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Skating Too Close to the Edge: A Cautionary Tale for Tax Practitioners About the Hazards of Waiver

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SKATING TOO CLOSE TO THE EDGE: A CAUTIONARY TALE
FOR TAX PRACTITIONERS ABOUT THE HAZARDS OF WAIVER

*Claudine V. Pease-Wingenter**

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I. INTRODUCTION

Prior to becoming a professor, I spent about eight years practicing corporate tax law. I did both tax controversy and tax planning work. During those years, I handled a wide variety of tax issues, but there was a reoccurring non-tax issue that plagued my colleagues and me: *When does the attorney–client privilege protect tax communications?*

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The answer to this question is not as straightforward as one might initially assume.¹ In other settings, it is often fairly easy to predict when privilege does or does not apply. If a criminal law defendant tells her client where she hid a murder weapon, that conversation is clearly within the scope of the attorney–client privilege. If an entrepreneur e-mails her lawyer to ask if she can fire a pregnant employee without being sued, that note and the lawyer’s response are undoubtedly shielded by privilege.

Things are not as clear-cut in a tax practice.² Communications involving *tax lawyers* can sometimes be protected by privilege, but the long-standing general rule was always that communications involving *tax accountants* were not.³ Further, courts have repeatedly opined that if a tax lawyer is doing work that a tax accountant could have done, then the lawyer is viewed as doing tax accounting work beyond the scope of the attorney–client privilege.⁴ Unfortunately, the delineation between the tax attorney and tax accountant professions has long been murky, if not illusory.⁵ This situation has made it challenging to predict when privilege will (or will not) apply in the tax context.⁶

In 1998, this challenge was exacerbated when Congress enacted section 7525 of the Internal Revenue Code (IRC or the Code) to create the Federally Authorized Tax Practitioner Privilege (FATP).⁷ FATP was a new privilege to shield certain communications with tax accountants (among other non-lawyer tax professionals).⁸ Confusingly, the statute adapted for such non-lawyers the already muddled tax attorney–client privilege framework.⁹ To make matters worse, the

1. Paul Seraganian, *Schedule UTP and Evidentiary Privilege in the Tax Law*, 21 J. INT’L TAX 30, 39 (2010) (noting the “unsettled state of the law” applying privilege in the tax context and discussing the need for “clarity and predictability” in this area of law).

2. *Id.* (noting the “unsettled state of the law” applying privilege in the tax context and discussing the need for “clarity and predictability” in this area of law).

3. *See, e.g.*, *United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999).

4. *See, e.g., id.*

5. Seraganian, *supra* note 1, at 34–35 (“There is significant uncertainty under existing authorities regarding the respective perimeters of legal advice on one hand and accountant’s work on the other, and the degree to which these spheres of activity may overlap. In particular, although some authorities suggest that the preparation of tax returns should be regarded as an accountant’s function, there appears to be little consensus regarding the point at which legal advice that is ultimately reflected in a tax return ceases to be eligible for the privilege.”).

6. *Id.* at 39 (noting the “unsettled state of the law” applying privilege in the tax context and discussing the need for “clarity and predictability” in this area of law); Claudine Pease-Wingenter, *Does the Attorney–Client Privilege Apply to Tax Lawyers?: An Examination of the Return Preparation Exception to Define the Parameters of Privilege in the Tax Context*, 47 WASHBURN L.J. 699, 700 (2008).

7. 26 U.S.C. § 7525(a)(3)(A) (2012).

8. *Id.* § 7525(a)(1).

9. *Id.*

courts interpreting section 7525 have sometimes been inconsistent with the pre-existing attorney–client privilege framework.¹⁰ In some cases the section 7525 case law has even been internally inconsistent.¹¹ This case law has led to even more confusion as to when privilege protects tax communications.

Because of this chaos, I have observed there to be a huge variance of understandings within the Tax Bar as to when privilege applies. At one extreme, some tax practitioners assume that all of their work-related communications are privileged. At the other extreme, others assume that none of their communications are protected. When I was in practice, my colleagues and I always wished that some learned scholar would write articles to bring clarity to this situation, but none did. So, I left practice and entered the academy myself.

From the start of the academic phase of my career, I envisioned a trilogy of articles to cover the key areas of confusion. The first article would explain when attorney–client privilege does—and does not attach—in the tax setting. The second would dissect the section 7525 case law to explain where some of the courts had gone awry. The third article would focus on the issue of subject matter waiver in a tax practice. Many practitioners are unsure which actions trigger a waiver. Further, in my experience, many practitioners believe a waiver only impacts a particular document that may be disclosed, and many are blissfully unaware of the wide breadth of a subject matter waiver.

In 2008 and 2010, respectively, I published the first two articles in this planned trilogy.¹² This third and final article begins where those prior articles left off. Assuming privilege has initially attached, this Article explores the law to identify when one loses privilege through waiver, and discusses the repercussions of such waiver.

Identifying when privilege is waived in the tax setting is quite vexing. Tax practitioner communications are often shared (or at least implicated in communications) with many persons beyond the taxpayer-client.¹³ Most taxpayers who may benefit from privilege have sophisticated business or estate transactions with complex tax consequences.¹⁴ As a

10. Claudine V. Pease-Wingenter, *Lemons from Lemonade: The Courts Fumble the FATP Privilege*, 129 TAX NOTES 977, 986 (Nov. 29, 2010) (citing *Doe v. Wachovia Corp.*, 268 F. Supp. 2d 627, 637 (W.D.N.C. 2003)).

11. *Id.* at 985 (citing *United States v. KPMG LLP*, 237 F. Supp. 2d 35, 39 n.4 (D.D.C. 2002) (“The *KPMG* opinion was internally inconsistent in finding the Exception applied to bar the FATP privilege to Document 22, but did not bar application of the attorney–client privilege to Document 442.”)).

12. *Id.* at 977; Pease-Wingenter, *supra* note 6, at 699.

13. See *Long-Term Capital Holdings v. United States*, No. 3:01 CV 1290, 2002 WL 31934139, slip op. at *7 (D. Conn. Oct. 30, 2002).

14. Edward J. Imwinkelried, *Types of Motivation That Render a Communication Incident or Germane to a Protected Relationship*, in *THE NEW WIGMORE: A TREATISE ON EVIDENCE: EVIDENTIARY*

result, most such taxpayers do not prepare their own tax returns.¹⁵ The return preparers they hire need to know at least the conclusions of a tax practitioner's advice (and sometimes even their supporting analysis) in order to do their jobs to prepare the taxpayer-client's tax returns.¹⁶ There is uncertainty as to what (if anything) can be shared with such return preparers without triggering waiver.¹⁷

To effect the privileged advice of a tax practitioner, the taxpayer-client's tax returns (and sometimes supporting documentation) generally must be filed or otherwise disclosed to the Internal Revenue Service (IRS or the Service).¹⁸ There is controversy as to whether the act of filing one's return waives privilege as to any underlying communications about advice from a tax practitioner.¹⁹ Largely due to some broad holdings in case law, some practitioners believe that it does.²⁰ However, if filing a return triggers a subject matter waiver, then privilege would be completely gutted in the tax context as virtually all tax advice eventually appears on a filed tax return.²¹

Beyond issues involving returns, there are also more subtle contexts where waiver is potentially implicated. In the corporate context, independent auditors may need to access privileged tax advice communications to certify a corporation's financials.²² Granting such access can waive privilege.²³

If the IRS assesses a penalty, a taxpayer-client may assert reliance on counsel as a defense.²⁴ However, such a defense can have devastating consequences if it is deemed to have triggered a subject matter waiver.²⁵

Because of the lingering confusion in these situations, and because there are many traps for the unwary, this Article will attempt to bring clarity to this muddled state of affairs. Part II reviews basic privilege concepts. Part III discusses important cases applying waiver principles in common tax fact patterns like those described above. Part IV reflects

PRIVILEGES § 6.11.1 (2012) ("It is felt that 'a taxpayer should not be able to invoke a privilege simply because he or she is wealthy enough to afford to hire an attorney to prepare a tax return.'").

15. *Id.*

16. See *Long-Term Capital Holdings v. United States*, No. 3:01 CV 1290, 2003 WL 1548770, slip op. at *4 (D. Conn. Feb. 14, 2003).

17. See *Long-Term Capital Holdings*, No. 3:01 CV 1290, 2002 WL 31934139, at *4.

18. Gregory C. Sisk & Pamela J. Abbate, *The Dynamic Attorney-Client Privilege*, 23 GEO. J. LEGAL ETHICS 201, 229 (2010).

19. *Id.*

20. See, e.g., *United States v. Cote*, 456 F.2d 142, 145 (8th Cir. 1972).

21. Sisk & Abbate, *supra* note 18, at 229.

22. See *United States v. Textron, Inc.*, 507 F. Supp. 2d 138, 151-52 (D.R.I. 2007); *United States v. El Paso Co.*, 682 F.2d 530, 539-40 (5th Cir. 1982).

23. *Textron, Inc.*, 507 F. Supp. 2d at 152; *El Paso Co.*, 682 F.2d at 540.

24. *In re G-I Holdings Inc.*, 218 F.R.D. 428, 432 (D.N.J. 2003).

25. *Id.*

on certain lessons learned from the state of the law. Finally, Part V states the author's conclusion.

II. THE FUNDAMENTALS OF PRIVILEGE LAW

A waiver of privilege presupposes that privilege initially has attached to certain communications, but that protection is subsequently lost.²⁶ Thus, to understand the basics of waiver, one must first have a solid understanding of when privilege attaches. Parts II(A) and II(B) provide primers on attorney–client privilege and the section 7525 FATP, respectively. Part II(C) then summarizes the basic legal principles governing waiver.

A. Attorney–Client Privilege

Federal law, not state law, is the basis of privilege claims in a federal income tax practice.²⁷ However, the source of the rule, Federal Rule of Evidence 501, simply defers to common law.²⁸ As a result, the federal attorney–client privilege is enunciated in different ways by different courts.²⁹ A common statement of the elements is based on the work of Professor Wigmore:

(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.³⁰

In applying the elements of privilege, courts have emphasized that only communications are protected, but underlying facts are not.³¹ The Supreme Court has shed light on this subtle delineation:

The client cannot be compelled to answer the question, ‘What did you say or write to the attorney?’ but may not refuse to disclose any relevant fact within his knowledge merely because he incorporated a statement of such

26. See, e.g., *Diversified Indus. v. Meredith*, 572 F.2d 596 (8th Cir. 1977).

27. *United States v. Liebman*, 742 F.2d 807, 808–09 (3d Cir. 1984).

28. FED. R. EVID. 501; Kent Sinclair, *Rule 501 Privileges: General Rule*, in *PLI TRIAL HANDBOOK* (2012) (“Congress manifested an affirmative intention not to freeze the law of privilege.”) (citing *Trammel v. United States*, 445 U.S. 40, 47 (1980)).

29. See *Knogo Corp v. United States*, 213 U.S.P.Q. 936, 938 (Ct. Cl. 1980) (using Judge Wyzanski’s formulation of the elements of privilege). *But see* *United States v. Mass. Inst. of Tech.*, 129 F.3d 681, 684 (1st Cir. 1997) (using Wigmore’s formulation).

30. *Mass. Inst. of Tech.*, 129 F.3d at 684; see Joni Larson, *Tax Evidence III: A Primer on the Federal Rules of Evidence as Applied by the Tax Court*, 62 *TAX LAW.* 555, 622 (2009).

