

IV.B.3. Attorney Client Privilege

Overview

Introduction During the examination of a tax shelter issue, the taxpayer may withhold information and/or documents requested in an IDR or summons on the grounds of privilege. There are several possible privileges that may be claimed, but the two most common in tax shelter cases are the attorney-client privilege and the work product doctrine. A third, which is basically a defense to a claim that an attorney-client privilege has been waived by the client, is the common interest doctrine. These privileges are narrow. For example, not every document prepared by a lawyer or prepared by a client for a lawyer, and not every conversation in which a lawyer participates, is covered by the privilege. In addition, although portions of a document may be privileged, other portions may not be. Finally, although a document may on its face appear to be privileged, the privilege may have been waived.

Withheld Information Taxpayers occasionally will erroneously withhold information/documents on grounds of privilege. The information and/or documents may be relevant and, in fact critical, to a complete and accurate determination of the issues under examination and to the Service's ultimate ability to prevail in its determination.

In addition, and perhaps more importantly, taxpayers occasionally do not apprise examining agents that information and/or documents are being withheld on grounds of privilege, particularly in response to IDRs, although it may also happen in response to summonses. This is a serious problem because it deprives the Service of the opportunity to evaluate the merits of the privilege claim.

Tax Shelter Exams As discussed in more detail below, an agent conducting a tax shelter examination must ascertain whether any documents are being withheld on privilege grounds, and if so, the particular privilege being asserted for each document and the factual basis supporting the claim.

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Overview, Continued

Seek Counsel Assistance

In tax shelter examinations, agents should not attempt to ascertain whether a claim of privilege is legally proper, nor should they simply accept claims of privilege--rather, they should immediately seek local counsel assistance.

Counsel will evaluate the privilege claims, and if appropriate, may recommend informal consultation with the taxpayer or third party to secure additional information or clarify facts pertaining to the claims. Alternatively, counsel may discuss the parties' positions if the privilege is claimed by a third party in response to an information request or summons to that party. Additionally, counsel may recommend the issuance of a summons (if the claims are in response to IDRs). If the claim was in response to a summons, counsel may recommend that the summons be forwarded to the Department of Justice and/or United States Attorney for enforcement.

Responsibilities of Examining Agents in Tax Shelter Examinations Pertaining to Privileges

Introduction

In all tax shelter examinations, agents should include on each IDR and summons issued, a request that the taxpayer state whether any documents are being withheld under a claim of privilege and if so, that the taxpayer identify each document withheld and provide a brief description of the nature of the document, the particular privilege claimed, and the justification for the claim. This is sometimes called a privilege log.

Suggested Language

Suggested language is as follows:

If a document is being withheld, in whole or in part, under a claim of privilege, provide the following information separately as to each document:

- The privilege claimed (e.g., attorney-client);
- The date of the document;
- The title and a brief description or summary of the content of the document;
- The purpose for preparing the document;
- The name, position, and address of the person who prepared the document;
- The name, position, and address of the person to whom the document was written;
- All ultimate recipients of the document, including but not limited to copied persons named on the document, and
- How the document or communication satisfies the asserted privilege or privileges;
- If the withheld document contains attachments, so state and provide the same information with respect to the attachments.

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Responsibilities of Examining Agents in Tax Shelter Examinations Pertaining to Privileges, Continued

Advantages

By including the above request in every IDR and summons, the agent will accomplish the following:

- Determine at the earliest possible time whether relevant documents exist that are not being provided.
- Enable counsel to evaluate the merits of the privilege claim as early as possible. Since the documents have been identified, it is more likely that they will be available if the case should proceed to litigation.
- In attempting to support all elements of the privilege, the taxpayer might realize that its privilege claim is not supportable.
- To the extent privilege claims are successfully challenged at the examination level, the agent will secure critical documents which may facilitate early resolution of the case. If the case is not resolved, these documents will assist the agent in determining the proper legal position in the revenue agent's report and/or notice of deficiency, thereby strengthening the Government's position at Appeals and in litigation.

Do not attempt to evaluate claims of privilege. Contact your local counsel.

