxpayer and any "federally authorized tax practitioner" involving tax advice that would have been privileged if it were a communication between a taxpayer and an attorney. This privilege may be asserted only in non-criminal tax matters before the Internal Revenue Service or any non-criminal tax proceeding in federal court brought by or against the United States.

### A. DEFINITIONS.

1. Federally Authorized Tax Practitioner. The term "federally authorized tax practitioner" means any individual who is authorized to practice before the IRS if such practice is subject to federal regulation under 31 U.S.C. § 330 (also often referred to as "Circular 230"). In other words, the phrase includes CPAs, enrolled agents, and enrolled actuaries.

---

a confidential relationship . . . should be determined as a case-by-case basis." S. Rep. No. 93-1277 (1974), as reprinted in 1974 U.S.C.C.A.N. 7058, 7059.

2. Tax Advice. The term “tax advice” means any advice given within the scope of the individual’s authority to practice before the IRS, including both tax advice and tax representation.

3. Exception for Tax Shelters. The Tax Practitioner Privilege does not apply to written communications between tax practitioners and directors, shareholders, officers, employees, agents, or representatives of a corporation in connection with the promotion of the direct or indirect participation in any corporate tax shelter as defined in I.R.C. § 6662(d)(2)(C)(ii).

4. Effective Date. The privilege may be asserted only as to communications made on or after July 22, 1998.

## **B. LIMITATIONS OF SECTION 7525: UNCOVERED RETURN PREPARERS**

By its terms, Section 7525 is applicable only to communications between a taxpayer and a “federally authorized tax practitioner.” Other accountants, bookkeepers, and possibly agents of otherwise qualified federally authorized tax practitioners do not appear to be included.

1. Scope. The extension of the privilege to “any non-criminal tax proceeding in Federal Court brought by or against the United States” in Section 7525(a)(2)(B) was inserted by the Senate (or the conference committee) and was designed to be broader than the House version of the bill, which had only covered tax litigation.

a. Non-Criminal. The statute is specifically inapplicable in criminal proceedings before the Internal Revenue Service and in criminal proceedings in a Federal Court. Note that today’s privileged communication loses its Section 7525 privilege protection upon commencement tomorrow by the IRS of a criminal investigation.

b. Bankruptcy Covered? Bankruptcy is not a non-criminal federal court matter “by or against the United States” until an adversary proceeding is filed.

c. All Bankruptcy Covered? Does the provision cover all bankruptcy cases in which the United States is a party, or just cases in which a determination of tax liability is involved?

2. Tax Shelters. The statute specifically carves out written communications between practitioners and representatives of a corporation in connection with the promotion of the direct or indirect participation in any tax shelter.

a. Ambiguous at Best. Although reference is made to Section 6662, the definition of tax shelter in that section is far from precise.

b. Legal Advice Still Privileged as to Shelters. The tax shelter exception originally was designed to remove privilege protection from attorneys who advised regarding tax shelters as well. In the conference committee bill, lawyers were carved out of the exception. Senate judiciary committee chair Orrin Hatch and House judiciary committee chair Henry Hyde pressured the conference committee to drop all references to the attorney-client privilege in the corporate tax shelter exception. The district court for the District of Columbia has also issued several important decisions in the arena of tax shelter litigation. In *United States v. KPMG LLP*, 237 F. Supp. 2d 35, 38-39 (D.D.C. 2002), citing *United States v. Frederick*, 182 F.3d 496 (7th Cir. 1999), the court determined that the Section 7525 privilege did not extend to opinion letters issued to an accounting firm's client because such letters were prepared in connection with the preparation of a tax return. In a subsequent decision, the court determined that some of the documents claimed to be protected by Section 7525 were actually protected. *United States v. KPMG LLP*, No. 02-0295, 2003 WL 22336072 (D.D.C. Oct. 10, 2003); see also *United States v. BDO Seidman, LLP*, 225 F. Supp. 2d 918 (N.D. Ill. 2002), *aff'd*, 337 F.3d 802 (7th Cir. 2003) (holding name of clients not privileged under Section 7525); *Black & Decker Corp. v. United States*, 219 F.R.D. 87 (D. Md. 2003) (holding accounting firm's advice not privileged because accounting firm's communications with company were not delivered to facilitate communications between company and its attorney).