31. Larson, *supra* note 30, at 622.

fact into his communication to his attorney.³²

In applying privilege, courts have determined that the requirement of communications “made . . . in confidence” require the client to have a subjective intent that the communications be kept confidential.³³ As a result, if a client provides an attorney with information so that the attorney can pass it along to third parties, privilege would not attach to those communications.³⁴

Although courts have repeatedly confirmed that the attorney–client privilege does have application in a tax practice, they have also developed the “Return Preparation Exception” (alternatively the “Exception”).³⁵ Pursuant to the Exception, the scope of privilege does not extend to certain documents and other communications associated with the preparation of a tax return.³⁶

Documents pre-dating the request for return preparation services clearly fall within the Return Preparation Exception.³⁷ Such documents typically include financial or accounting records.³⁸ The Return Preparation Exception has also frequently been applied to workpapers created in the course of preparing the client’s return.³⁹ These two applications of the Exception are not very controversial and seem consistent with other broader principles of attorney–client privilege.

However, the Return Preparation Exception has also sometimes been applied to communications by a client of factual information to an attorney.⁴⁰ When that factual information is then incorporated by an attorney into a tax return, the Exception sometimes bars the protection of privilege.⁴¹ Courts have adopted different legal rationales to justify application of the Exception in this context.⁴²

Some courts have theorized that privilege never attaches to the communication of such factual information because the elements of privilege require that the client must communicate with an attorney in

32. *Upjohn Co. v. United States*, 449 U.S. 383, 396 (1981).

33. *United States v. Robinson*, 121 F.3d 971, 976 (5th Cir. 1997).

34. *United States v. Threlkeld*, 241 F. Supp. 324, 326 (D. Tenn. 1965) (“Any communication by the client with the understanding that the information would be inserted in the return must be divulged. The reason is that, with such an understanding, it could not be intended to be confidential.”) (internal citations omitted).

35. Pease-Wingenter, *supra* note 6, at 707–08.

36. *Id.* at 707.

37. *Id.* (citing, *e.g.*, *Colton v. United States*, 306 F.2d 633, 639 (2d Cir. 1962)).

38. *Id.*

39. *Id.* at 707 (citing, *e.g.*, *United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999)).

40. *Id.* at 708.

41. *Id.* at 722 (citing, *e.g.*, *Canaday v. United States*, 354 F.2d 849 (8th Cir. 1966)).

42. *Id.* at 708.

her capacity as a lawyer.⁴³ Such courts have held that preparing a tax return is an accounting function, and not an occasion for the provision of legal advice.⁴⁴ As a result, a client's provision of factual information for return preparation services is not viewed as a communication with an attorney in her legal capacity.⁴⁵

Other courts have used a different legal rationale and emphasized the initial need for confidentiality for privilege ever to attach.⁴⁶ Such courts have theorized that when clients communicate factual information for attorneys to incorporate into a tax return, there is never the requisite client intention of confidentiality.⁴⁷ The view is that the client implicitly wants the attorney to divulge the communicated information because tax returns are prepared to be filed with a third party, i.e., the IRS.⁴⁸

Both of these rationales have weaknesses. Courts are not unanimous in the view that return preparation services are an accounting function and not a type of legal service. In *Colton v. United States*, the Second Circuit Court of Appeals explicitly held that "the preparation of tax returns . . . [is] basically [a] matter[] sufficiently within the professional competence of an attorney to make [it] prima facie subject to the attorney-client privilege."⁴⁹

Additionally, courts have recognized that even in the return preparation context, not all communications between the client and attorney are intended to be incorporated into the return.⁵⁰ To that end, they have held that the requisite lack of confidentiality is only found in communications of facts that actually are included in filed tax returns.⁵¹ By contrast, communications of factual information that is *not* transmitted on the return have been deemed to have the necessary intent for confidentiality such that privilege attaches.⁵²

Because of the Return Preparation Exception, it is quite possible that privilege will not initially attach to communications when an attorney is preparing a tax return or directing a non-lawyer to do so. However, there are other settings where the Exception has no application and attorney-client privilege more easily attaches.

For example, tax practitioners often advise clients about returns that have already been filed. Such advice typically arises in performing tax

43. *Id.* at 709 (citing, e.g., *Olender v. United States*, 210 F.2d 795 (9th Cir. 1954)).

44. *Id.*

45. *Id.*

46. *Id.* at 713.

47. *Id.* at 714 (citing, e.g., *Colton v. United States*, 306 F.2d 633, 636-37 (2d Cir. 1962)).

48. *Id.* at 715 (citing, e.g., *United States v. Merrell*, 303 F. Supp. 490 (N.D.N.Y. 1969)).

49. *Colton*, 306 F.2d at 637.

50. *See, e.g., United States v. Schlegel*, 313 F. Supp. 177, 179 (D. Neb. 1970).

51. *Id.* at 179-80; *Colton*, 306 F.2d at 638.

52. *United States v. Threlkeld*, 241 F. Supp. 324, 326. (D. Tenn. 1965).

controversy work, where the attorney is consulted to defend the filed return. It is without doubt that attorney communications can be privileged when the attorney is representing a client in tax litigation.⁵³

It is less obvious what the outcome is when the tax controversy is still at the administrative level, but there are strong indications that communications in that setting may also be protected.⁵⁴ Indeed, some cases have concluded that privilege does attach when the attorney represents the client in an IRS audit.⁵⁵

There appears to be no case law on privilege when the attorney represents a client before the IRS Office of Appeals (IRS Appeals), but there are strong arguments that privilege attaches in that setting too.⁵⁶ IRS Appeals is considered to be an adversarial setting.⁵⁷ Indeed, for purposes of the work product doctrine, IRS Appeals satisfies the “litigation” element.⁵⁸ It thus seems logical that privilege would attach as easily at IRS Appeals as in the case of actual litigation in court.

By contrast, there is confusion as to whether and when privilege might attach prior to filing a return. Such attorney advice generally involves the proper characterization and reporting of a particular event or events. As a result, courts have delineated such attorney advice as either “pre-transaction” or “post-transaction” advice.⁵⁹

Pre-transaction advice involves educating a client on potential tax repercussions before she engages in a contemplated transaction. Depending on the substance of the pre-transaction advice, the client may even ultimately decide against engaging in certain transactions. Alternately, the attorney may suggest modifying a contemplated transaction to improve the tax impact. Many cases have held that pre-transaction communications are within the scope of privilege.⁶⁰ Like communications in the tax controversy context, it seems clear that pre-

53. Martin J. McMahon, Jr. & Ira B. Shepard, *Privilege and the Work Product Doctrine in Tax Cases*, 58 TAX LAW 405, 407 (2005); Peter A. Lowy & Juan F. Vasquez, Jr., *Attorney-Client Privilege: When Does Tax Advice Qualify as “Legal Advice”?*, TAX NOTES TODAY, 2002 TNT 237-50 (Dec. 9, 2002).

54. Pease-Wingenter, *supra* note 6, at 724.

55. *See, e.g.*, *United States v. Hankins*, 631 F.2d 360, 364-65 (5th Cir. 1980); *United States v. Cote*, 456 F.2d 142, 144 (8th Cir. 1972); *United States v. Judson*, 322 F.2d 460, 462 (9th Cir. 1963); *United States v. Nelson*, 65 F.R.D. 563, 565 (M.D.N.C. 1974). *But see* *Boca Investorings P’ship v. United States*, 31 F. Supp. 2d 9, 11 (D.D.C. 1998).

56. Pease-Wingenter, *supra* note 6, at 724.

57. *See* Peter A. Lowy & Juan F. Vasquez, Jr., *When is the Work of a Tax Professional Done in Anticipation of Litigation and Thus ‘Work Product’?*, 98 J. TAX’N 155, 157 (2003).

58. *Id.*

59. *See* *United States v. Willis*, 565 F. Supp. 1186, 1189 (S.D. Iowa 1983).

60. *See, e.g.*, *In re Grand Jury Subpoena Duces Tecum*, 731 F.2d 1032, 1037 (2d Cir. 1984); *United States v. BDO Seidman, LLP*, No. 02-C-4822, 2005 U.S. Dist. LEXIS 5555, at *22, slip op. at *24 (N.D. Ill. Mar. 30, 2005); *United States v. ChevronTexaco Corp.*, 241 F. Supp. 2d 1065, 1070 (N.D. Cal. 2002); *In re Federated Dep’t Stores*, 170 B.R. 331, 355 (S.D. Ohio 1994).

transaction advice falls well within the scope of the attorney–client privilege.

However, it has been suggested that post-transaction advice may not be privileged, but may trigger application of the Return Preparation Exception.⁶¹ Nonetheless, the weight of precedent is that the privilege does attach in the post-transaction context.⁶² However, it is possible that communication explicitly on return preparation matters may trigger the Exception.⁶³

B. Section 7525

Accountants and lawyers have long had overlapping practices in the tax context.⁶⁴ However, accountants were at a perennial disadvantage in such turf battles because they had no professional privilege to protect client communications.⁶⁵ Because of lobbying by accounting firms, Congress added section 7525 to the Code in 1998.⁶⁶

Section 7525 states that with respect to “tax advice,” communications between a taxpayer and a “federally authorized tax practitioner” will receive the “same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney.”⁶⁷ Somewhat redundantly, the statute says that such common law protections apply “to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.”⁶⁸

A “federally authorized tax practitioner” is defined to include certified public accountants, enrolled agents, enrolled actuaries and enrolled retirement plan agents.⁶⁹ Thus, the FATP does not cover all accountants.

The statute defines “tax advice” in a cryptic manner: “advice given by an individual with respect to a matter which is within the scope of the individual’s authority to practice” before the IRS.⁷⁰ This means that

61. *See Willis*, 565 F. Supp. at 1193.

62. *See, e.g., In re Sealed Case*, 877 F.2d 976, 979 (D.C. Cir. 1989); *United States v. Liebman*, 742 F.2d 807, 810 (3d Cir. 1984); *United States v. BDO Seidman, LLP*, No. 02 C 4822, 94 A.F.T.R.2d 2004-5066 (N.D. Ill. June 29, 2004); *United States v. Lake*, 257 F. Supp. 35, 37 (E.D.N.C. 1966).

63. *Canaday v. United States*, 354 F.2d 849, 857 (8th Cir. 1966); *Olender v. United States*, 210 F.2d 795, 806 (9th Cir. 1954).

64. Jared T. Meier, *Understanding the Statutory Tax Practitioner Privilege: What is Tax Shelter “Promotion”?*, 78 U. CHI. L. REV. 671, 677 (2011).

65. *Id.*

66. *Id.*

67. 26 U.S.C. § 7525(a)(1) (2012).

68. *Id.*

69. *Id.* § 7525(a)(3)(A) (2012).

70. *Id.* § 7525(a)(3)(B) (2012).

only communications involving federal tax matters can be protected by section 7525.⁷¹ However, the statute simply sidesteps the tricky case law delineation between privileged “tax advice” and matters falling within the scope of the Return Preparation Exception. Nonetheless, brighter line guidance is provided to prohibit application of FATP in the context of criminal tax matters and tax shelters.⁷²

Because of existing confusion about the parameters of the Return Preparation Exception, some courts have erroneously denied FATP protection to “tax advice.”⁷³ Such opinions have been heavily criticized as subsuming the FATP by applying an overly broad understanding of the Return Preparation Exception.⁷⁴ One such opinion was even internally inconsistent and contrary to the plain wording of section 7525.⁷⁵ It egregiously applied the Return Preparation Exception to deny FATP protection to “tax advice” from accountants while similar “tax advice” from a lawyer was not subject to the Return Preparation Exception and was protected by the attorney–client privilege.⁷⁶

By contrast, other courts have done a better job applying FATP. Illustratively, in the 2007 case, *United States v. Textron*, the taxpayer had asserted FATP to protect tax accrual workpapers.⁷⁷ The District Court for the District of Rhode Island provided helpful guidance in understanding the statutory term “tax advice”:

Since [the corporate taxpayer’s] tax accountants participated in advising Textron regarding its tax liability with respect to matters on which the law is uncertain and/or estimating the hazards of litigation percentages, they were performing “lawyers’ work.” Accordingly, that advice would qualify for the privilege conferred by § 7525(a).⁷⁸

Thus, per the District Court, FATP has application (and the Return Preparation Exception has no bearing) when a federally authorized tax practitioner advises a client about tax liability when the tax law is “uncertain.” By extension, “estimating the hazards of litigation” suggests the need for analysis of matters where the tax law is “uncertain” such that it is not clear how a court would rule. Thus, it seems more likely that the Return Preparation Exception might bar protection when the tax repercussions are undisputed and clear.