Attorney Client Privilege

Introduction

The attorney client privilege protects from disclosure:

- Communications made **in confidence** by a client to any attorney for the purpose of obtaining legal advice; and
 - Confidential communications made by the attorney to the client if such communications contain legal advice or reveal confidential information on which the client seeks advice. Upjohn Co. v. U.S., 449 U.S. 383 (1981); Bernardo v. Commissioner, 104 T.C. 677 (1995), amended by 95 T.N.T. 140—27 (T.C. 1995); Hartz Mountain Indus. v. Commissioner, 93 T.C. 521 (1989).
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Definition

What is the attorney-client privilege?

- (1) A statement by a person who is a client or seeks to become a client;
 - (2) Made to a member of the bar of a court or his or her subordinate where
 - (3) The recipient of the communication is acting as a lawyer.
 - (4) The communication relates to a fact:
 - Communicated by the client to the lawyer;
 - Where no strangers are present;
 - For the purpose of obtaining
 - (a) a legal opinion; or
 - (b) legal services and is not
 - (c) for the purpose of committing a crime or tort.
 - (5) The privilege must be claimed and not waived by the client.
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Attorney Client Privilege, Continued

Attorney-Client Privilege in the Corporate Context

Corporations may assert the privilege. To qualify:

- The communication must be made by a corporate employee:
 - For the purpose of the corporation obtaining legal advice;
 - Concerning matters within the scope of the employee's corporate duties; and
 - Considered confidential when made
- The communication must have been kept confidential by the company.

The privilege applies to in-house as well as outside counsel, but in both cases the communications must involve legal advice, not business, financial or tax advice.

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Attorney Client Privilege, Continued

Important Subtleties

1. The advice of the lawyer is privileged only if disclosure of the advice would compromise the communication by the client. For example, if the lawyer receives information from a third party in a non-work product scenario, and passes on that information to the client and gives the client advice based upon that communication, neither the communication nor the advice is privileged.
2. The privilege belongs to the client. Thus, the client must assert it, not the attorney, unless the attorney is asserting it as an agent for the client. Also, an attorney cannot waive the privilege without the client's permission.
3. The privilege is triggered only by the exchange of some measure of legal advice, as contrasted with purely business advice. This is a particularly difficult distinction when dealing with in-house counsel, where the information exchanged is of a mixed nature and for a mixed purpose, with documents authored by an attorney versus non-legal personnel. It is also difficult in the context of corporate executives in non-legal positions, such as treasurer, who are also lawyers.
4. The privilege does not necessarily protect the entire document from disclosure if non-privileged information is also contained in the document, and redaction of privileged material is feasible. The fact that a clever opposing attorney may be able to guess as to what advice was given is not sufficient to withhold non-privileged material.
5. Although a document may be privileged, attached preexisting documents, such as schematics of a tax shelter or other documents provided by third parties, which independently would not have been protected by a privilege, generally are not privileged.
6. A communication which may initially have been privileged will lose the protection of the privilege if it is subsequently disclosed to a third party.

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Attorney Client Privilege, Continued

Important Subtleties (Continued)

7. Memoranda and conversations in connection with the preparation of tax returns and handling of tax audits generally are not considered privileged. United States v. Davis, 636 F.2d 1028, 1043 (5th Cir. 1981); United States v. Lawless, 709 F.2d 485, 488 (7th Cir. 1983).

8. The privilege may implicitly be waived when someone asserts a claim that in fairness requires examination of the protected communications. Thus, in tax shelter cases, the privilege may be waived where, to defend against the assertion of a penalty, the taxpayer claims that it relied on advice of counsel.

Additional Factors

1. In analyzing a taxpayer's claims of privilege, the Court is guided by the principle that privileges, because they obstruct the truth finding process, must be strictly construed.

2. The burden of proving the applicability of the privilege is on the taxpayer.

3. The burden of proving that the privilege was not waived is on the taxpayer.

4. Pre-existing documents which could have been obtained by court process from the client when the client was in possession may also be obtained from the attorney by similar process if the client transfers the documents to his/her attorney in order to obtain more informed legal advice.