3. Tax Return Preparation May Not Be Covered. The privilege for tax advice is the same as if the professional were an attorney. This means, among other things, that if the privilege does not protect communications if made to an attorney, it likewise does not protect those same communications to a tax practitioner. Consequently, tax practitioners and clients alike should be aware that tax return preparation communications may very well not be privileged.

## **VII. PRIVILEGES IN THE APPRAISAL PROCESS**

### **A. ATTORNEY TO HIRE APPRAISER?**

In the transfer tax area, valuation appraisals often serve as the basis for a taxpayer's position on the value of transferred property. Working with appraisers is an everyday event for most transaction planning attorneys. On the other hand, working with appraisers can be something of a rarity for most clients, many of whom have dealt with appraisers only in the purchase of real estate.

In most cases, the attorney, rather than the client, should hire the appraiser for a planning transaction. The attorney can offer guidance both to the client and to the appraiser on how similar transactions have been handled in the past by the IRS and the courts. Having the attorney hire the appraiser will also provide the taxpayer with an argument that any unused reports or correspondence are privileged, as the work of the appraiser was intended to assist the attorney in rendering legal advice.

However, if the appraiser ultimately produces a report used by the taxpayer, any documents in the appraiser's file, including correspondence, notes, or appraisal drafts may be subject to disclosure to the IRS. See, e.g., *United States v. Richey*, 632 F.3d 559, 567 (9<sup>th</sup> Cir. 2011) (holding appraiser's work papers not privileged where referred to in appraisal as additional material relied on but not attached to report and where appraisal was required by Code to qualify for deduction sought).

In *Richey*, the taxpayers made a charitable gift and sought a charitable deduction. In order for the gift to qualify for the charitable deduction, the Code required that the taxpayers obtain and attach to their income tax return an appraisal of fair market value for the value of the deduction sought. They did so.

In his report, the appraiser indicated that he relied on materials attached to his report, as well as other documents and information contained (not in the report but) in his work papers. The IRS summonsed the work papers. The attorney, relying on *Kovel* and its progeny, declined to produce the work papers, asserting both the work product doctrine and attorney-client privilege.

The trial court ruled in favor of the IRS, finding that the appraisal was not sought (and the appraiser engaged) to assist the attorney in rendering legal advice. Rather, the appraisal was sought in order to allow the taxpayers, in compliance with the Code, to qualify for the charitable deduction. Implicit in the court's analysis was the conclusion that the work of an appraiser – even if hired by the attorney – is not privileged if the appraisal is required to be submitted with the tax return in order for the taxpayer to take the position sought. On appeal, the Ninth Circuit reasoned that while there could be privileged information in the appraiser's file, the taxpayer had not, according to the evidence rules, identified specific communications that the privilege should protect. (The court also rejected the attorney's contention that the file was work product, prepared in anticipation of litigation.)

The Ninth Circuit opined that the appraiser should testify about the non-privileged documents contained in the work file and remanded the case to the trial court for an in-camera review of the documents in the appraiser's work file. The Appellate Court specified, "any communication related to the preparation and drafting of the appraisal for submission to the IRS was not made for the purpose of providing legal advice, but, instead, for the purpose of determining [ ] value . . . ." Further, to the extent the files contain documents that were not communications, they are not protected by the attorney-client privilege." *Id.* at 567.