71. *Attorney–Client Privilege Applies to Communications with Accountants and Other Federally Authorized Practitioners*, 34 AM. JUR.2D, *Federal Taxation* ¶ 70053 (2012).

72. 26 U.S.C. § 7525(b) (2012).

73. *Doe v. Wachovia Corp.*, 268 F. Supp. 2d 627, 629–30 (W.D.N.C. 2003).

74. Pease-Wingenter, *supra* note 10, at 986.

75. *See United States v. KPMG LLP*, 237 F. Supp. 2d 35, 39 (D.D.C. 2002).

76. *Id.* at 40.

77. *United States v. Textron, Inc.*, 507 F. Supp. 2d 138, 148 (D.R.I. 2007).

78. *Id.*

In construing FATP, the Court of Federal Claims has also warned against overly broad applications of the Return Preparation Exception: Not “every communication from an attorney to his or her client is discoverable so long as it relates in any fashion to the preparation of a return.”⁷⁹ The court explained:

[C]ommunications offering tax advice or discussing tax planning have been held to be ‘legal’ communications protected by the attorney–client privilege These rulings, which recognize that preparing a return is not all a matter of mechanics and mathematics, serve to effectuate one of the main purposes of the privilege, that is, to encourage clients to “make well-informed legal decisions and conform their activities to the law.”⁸⁰

Again, the Court of Federal Claims seems to limit the Return Preparation Exception to situations when advice to prepare a return is “a matter of mechanics and mathematics.” In other words, the Exception seems to bar protection when the federally authorized tax practitioner is consulted to perform mechanical tasks (e.g., copying numbers from pre-existing client documents) or performing mathematical computation (e.g., summing expenditures to determine the amount of deductions permissible). By contrast, when the federally authorized tax practitioner is consulted to opine on the appropriate application of tax law to a particular client fact pattern, then FATP applies.

These cases interpreting section 7525 can also be helpful in understanding the proper scope of the Return Preparation Exception in the context of the attorney–client privilege. Because the FATP is generally supposed to be co-extensive with the attorney–client privilege, a well-developed explanation of the Return Preparation Exception in the section 7525 context also has application in construing the federal attorney–client privilege.

C. Waiver

Having described when the attorney–client privilege and the FATP initially attach, the next critical issue becomes determining when the protections of such privileges might thereafter be lost. If privilege attaches to protect certain communications, that protection is not necessarily permanent. Indeed, the final element of Professor Wigmore’s formulation of privilege is “except the protection be waived.”⁸¹ Moreover, once a waiver occurs, it is permanent, and the

79. *Evergreen Trading, LLC v. United States*, 80 Fed.Cl. 122, 130 (2007).

80. *Id.* at 130–31.

81. *Jicarilla Apache Nation v. United States*, 88 Fed.Cl. 1, 7 (2009).

protections of privilege cannot ever be regained.⁸² The permanence of waiver makes it critical to understand how it occurs.

“Actual waiver” of privilege involves the disclosure of confidential communications to third parties.⁸³ This can occur various ways. Privileged communications can be disclosed orally⁸⁴ or in writing.⁸⁵ In the digital age, disclosure via social media is even a possibility.⁸⁶ Moreover, even if a privileged communication is not explicitly conveyed to a third party, actual waiver can still be deemed to occur.⁸⁷ Merely allowing the public access to a privileged communication is considered a type of disclosure.⁸⁸

For purposes of actual waiver, third parties can include various persons such as a testifying expert,⁸⁹ an attorney not advising on the case at hand,⁹⁰ and an employee of an unrelated company.⁹¹ Significantly, a representative of a governmental agency can also be a third party for purposes of actual waiver.⁹² Thus, a disclosure to the IRS can trigger an actual waiver.

It should be noted that sometimes actual waiver occurs even if the recipient of the disclosure is not a true third party. For example, corporations can be a “client” for purposes of attorney–client privilege, but dissemination of an attorney’s legal advice among employees is generally limited to those employees on a “need to know” basis.⁹³ Thus, a corporate client can waive privilege by disseminating privileged communications to other employees without such need.⁹⁴

82. David M. Greenwald, *Protecting Confidential Legal Information: A Handbook for Analyzing Issues Under the Attorney–Client Privilege and the Work Product Doctrine*, 862 PLI/Lit 307, 417 (2011) (citing *Reitz v. City of Mt. Juliet*, 680 F. Supp. 2d 888, 894–95 (M.D. Tenn. 2010) (“Once the privilege is waived, waiver is complete and final.”)).

83. *Id.*; Long-Term Capital Holdings, No. 3:01 CV 1290, 2002 WL 31934139, slip op. at *2–3 (D. Conn. Feb. 14, 2003) (describing disclosure of confidential communications as triggering an “actual waiver”).

84. See *United States v. Evans*, 113 F.3d 1457, 1462 (7th Cir. 1997).

85. See *Jonathan Corp. v. Prime Computer, Inc.*, 114 F.R.D. 693, 697 (E.D. Va. 1987); *Bowles v. Nat’l Ass’n of Home Builders*, 224 F.R.D. 246, 254–55 (D.D.C. 2004).

86. See *Lenz v. Universal Music Corp.*, No. C 07-03783 JF (PVT), 2010 WL 4286329, slip op. at *3–5 (N.D. Cal. Oct. 22, 2010) (plaintiff waived the privilege by disclosing her legal strategies and motivation for pursuing the action on her blog and through emails and Gmail Chat conversations).

87. See *Waste Mgmt., Inc. v. Int’l Surplus Lines Ins. Co.*, 596 N.E.2d 726, 730 (Ill. App. Ct. 1992).

88. See *id.*

89. See *In re Omeprazole Patent Litig.*, 227 F.R.D. 227, 231 (S.D.N.Y. 2005).

90. *United States v. Evans*, 113 F.3d 1457, 1462 (7th Cir. 1997).

91. *Jonathan Corp. v. Prime Computer, Inc.*, 114 F.R.D. 693, 697 (E.D. Va. 1987).

92. See *Maday v. Pub. Libraries of Saginaw*, 480 F.3d 815, 821 (6th Cir. 2007) (disclosure to a social worker waives privilege).

93. Greenwald, *supra* note 82, at 423.

94. *Byrnes v. Jetnet Corp.*, 111 F.R.D. 68, 72 (M.D.N.C. 1986).

The elements of privilege provide the underlying rationale for finding actual waiver in cases of disclosure. For privilege to attach initially, one of Wigmore's elements is that the communication must be "made in confidence." Courts have explained that a subsequent disclosure is inconsistent with such confidentiality and triggers waiver.⁹⁵

In addition to actual waiver triggered by *disclosures* of privileged communications, certain *uses* of privileged materials can trigger an "implied waiver."⁹⁶ For example, this occurs when a client puts privileged communications at issue in a case.⁹⁷ If a client asserts reliance on advice of counsel as a defense in litigation, the attorney's advice becomes an issue in the case such that privilege is impliedly waived.⁹⁸ Similarly, if a client sues her attorney for malpractice, the attorney's advice is considered to be placed at issue and an implied waiver has occurred.⁹⁹

Sometimes a client affirmatively takes action with the intent of waiving privilege. Other times the waiver is not intentional. As one might imagine, the former is less common than the latter.¹⁰⁰ Because privilege is such a powerful protection, clients rarely desire to relinquish it. Few published cases involve a client's affirmative decision to waive privilege.¹⁰¹ Such cases tend to involve the client receiving (or

95. *In re von Bulow*, 828 F.2d 94, 101 (2d Cir. 1987) ("Moreover, it is the client's responsibility to insure continued confidentiality of his communications. In *In re Horowitz*, 482 F.2d 72 (2d Cir.), cert. denied, 414 U.S. 867, 94 S.Ct. 64, 38 L.Ed.2d 86 (1973), Judge Friendly, speaking for the Court, warned: [i]t is not asking too much to insist that if a client wishes to preserve the privilege under such circumstances, he must take some affirmative action to preserve confidentiality.' *Id.* at 82.").

96. *Long-Term Capital Holdings v. United States*, No. 3:01 CV 1290, 2002 WL 31934139, slip op. at *4 (D. Conn. Oct. 30, 2002) ("An 'implied waiver [of the attorney-client privilege] may be found where the privilege holder asserts a claim that *in fairness* requires examination of protected communications.' *In re Grand Jury Proceedings*, 219 F.3d 175, 182-83 (2000). For example, 'a party who voluntarily asserts an advice-of-counsel defense is deemed to have waived its privilege with respect to the advice received.'").

97. *New Phoenix Sunrise Corp. v. Commissioner*, 408 Fed. Appx. 908, 919 (6th Cir. 2010).

98. Thomas M. Geisler, Jr., *Proof of Waiver of Attorney-Client Privilege*, 32 AM. JUR. 3D *Proof of Facts* 189 (2012) ("A party claiming an implied or at issue waiver of attorney-client privilege must make some showing that the opposing party relies on the privileged communication as a claim or defense or as an element of a claim or defense.").

99. See, e.g., *United States v. Woodall*, 438 F.2d 1317, 1324 (5th Cir. 1971) (en banc); see also *Aurora Loan Servs., Inc. v. Posner, Posner & Assocs., P.C.*, 499 F. Supp. 2d 475, 478 (S.D.N.Y. 2007).

100. PAUL R. RICE, 2 ATTORNEY-CLIENT PRIVILEGE IN THE UNITED STATES § 9:21 (2012) (describing the reality that waiver occurs based on client conduct, which may not reflect client intent, the author observes that "[i]f an intention to waive were required, waiver would seldom result from clients' disclosures").

101. See, e.g., *Fernandez v. United States*, No. 01-CV-3, 2001 WL 1682858, slip op. at *6 (S.D. Ohio Aug. 1, 2001) (To prove up his ineffective assistance of counsel defense on appeal, the petitioner affirmatively waived in writing his attorney-client privilege with respect to trial counsel); see also *Smith v. United States*, 337 U.S. 137, 151 (1949) (The Court pragmatically noted the low likelihood that the petitioner would waive a valuable evidentiary privilege without being offered something equally valuable in exchange, i.e., protection against prosecution).

attempting to receive) some type of benefit from the decision to waive.¹⁰² However, particularly in the tax setting, where the privilege rules have long been so confused, an unintended waiver due to misunderstanding of the confused rules is a real possibility and a frequent concern of practitioners and clients.

It should be noted that not all unintended disclosures necessarily result in the loss of privilege protection. For example, a party may inadvertently provide an adversary with privileged documents in response to large discovery requests.¹⁰³ When there has been such an inadvertent disclosure of a privileged communication, taking reasonable steps can cure the would-be waiver under certain circumstances.¹⁰⁴ However, a failure to make a timely objection to the disclosure will result in a waiver.¹⁰⁵

In the tax context, however, taxpayers do not necessarily make such inadvertent disclosures very often. Indeed, in the United States Tax Court, the discovery process is considered less burdensome than in most civil litigation.¹⁰⁶ Instead, it is more common that taxpayers and their advocates do not realize they have triggered a waiver because the tax privilege rules have been so confused. As a result, it becomes critical to determine the extent of a waiver after it has occurred.¹⁰⁷

Traditionally, the disclosure or use of privileged communications has not merely resulted in a waiver of those specific communications; rather, there are much wider repercussions.¹⁰⁸ The waiver is deemed to extend to all communications regarding the same subject matter.¹⁰⁹ Such “subject matter waiver” can force the client to provide previously non-disclosed documents on the same subject matter and testimony can be compelled on the same subject matter.¹¹⁰

The alternative to subject matter waiver would be “selective waiver” of only whatever has been disclosed or used inappropriately.¹¹¹

102. *Smith*, 337 U.S. at 151.