Inapplicability of the Privilege to Fees

1. Fee arrangement inquiries are generally not privileged.

2. Amount of fees and a general description of services (e.g., tax advice, litigation) are not generally privileged.

Waiver

1. Voluntary disclosure to a third party is inconsistent with maintaining confidentiality and waives the privilege.

2. A voluntary disclosure may waive the privilege not only as to the specific communication disclosed, but often as to all other communications relating to the same subject matter.

Work Product Doctrine

Introduction	The work product doctrine is technically not a privilege --it is more like a qualified immunity. It protects from disclosure documents and thoughts of any attorney, not client communications. The scope of the privilege is more narrow than the attorney client privilege.
Discovery	The work product doctrine protects from discovery information that an attorney secures from a potential witness, as well as the attorney's mental impressions, conclusions, opinions, and legal theories.
Supreme Court Case	In <u>Hickman v. Taylor</u> , 329 U.S. 495, 511 (1947), the Supreme Court stated that an attorney's work product was reflected in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and other tangible and intangible ways, and that this information was free from discovery subject to an exception for facts which are essential to the other party's case.
Anticipation of Litigation	An important element of this doctrine, however, is that it only covers information <u>prepared or collected in anticipation of litigation</u> . Litigation is frequently anticipated before the time a lawsuit is actually commenced. Litigation need not be imminent as long as the primary motivating purposes behind the creation of the document was to aid in possible future litigation, and at the time of the creation of the documents, the possibility of such litigation was "more than a remote possibility." <u>US v. Gulf Oil Corp.</u> , 760 F.2d 292, 296 (Temp. Emer. Ct. App. 1985); <u>U.S. v. Davis</u> , 636 F.2d 1028 (5 th Cir. 1981). <u>But see, Bernardo v. Commissioner</u> , 104 T.C. 677 (1995).

Common Interest Doctrine

Introduction Once a privileged communication has been disclosed purposely to a third party, the attorney client privilege is waived, unless the disclosed material falls under the common interest rule. “The common interest [rule] protects communications between a lawyer and two or more clients [relating] to a matter of common interest.” In re Sealed Case, 29 F.3d 715, 719 (D.C. Cir. 1994). This rule protects the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel. The parties claiming protection under the rule must share "a common interest about a legal matter, but it is unnecessary that there be actual litigation in progress. If the shared interest regards a business matter, however, the rule does not apply. United Technologies Corp v. United States, 97-2 USTC ¶50,721 (D.C. Ct. 1997)

Countering the Service’s Position This doctrine may be raised to counter the Service's assertion that the attorney client privilege has been waived when, in a tax shelter examination, the facts reveal that an otherwise tax opinion or other privileged communication and/or document was shared among and/or between the taxpayer and a promoter, accommodating party, or other similarly situated taxpayers.

Case Law There is no case law regarding this doctrine in the context of tax cases, and none regarding tax shelters

Contact Local Counsel As noted, local counsel should be contacted if this doctrine is asserted to support the withholding of documents

Tax Advice Privilege Under IRC Section 7525

Introduction	I.R.C. § 7525 extends the attorney-client privilege of confidentiality to tax advice that is furnished to a client taxpayer (or potential client-taxpayer) by an individual who is authorized under Federal law to practice before the IRS, including attorneys, certified public accountants, enrolled agents and enrolled actuaries. The privilege applies only to the extent that communications would be privileged if they were between a taxpayer and an attorney. It would not cover items that appear on a tax return.
Effective Date	The privilege applies to communications made on or after July 22, 1998.
Application	The privilege <u>does not apply</u> to any written communication between an authorized tax practitioner and any director, shareholder, officer, employee, agent or representative of a corporation in connection with promoting the direct or indirect participation of such corporation <u>in a tax shelter</u> .
Criminal Matters	The privilege may only be asserted in either: a noncriminal tax matter before the Service or a noncriminal tax proceeding in Federal Court brought by or against the United States. Therefore, it does not apply in criminal matters before the Service.