The work product doctrine and attorney-client privilege in this context only protect those communications necessary to assist the attorney in rendering legal advice – often read as allowing the attorney to understand the client's communications themselves. Once again, consider who the audience may ultimately be and understand that the appraiser's file may be reviewed by the examining agent, an appeals officer, district counsel, or the ultimate finder of fact in tax litigation. In any event, the planning lawyer may wish to have an oral discussion with the appraiser after he or she determines the value range but before he or she prepares a first draft of a written report so that

differences of opinion or relevant law may be discussed freely. In large and/or complex valuation cases, the planning lawyer may want to consider engaging two appraisers: one to aid the lawyer in his or her analysis of the appraisal (whose work as a consulting expert will not be disclosed), and one whose appraisal will ultimately be disclosed to the IRS, either as support for the value reported on the transfer tax return or at trial.

## **B. THE *KOVEL* ACCOUNTANT: SOLUTION?**

In part because of the limits of the Tax Practitioner Privilege, attorneys (rather than accountants or taxpayers directly) often engage experts and advisors, such as accountants, to assist them in rendering legal advice, while also ensuring that the consultant's work in assisting the attorney will remain confidential. This engagement is often referred to as a "Kovel Agreement," named after a landmark case on this issue. See *United States v. Kovel*, 296 F.2d 918, 921 (2d Cir. 1961); see also *United States v. Cote*, 456 F.2d 142, 144 (8th Cir. 1972); *Cavallaro v. United States*, 284 F.3d 236, 246 (1st Cir. 2002).

Under *Kovel*, in order to demonstrate that a consultant is assisting an attorney in providing legal services, a written engagement letter is important. Such a letter, if drafted with an eye toward *Kovel*, can serve as evidence sufficient to preserve the privilege. Such a *Kovel* engagement letter should include terms that focus on the following factors:

1. Control. Consultant is engaged by the attorney and is working under the attorney's direction.
2. Not Pure Return Preparation. Consultant's work is for the purpose of rendering legal advice, not simply for the preparation of tax returns. For example, the consultant is assisting the attorney in determining whether delinquent federal income tax returns should be prepared and filed and what positions to take on those returns.
3. Ownership. Work of the consultant belongs to the attorney.
4. Purpose. Any communications with the consultant are made solely for the purpose of enabling the attorney to provide legal advice to the client.

Attorneys often extrapolate the accountant concept to appraisers, attempting to cloak their communications with appraisers in the attorney-client privilege. However, if an appraiser is engaged to provide the taxpayer's rationale for a reporting position on a tax return, particularly if attaching the appraisal to the tax return is required, the appraiser's work papers may be considered tax return preparation materials and therefore discoverable, even if the appraiser was hired by the attorney. See *United States v. Richey*, 632 F.3d 559 (9th Cir. 2011).

Likewise, if an appraiser is engaged as a testifying expert, some or all communications (depending on which Rules of Evidence apply) with the appraiser may be discoverable. See, e.g., FED. R. EVID. 502 (requiring all data relied upon by testifying

appraiser to be disclosed, but not other communications with attorney); TAX CT. R. 70(c) (historically requiring disclosure of all requested communications with testifying expert to be disclosed but now protecting from disclosure communications between attorney and expert regardless of form, unless communication: (1) relates to expert's compensation; (2) identifies facts or data considered by expert in forming opinion; or (3) identifies assumptions considered by expert in forming opinion. FED. R. CIV. P. 26(b) (protecting trial experts' drafts from discovery); see also *United States v. Veolia Environment North Amer. Op., Inc.*, Civ. No. 13-mc-03-LPS (2013) (requiring production of materials containing facts or data considered by experts in forming opinions). An expert is not required to produce facts known or opinions held in anticipation of litigation or in preparation of trial if that witness is not expected to be called as a witness at trial, unless the expert's facts and opinions on the same subject matter cannot be obtained elsewhere. See *Veolia Environment North Amer. Op., Inc.*, Civ. No. 13-mc-03-LPS.