103. Greenwald, *supra* note 82, at 437.

104. *Id.* (citing RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 79).

105. *Id.* (citing *Large v. Our Lady Of Mercy Med. Ctr.*, No. 94 Civ. 5986, 1998 WL 65995, slip op. at *4 (S.D.N.Y. Feb. 17, 1998); *FDIC v. Ernst & Whinney*, 137 F.R.D. 14, 19 (E.D. Tenn. 1991) and *Byers v. Burleson*, 100 F.R.D. 436, 440 (D.D.C. 1983)).

106. Cym H. Lowell & Jack P. Governale, *Involvement of IRS Attorneys*, U.S. INT'L TAX: PRAC. & PROC. ¶ 5.03 (2012) (describing the “carefully circumscribed rules of the Tax Court with respect to discovery”).

107. Seraganian, *supra* note 1, at 35.

108. Greenwald, *supra* note 82, at 427.

109. *Id.*

110. Roberta M. Harding, “Show and Tell”: *An Analysis of the Scope of the Attorney–Client Waiver Standards*, 15 REV. LITIG. 367, 388 (1995); *Developments in the Law—Privileged Communications*, 98 HARV. L. REV. 1629, 1633 (1985).

111. RICE, *supra* note 100, § 9:81.

However, courts have prevented clients from using this approach.¹¹² Their rationale is based on concerns of fairness.¹¹³ If a client could choose to waive some—but not all—communications on a particular subject matter, she could use helpful privileged communications as a “sword” but hide damaging communications behind the “shield” of privilege.¹¹⁴

Because subject matter waiver is the general rule, the definition of the waived subject matter is critical in determining which other communications are no longer protected. Defining the waived subject matter is dependent on the “nature and context of the disclosure, the resulting advantages to the client and disadvantages to the adversary, and of course the objectives of the attorney–client privilege.”¹¹⁵ In weighing these factors, fairness is an overriding consideration in determining the extent of the subject matter waiver.¹¹⁶ This approach fails to provide bright line precision, and leaves the courts with much discretion.¹¹⁷

Nonetheless, as a general matter, the courts tend to take a fairly narrow approach in defining the waived subject matter.¹¹⁸ Matters not explicitly addressed in the disclosed communications are typically not considered to be a part of the waived subject matter.¹¹⁹ However, due to the fact-specific nature of the inquiry, it is difficult to predict outcomes.¹²⁰

One last point about waiver is worth re-emphasizing. A waiver presupposes that privilege initially attached to protect the

112. *Id.*

113. *Id.*

114. *Id.*; see also, e.g., *Ross v. City of Memphis*, 224 F.R.D. 411, 413 (W.D. Tenn. 2004); *United States v. Bilzerian*, 926 F.2d 1285, 1292 (2d Cir. 1991).

115. RICE, *supra* note 100, § 9:83.

116. Seraganian, *supra* note 1, at 35 (“The scope of waiver appears to be determined case by case and largely by reference to considerations of fairness. An assessment of fairness in this context requires a delicate balancing of competing interests. On one hand, consideration is given to the notion that the integrity of the adversarial process would be impaired if a client were entitled to selectively disclose certain advantageous elements of a confidential communication when doing so would advance the client’s case against its adversary, while at the same time asserting privilege in respect of related communications that would be damaging to the client. On the other hand, consideration of fairness also appears to take into account that, where a client is not seeking to selectively disclose certain elements of privileged communications in a self-serving manner, waiver of excessively wide scope may constitute an unjustifiable advantage for the client’s adversary.”).

117. *Id.* at 39 (“They also strongly suggest that determinations regarding the scope of waiver in any particular case touch raw policy nerves and are not susceptible to resolution by broad rules of general application. Rather, it seems that decisions about the appropriate breadth of a waiver of privilege require careful balancing and adjudication case by case.”).

118. RICE, *supra* note 100, § 9:83; Harding, *supra* note 110, at 388.

119. RICE, *supra* note 100, § 9:83.

120. *Id.*

communications at issue.¹²¹ Indeed, in Wigmore's formulation, initial confidentiality and subsequent waiver are separate elements.¹²² If a communication with a tax practitioner was not initially made in confidence, then privilege never attached in the first place, such that a subject matter waiver is just not possible.¹²³ This point is sometimes lost when courts write with imprecision in their published opinions; they blur the line between initial lack of confidentiality and subsequent loss of confidentiality.¹²⁴ But this point can have huge repercussions to clients who may or may not be forced to divulge previously undisclosed confidential communications due to application of subject matter waiver principles.

Moreover, this is particularly a critical legal nuance to explore in the tax setting where there can be much confusion as to whether privilege ever attaches initially.¹²⁵ Because of that confusion, there is a risk that parties may jump prematurely to assertions and analysis of subject matter waiver. However, it must be remembered that not until it has been determined that the basic elements of privilege are satisfied is it ever appropriate to move to an analysis of whether there has been a waiver, and a determination of the possible scope of a subject matter waiver.

III. IMPORTANT WAIVER CASES IN THE TAX CONTEXT

Part III will summarize five particularly influential cases that illustrate the application of waiver principles in the tax setting. A 2002 case from the United States District Court for the District of Connecticut, *Long-Term Capital Holdings v. United States*, discussed the impact of disclosures to return preparers.¹²⁶ The Eighth Circuit's 1972 opinion, *United States v. Cote*, has been an important precedent for

121. See, e.g., *Bouschor v. United States*, 316 F.2d 451, 457 (8th Cir. 1963).

122. *In re Dow Corning Corp.*, 261 F.3d 280, 287 (2d Cir. 2001).

123. *In re Grand Jury Subpoena Duces Tecum*, 731 F.2d at 1037 (2d Cir. 1984) ("If confidentiality were not intended, of course, the privilege would not attach . . . Confidentiality may also, of course, be waived; but we see no indication that a waiver has yet occurred.")

124. See, e.g., *United States v. Frederick*, 182 F.3d at 500-01 ("It is true that if the client transmitted the information so that it might be used on the tax return, such a transmission destroys any expectation of confidentiality. That is, the transmittal operates as a waiver of the privilege.") (internal citations omitted); *Bernado v. Commissioner*, 104 T.C. 677, 686 (1995) ("Materials provided by a taxpayer to his attorney for tax preparation purposes are intended to be disclosed to the IRS in the taxpayer's return. Consequently, under such circumstances, the taxpayer is considered to have waived the attorney-client privilege as to such information.")

125. Seraganian, *supra* note 1, at 34-35.

126. See *Long-Term Capital Holdings v. U.S.*, No. 3:01 CV 1290, 2002 WL 31934139, slip op. at *4-5 (D. Conn. Oct. 30, 2002), *on reconsideration in part*, *Long-Term Capital Holdings v. United States*, No. 3:01 CV 1290, 2003 WL 1548770 (D. Conn. 2002).

the privilege repercussions of filing a tax return.¹²⁷ Two different cases have been important to understanding the effect of sharing tax reserve materials with independent auditors: the Fifth Circuit's 1982 opinion in *United States v. El Paso Company* and the United States District Court for the District of Rhode Island 2007 opinion in *United States v. Textron, Inc.*¹²⁸ Finally, the District Court for the District of New Jersey's 2003 opinion *In re G-I Holdings Inc.*, is a critical illustration of the impact of reliance on counsel defenses.¹²⁹ Each of these cases will be discussed in turn.

A. Disclosures to Return Preparers (and the IRS): Long-Term Capital Holdings v. United States (2002)

Long-Term Capital Holdings v. United States was a 2002 United States District Court for the District of Connecticut opinion.¹³⁰ With regard to related transactions, a taxpayer had secured one legal opinion from Shearman and Sterling (S&S) and a separate legal opinion from King and Spalding (K&S).¹³¹ To facilitate preparation of its tax return, the taxpayer had told the return preparer the conclusion of the K&S opinion.¹³² The taxpayer was later audited.¹³³ During the "IRS's administrative proceedings," the taxpayer produced the S&S legal opinion.¹³⁴ The case involved the IRS's attempt to compel production of the K&S opinion over the taxpayer's assertion of attorney-client privilege.¹³⁵

The IRS had two main theories to support its position that the taxpayer had waived privilege with regard to the K&S opinion. First, the IRS alleged that waiver occurred with respect to the K&S opinion because the taxpayer had "disclos[ed] the substance of that opinion to its tax accountant."¹³⁶ The K&S opinion itself concluded that it was "more likely than not" that the taxpayer could take a particular tax deduction

127. See *United States v. Cote*, 456 F.2d 142, 145 (8th Cir. 1972).

128. *United States v. Textron, Inc.*, 507 F. Supp. 2d 138, 151 (D.R.I. 2007); *United States v. El Paso Co.*, 682 F.2d 530, 540 (5th Cir. 1982).

129. *In re G-I Holdings Inc.*, 218 F.R.D. at 432, 433 (D. N.J. 2003).

130. *Long-Term Capital Holdings*, No. 3:01 CV 1290, 2002 WL 31934139, slip op. at *2-3 (D. Conn. Feb. 14, 2003) (describing disclosure of confidential communications as triggering an "actual waiver").

131. *Id.* at *1.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.* at *1-2.

136. *Id.* at *2.

on its tax return.¹³⁷ The taxpayer did not give the legal opinion itself to its tax accountant, but to enable the tax accountant to prepare the taxpayer's return, the taxpayer did "disclose the gist or substance of the opinion" to him.¹³⁸

Interestingly, the court explicitly noted the motivation of the taxpayer in securing the legal opinion was "in part, to identify whether it could take the deduction."¹³⁹ This language seems to suggest the K&S opinion was sought to help determine the taxpayer's return position. As a result, it seems predictable that the taxpayer would have need to share the "gist or substance of the opinion" with the taxpayer's return preparer. Thus, one should logically question whether there was ever actual intent for confidentiality such that privilege would attach initially.

Nonetheless, the court never explored this critical preliminary issue and simply jumped prematurely to a discussion of waiver. The court stated that the taxpayer's "disclosure of the 'more likely than not' language to its accountant is a disclosure of the gist of the opinion, and therefore weighs in favor of a finding that the attorney-client privileged was waived."¹⁴⁰

The court elaborated that the taxpayer's statement to its accountant was "more than just a general reference to the fact that [the taxpayer] had sought legal advice from K&S."¹⁴¹ Instead, the taxpayer's disclosure "referred directly to the advice received."¹⁴² The accountant who prepared the taxpayer's return testified that the taxpayer's lawyer told him that they had a K&S opinion "upon which they would rely" because it opined that it was "'more likely than not' that the loss [could] be taken."¹⁴³ The court stated the "specificity of this disclosure [to the return preparer] weighs in favor of a finding of waiver."¹⁴⁴

A second theory that the IRS asserted was that a waiver of privilege to the S&S opinion triggered a subject matter waiver extending to the K&S opinion.¹⁴⁵ The taxpayer initially disputed this by claiming the S&S opinion was never protected by privilege.¹⁴⁶ However, the S&S opinion itself indicated that it was a legal opinion in response to the taxpayer's request for advice.¹⁴⁷ Additionally, the taxpayer had

137. *Id.* at *3.