Privilege Issues in Tax Shelter Context

Introduction The purpose of this section is to apprise agents of situations where they might expect to see the privilege raised, not whether the claim would have merit - these situations should be referred to local counsel

In-house Counsel The taxpayer asserts attorney-client privilege or work product doctrine for documents created by in-house counsel when a transaction was being considered (i.e., not during the audit or in litigation) such as notes taken at a meeting with an investment banker, memoranda summarizing meetings, or the proposed transaction, etc.

Executives The taxpayer's executives (treasurer, controller, chief financial officer) refuse to answer questions during a Q&A interview pursuant to summons, based on the fact that they were members of the bar.

IDRs In-house attorney drafts IDR responses and conducts a search for documents requested in IDR. Attorney refuses to submit to Q&A interview regarding the information gathering process pursuant to summons.

Tax Opinion Taxpayer claims attorney-client privilege for tax opinion attached to promotional material.

Investment Banker At a question and answer interview of an investment banker promoter, taxpayer directs investment banker not to answer any questions on conversations regarding the proposed transaction with corporation's in-house attorney, based on attorney-client privilege.

Outside Counsel Taxpayer refuses to provide bills and invoices for work performed by outside legal counsel on the transaction, based on attorney-client privilege.

Recent Tax Shelter Cases Involving Attorney/Client Privilege and Work Product Doctrine

Introduction The following legal opinions establish that lawyers do not bring automatic privilege coverage to tax shelter planning.

Ackert United States v. Ackert, 169 F. 3d 136 (2d Cir. 1999).

The lawyer for the corporate taxpayer had contacted a large investment house to find out more about a tax-advantaged investment deal that they were marketing, which was similar to the one offered in ACM. This contact eventually resulted in the corporation's buying in on a shelter. When the IRS tried to summon the investment banker to testify as to the tax-motivated intent shown by the taxpayer's attorney, attorney-client privilege was invoked. The Second Circuit held that since the attorney sought out information that the client did not have, the conversations between the attorney and the investment banker were not privileged (if lawyers were scouting out shelters for their clients).

Ackert Revisited United States v. Ackert, 76 F. Supp.2d 222 (D.Conn. 1999), on remand from 169 F.3d 136 (2d Cir. 1999).

The work product doctrine did not protect from disclosure conversations between the taxpayer's attorney and an investment banker regarding a proposed investment transaction. For that doctrine to apply, the taxpayer (client) had to show that the material in question, the investment banker's recollection of his conversations with the attorney, was prepared in anticipation of litigation. However, the conversations took place in connection with a proposed investment, rather than an impending lawsuit.

Boca Boca Investering Partnership v. United States, 1 F. Supp.2d 9 (D.D.C. 1998)

In this case, certain portions of the in-house tax counsel's and outside tax counsel's memoranda were ordered disclosed while other portions were protected. The opinion discusses the criteria used to distinguish privileged communications made by and to lawyers from those that are not.

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Recent Tax Shelter Cases Involving Attorney/Client Privilege and Work Product Doctrine, Continued

Saba

Saba Partnership v. Commissioner, T.C. Memo. 1999-359.

In another case involving a transaction similar to ACM, the Tax Court, citing the Second Circuit's opinion in Ackert, 76 F. Supp.2d at 222, , ordered disclosed the portion of a memorandum prepared by the in-house tax counsel of a corporation which contained "a bullet point summary" of a transaction proposed by an investment banker to the corporation to generate sufficient capital losses to offset the capital gain which was expected to be generated on the sale of a corporate subsidiary. The Tax Court determined that the portion of the memorandum that was ordered disclosed did not contain communications from the corporation to its in-house attorney, or legal advice or analysis, but was merely a factual account of a meeting between a third party (the investment banker) and the corporation's tax counsel.

The Court also determined that the disclosure of portions of the memorandum would not infringe upon the work product doctrine because the disclosed portions consisted only of a factual account of a meeting between the in-house attorney and representatives of the investment banker and was bereft of material that could be characterized as the attorney's legal opinion or judgement.

TNT Article

See also, Lee A. Sheppard , Corporate Tax Shelters: "Red Herrings and Real Solutions", , 2001 TNT 117-73 (June 15, 2001).