### **C. DISCUSSING METHODOLOGY BEFORE CONCLUSIONS ARE MEMORIALIZED**

Yet, regardless of the applicability of the attorney-client privilege, hiring a qualified appraiser is only the first step. Estate planners should examine the underlying assumptions, analysis, and conclusions of the appraiser and ensure that they are logical. Appraisers can and do make mistakes. Planners should discuss with appraisers the methodology of examination perhaps even before any analysis is put to paper. Attorneys should not "coach" the appraiser or dictate the desired result. That said, attorneys should be comfortable that the appraiser's assumptions and analyses are correct. If questions or concerns arise, the attorney should discuss those concerns with the appraiser at length, if needed. If the concerns cannot be addressed, the taxpayer and her attorney should consider choosing another appraiser. If a second appraiser is engaged before the first appraiser has reduced his findings to writing, there will be no documents from the first appraiser to produce in response to an examining agent's request for "copies of all appraisals."

## **VIII. EFFECT OF ASSERTING ATTORNEY-CLIENT PRIVILEGE ON BURDEN OF PROOF IN DISPUTED CASES**

In certain situations, the taxpayer can shift the burden of proof from the taxpayer to the government in court. See I.R.C. § 7491. Section 7491 provides:

### **A. BURDEN SHIFTS WHERE TAXPAYER PRODUCES CREDIBLE EVIDENCE**

1. General Rule. If, in any court proceeding, a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B, the Secretary shall have the burden of proof with respect to such issue.

2. Limitations. Paragraph (1) shall apply with respect to an issue only if –

a. the taxpayer has complied with the requirements under this title to substantiate any item;



b. the taxpayer has maintained all records required under this title and has cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews; and

c. in the case of a partnership, corporation, or trust, the taxpayer is described in section 7430(c)(4)(A)(ii).

Subparagraph (C) shall not apply to any qualified revocable trust (as defined in section 645(b)(1)) with respect to liability for tax for any taxable year ending after the date of the decedent's death and before the applicable date (as defined in section 645(b)(2)).

3. Coordination. Paragraph (1) shall not apply to any issue if any other provisions of this title provides for a specific burden of proof with respect to such issue.

#### I.R.C. § 7491.

To shift the burden of proof, the taxpayer must comply with the substantiation requirements of the Internal Revenue Code and keep all required records. In addition, the taxpayer must have cooperated with “reasonable requests”<sup>4</sup> by the IRS for “witnesses, information, documents, meetings, and interviews” and must present “credible evidence” in court on the factual matters at issue. If all of these conditions are met, Section 7491 provides that the burden of proof shifts to the IRS.

Moreover, filing a motion to quash a summons does not (in and of itself) indicate lack of cooperation such that the burden of proof cannot shift to the IRS. In *Estate of Kohler*, the Tax Court determined that a taxpayer did not fail to reasonably cooperate simply because it filed a motion to quash a summons that the IRS had issued to obtain certain documents during discovery. The Tax Court found that the taxpayer:

had a good faith belief that some of the documents respondent sought were irrelevant, sealed, or contained sensitive . . . business information and filed a motion to quash the summons to protect its rights. Once the court denied the estate's motion to quash the summons, the estate provided the documents respondent requested. Respondent has not argued that respondent's investigation was impaired by any lack of documentation.

*Estate of Kohler v. Comm'r*, 92 T.C.M. (CCH) 48, 52 (2006). Consequently, the burden of proof shifted in *Kohler* to the IRS.

If the taxpayer complies with Section 7491, the IRS has another layer of litigation hazards to consider, which could aid in resolving more cases before trial.

---

<sup>4</sup> The question yet to be addressed by the courts is whether a request that seeks privileged information can ever be “reasonable.”

## **IX. CONCLUSION**

In sum, there are numerous protections of communications among advisors and between advisors and their clients. To best protect those communications from discovery or, if produced, from misinterpretation, it is important to understand the differences among those protections and to ensure that the communications are documented in the context of the broader goals of the clients, such that tax and non-tax reasons for the transaction are clearly indicated. Keeping these protections in mind at all times can assist the client's advisors in rendering advice to the taxpayer and in accomplishing the client's goals. And, although privileges generally are thought to protect communications with attorneys, anticipating that at some point the client might find it advantageous to waive these privileges and, as a result, deliberately documenting communications that could be helpful in the event of a tax audit or dispute could be the lynchpin for the client's case.