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.* at *7.

142. *Id.* at *7.

143. *Id.* at *3 n.10.

144. *Id.* at *7.

145. *Id.* at *2.

146. *Id.*

147. *Id.* at *5.

originally withheld the S&S opinion from the IRS by asserting attorney–client privilege.¹⁴⁸ From this record, the court quickly concluded the S&S opinion was privileged.¹⁴⁹

However, this is rather a remarkable conclusion with questionable legitimacy. In other cases, privilege labeling has been given little or no credence.¹⁵⁰ Further, a taxpayer’s own assertion of privilege is hardly dispositive of whether privilege actually attaches.¹⁵¹ Before jumping ahead to waiver, the court should have analyzed in greater depth whether privilege had ever attached to the S&S opinion.

The taxpayer asserted alternatively that if the S&S opinion was privileged, it was not of the same subject matter as the K&S opinion.¹⁵² The taxpayer’s alternative theory was that a waiver of the S&S opinion had no impact on the privilege protection of the K&S opinion because they involved different subject matter.¹⁵³ In effect, this alternative was premised not on a denial that a waiver of S&S had occurred, but was dependent on a narrow definition of the waived subject matter.

The court also found this alternative unpersuasive. The taxpayer had asserted that the S&S opinion concerned the impact of lease transactions on the tax basis of certain stock contributed to a partnership, and the K&S opinion provided advice on “certain partnership tax issues.”¹⁵⁴ The court found the taxpayer’s distinction “insubstantial” because the issues were intertwined and addressed “the same overarching issue.”¹⁵⁵ The court concluded that the taxpayer’s production of the S&S opinion, which related to the issue discussed in the K&S opinion, “weighs in favor of a finding that the attorney–client privilege was waived” with respect to the K&S opinion.¹⁵⁶ The court emphasized that the taxpayers made a “deliberate decision” to disclose the S&S opinion “in a forum where disclosure was voluntary and was calculated to their benefit.”¹⁵⁷

Ultimately, the court held the taxpayers waived attorney–client

148. *Id.*

149. *Id.*

150. *See, e.g.,* *Chevron U.S.A., Inc. v. United States*, 83 Fed.Cl. 313, 321–22 (Fed. Cl. 2008).

151. *United States v. Willis*, 565 F. Supp. 1186, 1204 (S.D. Iowa 1983) (“The burden of establishing the privilege is on the party asserting it; this burden extends to all the essential elements of the privilege, including the elements of confidentiality and nonwaiver of privilege A party’s bare assertion that it intended the documents to be confidential does not satisfy the burden Similarly, a party’s bare assertion that it did not intend to waive the privilege is an insufficient showing to meet its burden.”) (internal citations omitted).

152. *See Long-Term Capital Holdings v. United States*, No. 3:01 CV 1290, 2002 WL 31934139, slip op. at *2 (D. Conn. Oct. 30, 2002).

153. *Id.*

154. *Id.* at *5.

155. *Id.*

156. *Id.*

157. *Id.* at *6.

privilege, but did not compel production of the K&S opinion because there were still separate lingering work product doctrine claims to analyze.¹⁵⁸ Due to an amended record, the court also issued a later opinion in the same case, which modified slightly its analysis under somewhat extraordinary circumstances.¹⁵⁹

B. Filing a Tax Return: *United States v. Cote (1972)*

In 1972, the United States Court of Appeals, Eighth Circuit, issued *United States v. Cote*.¹⁶⁰ The case involved the IRS's attempt to enforce a summons issued to Donald Cote and Thomas Murphy, a certified public accountant and lawyer, respectively.¹⁶¹ The taxpayers, John and Evelyn Erickson had employed Cote as a return preparer for years.¹⁶² When the Ericksons were audited, Cote referred them to an attorney named Murphy, who in turn retained Cote to "audit" the taxpayers' books and records.¹⁶³ Because of information revealed in Cote's audit, Murphy ultimately advised the Ericksons to file amended returns for several years.¹⁶⁴

After these returns were filed, a special agent of the IRS summoned Cote to "appear as a witness and produce all workpapers used in preparing both the original and amended returns."¹⁶⁵ Cote refused, claiming the workpapers were "in the possession and control" of Murphy.¹⁶⁶ A similar summons was then issued to Murphy.¹⁶⁷ In response, Murphy produced a copy of one original return and asserted privilege as to the underlying workpapers.¹⁶⁸

The summons dispute was litigated in the United States District Court for the District of Minnesota.¹⁶⁹ The trial court ruled that the workpapers supporting the *original* returns had to be produced.¹⁷⁰ That ruling was not disputed on appeal.¹⁷¹ The only issue before the Eighth

158. *Id.* at *9.

159. *Long-Term Capital Holdings v. United States*, No. 3:01 CV 1290, 2003 WL 1548770, slip op. at *10 (D. Conn. Feb. 14, 2003).

160. *United States v. Cote*, 456 F.2d 142 (8th Cir. 1972).

161. *Id.* at 143–44.

162. *Id.* at 143.

163. *Id.*

164. *Id.*

165. *Id.* at 144.

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.* at 142.

170. *Id.* at 144.

171. *Id.*

Circuit was whether the attorney–client privilege extended to the Cote’s work memoranda used in preparing the *amended* returns.¹⁷²

The Eighth Circuit’s analysis began by observing that the trial court held “privilege did not attach” to the amended return workpapers because Cote was not under the direct control of Murphy, and Cote’s workpapers were not prepared to assist counsel in giving legal advice.¹⁷³ Analyzing the facts of Cote’s work with Murphy, the Eight Circuit concluded that “the accountant’s aid to the lawyer preceded the [legal] advice and was an integral part of it.”¹⁷⁴ The court announced that the proper standard was “whether the accountant’s services are a necessary aid to the rendering of effective legal services to the client.”¹⁷⁵ However, the Eighth Circuit’s opinion was not explicit as to what the legal relevance of this relationship was.

Though it was not clear the precise legal issue that the new standard analyzed, the next paragraph announced:

Notwithstanding our recognition that the attorney–client privilege attached to the information contained in the accountant’s workpapers under the circumstances existing here, we find that by filing the amended returns the taxpayers communicated, at least in part, the substance of that information to the government, and they must now disclose the detail underlying the reported data. A client may waive the privilege which protects what he earlier confided to his attorney or his attorney to him.¹⁷⁶

Thus, in a somewhat cryptic fashion, the court apparently provided analysis determining that privilege attached initially to Cote’s amended return workpapers, but also concluded the filing of the amended returns waived the privilege. To support its waiver holding, the court provided just three sentences of analysis:

Here, Cote, the accountant, testified that the information on his workpapers was later transcribed onto the amended returns which were filed by the taxpayers with the government. This disclosure effectively waived the privilege not only to the transmitted data but also as to the details underlying that information. As stated in *United States v. Tellier*, [t]he privilege attaches to the substance of a communication and not to the particular words used to express the communication’s content.¹⁷⁷

The Eighth Circuit’s opinion was very brief, but it has been very influential on other courts.¹⁷⁸ Because it has been cited so widely, it is

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.* at 144–45.

177. *Id.* at 145 (internal citations omitted).

178. *United States v. Cote* has been cited in over 600 publicly available court opinions, court

important to examine in greater depth what exactly was decided in this concise opinion.

First, it should be noted the waiver was triggered in *Cote* because an accountant transferred “data” from his worksheets to the amended return, which was then filed.¹⁷⁹ Typically, privilege would never even apply to such documentation.¹⁸⁰ An accountant’s workpapers are generally not within the scope of the attorney–client privilege.¹⁸¹ Indeed, even after enactment of section 7525, such return preparation workpapers are not even within the scope of FATP.¹⁸²

Cote involved a highly unusual fact pattern where an attorney hired an accountant to gather factual information to help determine whether amended returns were necessary.¹⁸³ It was a fluke that privilege ever initially attached in the *Cote* facts such that waiver was properly at issue in the case. As a result, absent similarly unique facts bringing return preparation materials into the scope of the attorney–client privilege, it would be inappropriate to cite *Cote* as broad precedent for waiver.

Indeed, the Eighth Circuit explicitly warned against such possible over-reading of *Cote*.¹⁸⁴ In Footnote 3, the court noted that “[i]n tax cases waiver is often not even an issue since the privilege is said not to attach to information which the taxpayer intends his attorney to report in the contents of a tax return.”¹⁸⁵ To support this warning, the Eighth Circuit cited a long list of other influential opinions involving tax returns and analogous filings in nontax settings.¹⁸⁶

Moreover, the Eighth Circuit provided another strong warning in Footnote 4 of its opinion.¹⁸⁷ The court instructed that future disputes as

documents, administrative materials and secondary sources. Search of Westlaw, KeyCite (May 17, 2012).

179. *Cote*, 456 F.2d at 145.

180. *United States v. Baucus*, Civil No. 2984, 1971 WL 495, at *13 (D. Mont. 1971) (“While it is true that communications not intended to be confidential are not within the privilege, petitioners’ argument is too broad. The work papers contain only raw data which Baucus used to prepare the returns and in this respect they are analogous to a client interview . . . as long as adequate means exist to compel Baucus to disclose the non-confidential matter, he should not be required to produce direct communications from his client because of the danger that confidential matter will also be revealed.”); *Canaday v. United States*, 354 F.2d 849, 857 (1966) (privilege does not attach when the return preparer acts merely as a “scrivener”).

181. Francis M. Dougherty, *Privileged Communications Between Accountant and Client*, 33 A.L.R. 4TH 539 § 8 (citing *United States v. Kelly*, 311 F.Supp 1216 (E.D. Pa. 1969)).

182. *United States v. Arthur Andersen, L.L.P.*, 273 F. Supp. 2d 955, 958 (N.D. Ill. 2003) (documents communicated or generated for the purpose of preparing a tax return are not within the scope of section 7525).

183. *Cote*, 456 F.2d at 143.

184. *Id.* at 143 n.4.

185. *Id.* at 143 n.3.

186. *Id.*

187. *Id.* at 143 n.4.

to whether particular workpapers contained “*unpublished* expressions which are not part of the data revealed on the tax returns” were to be submitted to the court for in camera rulings.¹⁸⁸ The court explained this instruction:

Too broad an application of the rule of waiver requiring unlimited disclosure by reason of filing an income tax return might tend to destroy the salutary purposes of the privilege which invite confidentiality between the attorney and client. Such a rule is unnecessary to the recognition of the above principles. *See Colton v. United States*, which specifically withholds disclosure of memoranda and worksheets to the extent they contain confidential data not already published on the tax return.¹⁸⁹

Finally, it should also be noted the unusual nature of the waived subject matter. The taxpayers consulted the attorney, Murphy, only after they learned the IRS was auditing them.¹⁹⁰ Murphy then hired the accountant, Cote, to “conduct an audit of taxpayers’ books and records,” the results of which led Murphy to advise the taxpayers to file the amended returns.¹⁹¹ The IRS sought first from Cote and then from Murphy “all workpapers used in preparing both the original and amended returns.”¹⁹² Thus, it appears the lawyer, whose involvement prompted the privilege claim, actually had a very limited role.

Murphy had never been involved in any tax planning. It appears he was representing the taxpayers before the IRS in the audit, but the scope of the taxpayers’ consultation is not clear in the Eighth Circuit’s opinion. It does not appear that he did much for the taxpayers other than direct Cote to audit their books and record; his sole advice to the taxpayers seems to be to file amended returns. Perhaps not surprisingly, the IRS had not summoned Murphy to testify or produce privileged communications. Instead, the IRS merely sought from the attorney the return preparation workpapers that the accountant had prepared and then given to Murphy.¹⁹³ There was no claim of a subject-matter waiver giving the IRS access to Murphy’s written correspondence with the taxpayers or Cote. The IRS was not seeking to depose Murphy to ask him to reveal confidential communications with his clients. At issue were simply return preparation workpapers that would not have been privileged in most other situations.¹⁹⁴

188. *Id.*

189. *Id.* (internal citations omitted.)

190. *Id.* at 143.

191. *Id.*

192. *Id.* at 144.

193. *Id.*

194. *Id.*

Nonetheless, other courts have failed to heed the Eighth Circuit's warnings and have read *Cote* to more broadly permit a subject matter waiver of all attorney communications relating to any matters incorporated in a filed tax return.¹⁹⁵

C. Disclosure to Independent Auditors

Two important waiver cases involve independent auditors. The first was poorly reasoned, but was decided by an appellate court and has been influential for decades.¹⁹⁶ The second was issued just a few years ago by a district court, but it provides much clearer analysis for future cases.¹⁹⁷

1. *United States v. El Paso Company* (1982)

In 1982, the United States Court of Appeals, Fifth Circuit, issued its opinion in *United States v. El Paso Company*.¹⁹⁸ The case involved an IRS summons seeking a corporate taxpayer's "tax-pool analysis."¹⁹⁹ The taxpayer refused to comply with the summons based on several legal theories including attorney-client privilege.²⁰⁰ The United States District Court for the Southern District of Texas entered a judgment enforcing the summons.²⁰¹ The taxpayer then appealed to the Fifth Circuit, which affirmed.²⁰²

The summoned analysis (a.k.a. "the noncurrent tax account, the tax

195. See, e.g., *In re Grand Jury Investigation (Schroeder)*, 842 F.2d 1223, 1225–26 (11th Cir. 1987); *United States v. Windfelder*, 790 F.2d 576, 579 (7th Cir. 1986); *United States v. Willis*, 565 F. Supp. 1186, 1192, 1203–04 (S.D. Iowa 1983). Despite indicating that privilege did not attach to information the client conveyed to the attorney that the attorney ultimately included in the filed return, the district court also noted it did not "intend to alter or eliminate the established principle that disclosure of information via submission of a tax return effects a waiver as to the details underlying the information reported." *Id.* at 1193. The court later stated:

Where the privilege is claimed regarding tax documents, the party asserting the privilege has a difficult burden to meet. A good deal of information transmitted to an attorney by a client for tax return preparation is not intended to be confidential; rather, it is given to the attorney to be transmitted to others—"for example, for inclusion in the tax return. Such information is, of course, not privileged."

Id. at 1204. In addition, filing tax returns with the IRS constitutes a waiver of the privilege "not only to the transmitted data but also as to the details underlying that information"); *United States v. Lawless*, 709 F.2d 485, 488 (7th Cir. 1983).

196. See *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982).

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

198. *El Paso Co.*, 682 F.2d 530.

199. *Id.* at 532.

200. *Id.* at 533.

201. *Id.* at 532.

202. *Id.*

accrual work papers, and the tax pool analysis”) was a “summary” of the taxpayer’s “contingent liability for additional taxes should it ultimately be determined that [the taxpayer] owed more taxes than indicated on its return.”²⁰³ The purpose of the tax pool analysis was “solely to insure that the corporation sets aside on its balance sheet a sufficient amount to cover contingent tax liability.”²⁰⁴ The analysis was not used in preparing a return and was not a “source document of an actual transaction.”²⁰⁵ It was created to support the taxpayer’s financial accounting, not to report its tax liability.²⁰⁶

The Fifth Circuit’s discussion of privilege included several initial paragraphs to lay out the relevant legal principles.²⁰⁷ The court then devoted just one paragraph to address whether the tax-pool analysis was within the scope of the attorney–client privilege.²⁰⁸ The court articulated both reasons why the tax pool analysis might be privileged legal work, as well as reasons why it might instead be non-privileged accounting work.²⁰⁹ The court’s analysis of the applicability of privilege then concluded with the strange statement: “We need not decide this issue, however, because we believe that El Paso’s attempt to claim the privilege fails on other grounds.”²¹⁰ The next four paragraphs of the opinion are an analysis of waiver.²¹¹

In its analysis of waiver, the court explained that to “retain the attorney–client privilege,” confidentiality “must be preserved” and a “breach of confidentiality” waives the privilege.²¹² The court then noted that the taxpayer discussed with its independent auditors “some of the information and many of the potential tax liability issues” in the tax pool analysis.²¹³ The court elaborated: “Confidentiality as to these documents is neither expected nor preserved, for they are created with the knowledge that independent accountants may need access to them to complete the audit.”²¹⁴ The court concluded that the taxpayer’s “disclosure of the tax pool analysis to the auditors destroys confidentiality with respect to it. With the destruction of confidentiality

203. *Id.* at 532–33.

204. *Id.* at 535.

205. *Id.* at 535, 537.

206. *Id.* at 535.

207. *Id.* at 539.

208. *Id.* at 541.

209. *Id.*

210. *Id.* at 539.

211. *Id.* at 539–40.

212. *Id.* at 539.

213. *Id.* at 539–40.

214. *Id.* at 540.

goes as well the right to claim the attorney–client privilege.”²¹⁵ Because it could not view the taxpayer’s “discussion with its auditors as confidential,” the court then held that the “attorney–client privilege is, therefore, waived.”²¹⁶ The court then moved on to a separate issue for analysis.²¹⁷

El Paso was an incredibly sloppy opinion, which has unfortunately been quite influential on other courts.²¹⁸ Before fully analyzing or providing a conclusion on whether privilege ever attached to the tax pool analysis, the court jumped ahead to an examination of whether privilege was waived.²¹⁹ The court referenced a “breach” and a “destruction” of privilege,²²⁰ but there should have first been in-depth discussion of whether there was ever a privilege to breach or destroy. Indeed, the court emphasized that the tax pool analysis was created with an understanding that they would be shared with independent auditors.²²¹ Because it sheds doubt on whether there was initial confidentiality, this point alone should have been cause to consider whether privilege ever attached.

Moreover, the court’s waiver analysis was internally inconsistent. In the same sentence, the court described the taxpayer as having “neither expected nor preserved” confidentiality with regard to the tax pool analysis.²²² Those verbs carry very different connotations. If one creates a document without an expectation of confidentiality, then it is not a communication “made in confidence” as Wigmore’s formulation requires for privilege to attach. By the plain meaning of the word, one cannot preserve what never existed. If there was an initial lack of confidentiality there is no “protection [to] be waived.”

In his dissent, Judge Garwood tried valiantly to flag the majority’s flawed analysis and holding.²²³ He agreed that “*El Paso* failed to particularize its assertion of the [attorney–client] privilege and prove its case with respect to any specific document,” and on that ground he believed *El Paso*’s assertion of privilege should fail.²²⁴ Judge Garwood noted his concern with the majority’s waiver analysis:

215. *Id.*

216. *Id.* at 541.

217. *Id.* at 541–42.

218. Search of Westlaw, KeyCite (May 17, 2012). *United States v. El Paso Co.* has been cited nearly 2,000 times in publicly available cases, administrative materials, secondary sources and court documents.

219. See *El Paso Co.*, 682 F.2d at 539.

220. *Id.* at 539–40.

221. *Id.*

222. *Id.* at 540.

223. *Id.* at 545–51.

224. *Id.* at 549.

I am concerned, however, with the majority's holding that El Paso waived any possible attorney-client privilege. Not only is this holding unnecessary to the result reached, but this case presents a particularly unfortunate context within which to make such a determination of waiver. Because we really have no information whatever respecting any asserted attorney-client communication, determining whether the privilege in regard thereto has been waived is virtually impossible (which is another good reason to deny blanket assertions of the privilege).²²⁵

Because the taxpayer's assertion of privilege was so anemic, Judge Garwood believed it was not even possible on the record to determine whether privilege initially attached. The jump to the waiver issue was simply without solid foundation.

Moreover, Judge Garwood also criticized the overly broad scope of the majority's waiver finding:

But what of the supporting memoranda and items in the tax pool analysis that are not discussed with or shown to the auditors? (The evidence and findings below indicate such items exist, and indeed that a substantial number of the "subject files" fell into this category.) Moreover, even regarding a subject file or tax pool item that has been "discussed" with the auditors, the scope of the waiver would appear to depend on the scope of the discussion. Surely not every discussion relating to a topic included in a file mandates a waiver of the entirety of every item in that file. Footnote 18 in *United States v. Davis* is far too slender a reed to bear the full weight of such an extensive holding.²²⁶

To emphasize the overly broad analytical approach the majority took, Judge Garwood offered the following common sense analogy:

For example, a young man informs his mother that he was at the convenience store which was held up earlier in the evening. At her suggestion he sees Lawyer Jones, and on returning home his mother asks, "Did you tell Lawyer Jones you were at the store when it was held up?" He acknowledges that he did so. Has he thereby waived the privilege as to his entire conversation with Lawyer Jones respecting the occurrence at the store?²²⁷

With this simple analogy, Judge Garwood demonstrated the need for some principled parameters in declaring a waiver. A mere generalized mention of a topic to a third party cannot trigger a subject matter waiver of all details thereof without gutting the privilege. Such gutting would not be wise from a policy perspective.

With an ironic word choice, Judge Garwood concluded, "For these reasons I cannot accept the majority's *blanket* and unnecessary

225. *Id.* at 550.

226. *Id.*

227. *Id.* at n.16.

invocation of waiver of the attorney–client privilege in the context of this case.”²²⁸

Unfortunately, the majority did not heed Judge Garwood’s warning.

2. *United States v. Textron, Inc.* (2007)

Twenty-five years after the Fifth Circuit decided *El Paso*, there was another landmark opinion involving application of privilege to a tax pool analysis.²²⁹ *United States v. Textron, Inc.* was a 2007 opinion by the United States District Court for the District of Rhode Island.²³⁰ The IRS had sought to enforce a summons on the corporate taxpayer’s “tax accrual workpapers,” but the taxpayer refused to produce them.²³¹ The taxpayer asserted multiple theories, including application of attorney–client privilege, the FATP, and work product doctrine.²³² The court determined that the attorney–client privilege and FATP were “waived,” but due to application of the work product doctrine, the court ultimately denied the government’s petition to enforce the summons.²³³

The government appealed, but the First Circuit initially affirmed.²³⁴ After granting a rehearing *en banc*, the First Circuit vacated the District Court’s judgment and held that the tax accrual workpapers were not within the scope of the work product doctrine because there were not prepared in anticipation of litigation.²³⁵ Nonetheless, because the District Court’s holding on attorney–client privilege was not appealed, it was not disturbed by the First Circuit’s subsequent opinion.²³⁶ Significantly, the District Court’s precedent on attorney–client privilege is still good law.²³⁷

The District Court’s conclusion with regard to privilege was similar to that of the Fifth Circuit’s in *El Paso*, but *Textron*’s analysis is much clearer and more thorough. It provides stronger, better-articulated precedent on the same issue.

The District Court provided five solid paragraphs analyzing whether

228. *Id.* at 551 (emphasis added).

229. *United States v. Textron, Inc.*, 507 F. Supp. 2d 138, 141 (D.R.I. 2007).

230. *Id.* at 141.

231. *Id.*

232. *Id.* at 142–46.

233. *Id.* at 152–55.

234. *United States v. Textron, Inc.*, 553 F.3d 87 (1st Cir. 2009).

235. *United States v. Textron, Inc.*, 577 F.3d 21, 31–32 (1st Cir. 2009).

236. Claudine V. Pease-Wingenter, *The Application of the Attorney–Client Privilege to Tax Accrual Workpapers: The Real Legacy of United States v. Textron*, 8 HOUS. BUS. & TAX L. J. 337, 348–349 (2008).

237. *Id.* at 349.

privilege initially attached, before affirmatively concluding that it did.²³⁸ The court carefully delineated between privileged attorney work and non-privileged accountant work in various contexts, including return preparation and audit representation.²³⁹ The court explained existing precedent to note that “legal advice provided by an attorney may be privileged even though [it is] made in connection with the preparation of a return” because “[d]etermining the tax consequences of a particular transaction is rooted entirely in the law.”²⁴⁰ Similarly, privilege may attach when an attorney participates in an IRS audit “to deal with issues of statutory interpretation or case law” raised in an examination of the taxpayer’s return.²⁴¹

Applying such synthesis to tax accrual workpapers, the court concluded the attorney–client privilege applied because the documents “essentially consist of nothing more than counsel’s opinions regarding items that might be challenged because they involve areas in which the law is uncertain and counsel’s assessment regarding Textron’s chances of prevailing in any ensuing litigation.”²⁴²

The District Court also provided a thoughtful analysis of the taxpayer’s assertion of FATP. The court stated that because the taxpayer’s CPAs “participated in advising Textron regarding its tax liability with respect to matters on which the law is uncertain and/or estimating the hazards of litigation percentages, they were performing ‘lawyers work’” such that FATP applied.²⁴³ The court then analyzed and rejected the government’s assertion that the section 7525(b) exclusion for tax shelters barred application of FATP.²⁴⁴

After thorough analyses as to whether attorney–client privilege and FATP attached, in a later portion of the opinion, the court then provided analysis of waiver.²⁴⁵ Parenthetically, this internal segregation in the opinion seems to be a conceptually prudent approach to ensure readers do not erroneously conflate these separate issues. The court’s analysis of the waiver issue was relatively short and straightforward.²⁴⁶ The undisputed fact was that the taxpayer had provided the tax accrual workpapers to its independent auditors.²⁴⁷ The court held that this action waived both the attorney–client privilege and FATP in doing

238. *Textron, Inc.*, 507 F. Supp. 2d at 146–47.

239. *Id.*

240. *Id.* at 146 (internal citations omitted).

241. *Id.* at 146–47.

242. *Id.* at 147.

243. *Id.* at 148.

244. *Id.*

245. *Id.* at 151–52.

246. *See id.*

247. *Id.* at 151.

so.²⁴⁸

This conclusion was not surprising. Textron had tried to argue that “because it occasionally revises its reserves based on the opinions of the independent auditor,” the auditor’s review should be considered to be “in connection with providing ‘tax advice’ to Textron.”²⁴⁹ The court rejected this attempt by noting that independent auditors actually have a professional responsibility to report to the investing public whether a company’s financial statements fairly and accurately reflect its financial condition.²⁵⁰ Such responsibility defies assertion of a confidential relationship.²⁵¹ Indeed this conclusion is consistent with a large body of prior case law holding that independent auditors have a non-privileged relationship with the companies they audit and a disclosure of privileged communications to them waives privilege.²⁵²

D. Reliance on Counsel for Penalty Protection: In re G-I Holdings Inc.
(2003)

In 2003, the District Court for the District of New Jersey issued its opinion for the case *In re G-I Holdings Inc.*²⁵³ The corporate taxpayers at issue were debtors in bankruptcy when the Commissioner of Internal Revenue asserted claims for unpaid income tax liabilities and penalties.²⁵⁴ The claims were based on certain transactions with a limited partnership.²⁵⁵ The government theorized that one transaction was actually a taxable disguised sale of property.²⁵⁶ Alternatively, the government urged that the taxpayers recognized taxable gain because either there was no partnership for tax purposes or the taxpayers were not a partner thereof.²⁵⁷ Because the government’s claims would require “substantial and material consideration of non-bankruptcy Code statutes,” the District Court for the District of New Jersey ultimately

248. *Id.* at 152.

249. *Id.* at 151–152.

250. *Id.* at 152.

251. *Id.*

252. *See, e.g.*, *First Fed. Savs. Bank v. United States*, 55 Fed. Cl. 263, 269–70 (Fed. Cl. 2003); *In re Honeywell Int’l, Inc. Sec. Litig.*, 230 F.R.D. 293, 298 (S.D.N.Y. 2003); *United States ex rel. Robinson v. Northrop Grumman Corp.*, 2003 WL 21439871, slip op. at *1–2 (N.D. Ill. June 20, 2003); *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1162 (9th Cir. 1992); *Eglin Fed. Credit Union v. Cantor Fitzgerald Sec. Corp.*, 91 F.R.D. 414, 418 (N.D. Ga. 1981); *Couch v. United States*, 409 U.S. 322, 335 (1973).

253. *In re G-I Holdings Inc.*, 218 F.R.D. 428 (D.N.J. 2003).

254. *Id.* at 430.

255. *Id.*

256. *Id.*

257. *Id.* (internal citations omitted.)

exercised jurisdiction over the claim.²⁵⁸

The corporate taxpayers moved to bifurcate the litigation into two phases; the first would focus on the “substantive tax” issues and (if necessary) the second would address penalties.²⁵⁹ To meet their burden in establishing the need for such bifurcation to “avoid prejudice,” the taxpayers explained they wanted to avoid the “prejudice” of premature waiver of the attorney–client privilege.²⁶⁰ In defending against the penalty claims, the taxpayers indicated “they might assert a ‘reasonable cause’ affirmative defense” by showing “the taxpayer reasonably relied on professional advice” as permitted under I.R.C. section 6664(c)(1) and Treasury Regulation section 1.6664-4(b).²⁶¹ The taxpayers argued that a bifurcation would allow them to “delay disclosure of confidential communications with their legal counsel until the penalty phase.”²⁶² They argued this would allow them to “limit their waiver of the attorney–client privilege to the penalty phase only and protect their privileged communications in a substantive tax phase.”²⁶³

Interestingly, in considering the Motion to Bifurcate, the District Court identified the dispositive issue as whether the requested bifurcation would even accomplish the goal of limiting their waiver of privilege.²⁶⁴ The court noted that when a party cites legal representation as an affirmative defense, the advice is placed “at issue” such that the attorney–client privilege is waived.²⁶⁵ The court explained the rationale for the rule was to permit the opposing party to the litigation to be able to “test what information was conveyed by the client, whether counsel was provided with all material facts in rendering advice, and whether that advice was heeded by the client.”²⁶⁶

The court also noted the rule against selective waiver:

The client cannot be permitted to pick and choose among his opponents, waiving the privilege for some and resurrecting the claim of confidentiality to obstruct others, or to invoke the privilege as to communications whose confidentiality has already been compromised for his own benefit. The attorney–client privilege is not designed for such tactical employment.²⁶⁷

258. *Id.*

259. *Id.* at 431.

260. *Id.* at 430–31.

261. *Id.* at 431.

262. *Id.*

263. *Id.*

264. *Id.*

265. *Id.* at 431.

266. *Id.* at 432.

267. *Id.*

The court observed that once attorney–client communications are placed at issue, the party waives privilege “with regard to all communications on the same subject matter.”²⁶⁸ Further, once a party waives privilege, “it relinquishes the privilege for all purposes and circumstances thereafter.”²⁶⁹

Though the taxpayers argued that they were “currently in a position to decide whether to waive their attorney–client privilege,” the court held they already had waived privilege.²⁷⁰ The court noted that in its interrogatories, the government had asked the taxpayers whether they contended they were not liable for the asserted penalties.²⁷¹ If the taxpayers contended there were not so liable, the interrogatories also asked them to “state the basis for that contention . . . including communications with tax and/or legal advisors.”²⁷² The taxpayers’ response to the interrogatories indicated they had “consulted with outside legal counsel and other advisers regarding the tax treatment” of the transaction in question.²⁷³ The court concluded this amounted to a permanent waiver of privilege because it put the legal advice at issue.²⁷⁴

The court then shifted gears to define the subject matter, to which the waiver extended.²⁷⁵ The court applied a very broad definition: “the tax treatment of the 1990 Transaction and Subsequent Events.”²⁷⁶ As “tax treatment” is an extremely expansive concept, it seems unlikely that the scope of the waiver did not encompass any previously privileged communications. Indeed, arguably, the court might have taken a narrower approach by identifying certain tax law issues as the waived subject matter. The court decided against that sort of a definition.

Because the court determined privilege had already been a subject matter waiver “allowing the Government to access relevant communications for tax and penalty phases of litigation,” it denied the Motion to Bifurcate and addressed other issues in the case.²⁷⁷ One such issue was the government’s request to depose famed tax attorneys, William S. McKee and William F. Nelson, who had provided tax planning to the taxpayers on the transaction at issue in the case.²⁷⁸ Because of the broad subject matter waiver, the court instructed that the

268. *Id.*

269. *Id.*

270. *Id.* at 432.

271. *Id.*

272. *Id.*

273. *Id.*

274. *Id.* at 433–34.

275. *Id.* at 433.

276. *Id.*

277. *Id.* at 434.

278. *Id.* at 437.

taxpayer “must produce relevant communications between them and McKee and Nelson,” and the “Government may depose McKee and Nelson.”²⁷⁹

The court was utterly unsympathetic to the taxpayer’s claims that Mr. Nelson’s continued role as attorney on the case and his potential material witness created a conflict of interest.²⁸⁰ The court sided with the government in finding the taxpayers had “created the very prejudice of which they complain.”²⁸¹ The court affirmed the government’s right to depose Mr. Nelson, and kindly reminded him to comply with the relevant Rules of Professional Conduct when he gave his testimony.²⁸²

IV. LESSONS LEARNED

Both practitioners and courts have much to learn from these important waiver cases. The key lessons will be discussed below.

A. Practitioners Beware

In my twelve years of professional experience, it has been my observation that tax practitioners are extremely well-versed in matters involving tax codes, but typically are not as familiar with issues grounded in non-tax legal authorities. Moreover, even the best Evidence courses in law school typically only spend a class or two studying privileges of all kinds.²⁸³ As a result, it is no wonder that even many veteran tax practitioners are not terribly familiar with the leading cases involving the application of attorney–client privilege in the tax context. For such practitioners, two main points are particularly important to take from the waiver cases summarized in Part III.

1. It’s Easy to Waive: Be Careful with References to Tax Advice

When I was in practice, I sometimes encountered in colleagues and clients an overconfidence about the availability and permanence of privilege, and a lack of awareness that subject matter (not selective) waiver was the prevailing rule. As a sort of shock therapy, I would tell them about *In re G-I Holdings Inc.* It was eye-opening to learn that

279. *Id.* at 437–38.

280. *Id.* at 437.

281. *Id.*

282. *Id.* at 438.

283. E-mail from Joshua Kanassatega, Assistant Professor of Law, Phoenix School of Law (Jun. 4, 2012) (on file with author); e-mail from Placido Gomez, Professor of Law, Phoenix School of Law (May 18, 2012) (on file with the author).

renowned tax advisers like William S. McKee and William F. Nelson had accidentally waived privilege and were forced to testify against their clients to divulge intimate details of their elaborate tax planning schemes.

But that misstep by such titans in the tax field can be a useful lesson for the rest of us mere mortals. The court in *In re G-I Holdings Inc.* held that privilege was waived because of the taxpayers' response to an interrogatory asking whether they contended they were not liable for the asserted penalties.²⁸⁴ That interrogatory also specifically asked that if the taxpayers contended they were not so liable to "state the basis for that contention . . . including communications with tax and/or legal advisors."²⁸⁵ In retrospect, it is clear that answering such questions were a trap for the unwary.

The opinion indicates the taxpayers' response to these questions (which were no doubt prepared by their learned counsel) revealed that the taxpayers had "consulted with outside legal counsel and other advisers regarding the tax treatment" of the transaction in question.²⁸⁶ This response was a fatal error.

It should be a huge red flag to practitioners whenever the government asks questions about communications with tax and/or legal advisors. In *In re G-I Holdings Inc.*, the pivotal questions came during litigation in the form of interrogatories.²⁸⁷ But in other cases, such questions might arise much earlier. For example, they could easily be posed during the initial audit phase of a tax controversy.

Whenever such questions arise, the appropriate response would be an assertion of privilege and a refusal to answer further. The court's holding in *In re G-I Holdings Inc.* may seem surprising to some tax practitioners, but it is actually quite consistent with the body of case law in similar non-tax contexts.²⁸⁸

One helpful illustration is *Nguyen v. Excel Corporation*, a case involving the Fair Labor Standards Act (FLSA).²⁸⁹ The Fifth Circuit affirmed a finding that the corporate client waived privilege when it failed to object to "all questions designed to elicit information about privileged communications" during testimony by its executives.²⁹⁰ The Fifth Circuit noted that the corporate client had "raised some privileged-

284. *In re G-I Holdings Inc.*, 218 F.R.D. at 432-33.

285. *Id.*

286. *Id.* at 433.

287. *Id.* at 432-33.

288. See, e.g., *United States v. Sander*, 979 F.2d 87, 91-92 (7th Cir. 1992); *Hollins v. Powell*, 773 F.2d 191, 196-97 (8th Cir. 1985); see also CHARLES A. WRIGHT et al., 8 FEDERAL PRACTICE AND PROCEDURE § 2016.1, at 228-29 (3d ed. 2012).

289. *Nguyen v. Excel Corp.*, 197 F.3d 200, 202 (5th Cir. 1999).

290. *Id.* at 206-07.

based objections” to some questions posed.²⁹¹ But the failure to object to *all* such questions was the critical flaw.²⁹²

Notably, the corporate client in *Nguyen v. Excel Corporation* had believed it had not waived privilege because it had deliberately not raised a “reliance-on-advice-of-counsel as support for its good faith defense” to the FLSA claims.²⁹³ As a result, it claimed it had not placed at issue the attorney’s advice.²⁹⁴ The corporate client further characterized the executives’ responses as having involved only “‘generic’ references to communications with counsel.”²⁹⁵ The corporate client believed it had successfully navigated the minefield of privilege waiver. However, in the court’s judgment, the allegedly “generic” references had crossed a vague line and were too specific to preserve privilege.²⁹⁶

Because specificity is in the eye of the beholder and waiver is permanent, it is best to err on the side of caution and assert privilege instead of responding to any questions that potentially might be interpreted as inquiring about confidential communications.

2. Tactical Decisions to Waive: Understand the Potentially Wide Scope

In *Long-Term Capital Holdings v. United States*, the taxpayer’s major misstep was its decision to provide the S&S legal opinion to the government during the IRS’s administrative proceedings.²⁹⁷ The court initially held this document was privileged and this disclosure was a waiver.²⁹⁸ This holding was detrimental to the taxpayer because the court then defined the waived subject matter to encompass the K&S legal opinion.²⁹⁹ Thus, the taxpayer’s assertion of privilege as to that withheld opinion failed.³⁰⁰

To many tax practitioners who have represented clients in “administrative proceedings,” the taxpayer’s decision to provide the S&S opinion may not be surprising. Providing some significant documentation on a disputed point can sometimes satisfy those issuing Information Document Requests (IDRs) from asking for the kitchen

291. *Id.*

292. *Id.* at 207.

293. *Id.* at 205.

294. *Id.*

295. *Id.*

296. *Id.* at 209.

297. *Long-Term Capital Holdings v. United States*, No. 3:01 CV 1290, 2003 WL 1548770, slip op. at *1 (D. Conn. 2003).

298. *Id.* at *5.

299. *Id.* at *5.

300. *Id.* at *4.

sink. Particularly in the corporate context, IDRs can be so broad and encompassing that they require ample resources to respond adequately and in a timely fashion. Consequently, there is often an ongoing negotiation with the IRS about the breadth of what a taxpayer will actually provide in response to a particular IDR.³⁰¹ However, in the context of such negotiations, it is important to remember waiver repercussions when deciding what to provide.

Whenever a taxpayer contemplates the production of documentation in response to an IDR (or other administrative request), the taxpayer must first scrutinize whether attorney–client privilege or FATP might possibly attach to the contemplated documentation. In *Long-Term Capital Holdings v. United States*, it was not obvious that the S&S opinion was privileged.³⁰² Nonetheless, in its first opinion, the court never analyzed this issue in any great depth before jumping ahead to the waiver issue.³⁰³ As a result, practitioners should err on the side of caution when making a determination that documentation might or might not be privileged. If there is any possibility that privilege might have attached, the documentation should be withheld.

In the real world practitioners face difficult dilemmas, and sometimes tactical decisions are made to waive privilege. If that is contemplated, it is critical to analyze carefully how a court might define the scope of a waived subject matter. Although commentators have asserted that the subject matter is generally defined in a narrow fashion,³⁰⁴ the cases described in Part III demonstrate that is not always true in the tax context. Before making a tactical decision to waive privilege by providing some protected documentation, practitioners should determine the widest possible scope of the waived subject matter and discern if it is

301. Erin M. Collins & Edward M. Robbins, Jr., *Other Factors to Consider for an LB&I Examination*, PLI REF-IRS § 7:4.2, at 7–27 (2012) (“Orally discussing IDRs prior to issuance provides the opportunity to negotiate before the IRS has formalized its requests. Generally, it is more difficult to negotiate the wording once the IDR has been issued.”).

302. *Long-Term Capital Holdings*, 2003 WL 1548770 at *1–2.

303. *Id.* at *4–5. It should be noted that in the court’s subsequent unpublished opinion in the case, the court entertained the taxpayer’s motion for reconsideration and did reverse course somewhat. *Id.* After an in camera review, the court ultimately held that the K&S opinion was separate from the S&S opinion “as the former does state the consideration of possible tax consequences that may have resulted from a subsequent transaction.” *Id.* at *2. Thus, the scope of waiver was much curtailed in the court’s second opinion. *Id.* at *2–3. Moreover, after some creative legal maneuvering by the taxpayers, they were also able to convince the court that the S&S opinion was never privileged in the first place. *Id.* However, this holding is unlikely to apply to many other taxpayers as it was premised on an assertion the legal opinion was necessary to comply with sections 722 and 723 of the Internal Revenue Code and Treasury Regulations section 301.6231(a)(3)-(1)(c)(2). *Id.* at *4. The court’s granting of such a motion for reconsideration and the taxpayer’s ability to supplement the record so abundantly is extraordinary. *Id.* at *4–5. Other taxpayers should not rely in the future on the ability to follow suit and get a second bite at the apple. *Id.*

304. See RICE, *supra* note 100, § 9:83, at 2 (2011); Harding, *supra* note 110, at 388.

truly desirable to waive all communications within that scope. Again, because of the permanence of waiver, it is prudent to be conservative in such analysis and decision-making.

3. The Independent Auditor Minefield

The taxpayers in *El Paso* and *Textron* faced a common dilemma amongst public corporations. On the one hand, they could more easily secure a favorable opinion from their independent auditors by giving them free access to their tax accrual workpapers and supporting documentation. The pitfall with this option is that the taxpayer will surely be deemed to have triggered a subject matter waiver on all sensitive tax matters discussed therein. That is not a pleasant possibility for the taxpayer or its advisers.

The other option is to give little or no access to their tax accrual workpapers in order to preserve privilege. However, the result is likely a qualified or unfavorable opinion from the independent auditors. Because of the catastrophic repercussions to the corporation from such an opinion, that option is not a practical consideration.

Corporation taxpayers must therefore walk a tightrope between the extremes of full access and no access in an attempt to satisfy the independent auditors while trying to preserve privilege.³⁰⁵ There are unfortunately no silver bullets to this dilemma.

However, it has been recommended that waiver might be avoided by preparing especially for the independent auditors separate summary documentation about the reserve.³⁰⁶ Courts have always emphasized that privilege never protects facts; it only attaches to certain confidential communications.³⁰⁷ To the extent that only factual summaries of the reserve components are provided to independent auditors, privilege

305. Ricardo Colón, *Caution: Disclosures of Attorney Work Product to Independent Auditors May Waive the Privilege*, 52 LOY. L. REV. 115, 116 (2006) (“Corporations face difficult choices as auditors and lawyers strive to carry out their separate and sometimes conflicting responsibilities in the post-Sarbanes world. Corporations whose independent auditors request disclosure of information ordinarily protected by the attorney–client privilege or by the attorney work product privilege must decide whether to disclose the information and risk waiving applicable privileges and protections, or to withhold such information and risk receiving a qualified audit opinion or even a disclaimer of opinion.”).

306. Pease-Wingenter, *supra* note 236, at 353–54.

307. *Upjohn Co. v. United States*, 449 U.S. 383, 395–96 (1981) (“[T]he protection of the privilege extends only to communications and not to facts. A fact is one thing and a communication concerning that fact is an entirely different thing. The client cannot be compelled to answer the question, ‘What did you say or write to the attorney?’ but may not refuse to disclose any relevant fact within his knowledge merely because he incorporated a statement of such fact into his communication to his attorney.” (quoting *Philadelphia v. Westinghouse Elec. Corp.*, 205 F. Supp. 830, 831 (E.D. Pa. 1962))).

should be viewed as intact.³⁰⁸ The pragmatic question remaining would be whether such factual summaries satisfy the independent auditors.

B. Advice for the Judiciary

Because some waiver cases in the tax context have been sloppily written or poorly reasoned, or both, the courts also have important lessons to learn from the cases summarized in Part III to avoid making the same mistakes as their predecessors.

1. Understand the Limited Scope of *Cote*'s Waiver by Tax Return Filing

As explained in Part III(B), *Cote* involved extremely unusual facts that the Eighth Circuit relied upon to find that an accountant's return preparation workpapers were initially privileged. Only because of the unusual facts to support an attachment of privilege was the Eighth Circuit correct in moving to an analysis of waiver due to the taxpayer's filing of a tax return.

However, future courts should not be quick to follow *Cote*'s waiver analysis. The deeply entrenched general rule is that return preparation workpapers are not privileged.³⁰⁹ Without a finding of privilege initially attaching, it is legally incorrect to jump ahead to a discussion of waiver. Again, one cannot be deemed to waive protection that never existed in the first place.³¹⁰

The Eighth Circuit was mindful of the exceptionality of the facts before it. *Cote* contains an explicit warning that most tax cases should never even reach an analysis of waiver.³¹¹ The court stated, "In tax cases waiver is often not even an issue since the privilege is said not to attach to information which the taxpayer intends his attorney to report in the contents of a tax return."³¹² This is an important reminder of the criticality of not jumping prematurely to a waiver analysis.

Moreover, even if future courts find that privilege attaches to communications involving return matters, it is helpful to recall what was at stake in *Cote*. The taxpayers had consulted with the attorney only upon notification of an IRS audit, and it appears his role was

308. Pease-Wingenter, *supra* note 236, at 353–54.

309. J. Bradford Anwyll, *Administrative Audits: Audit Techniques and Procedures*, ST009 ALI-ABA 1 (2011) ("Thus, there is no privilege created for . . . tax return preparation . . ."); James H. Feldman & Carolyn Sievers Reed, *Silences in the Storm: Testimonial Privileges in Matrimonial Disputes*, 21 FAM. L. Q. 189, 234 n.187 (1987).

310. Pease-Wingenter, *supra* note 6, at 713.

311. *United States v. Cote*, 456 F.2d 142, 145 n.4 (8th Cir. 1972).

312. *Id.* at 145 n.3.

circumscribed.³¹³ The IRS never claimed a waiver extended to all of Murphy's written or oral communication with the taxpayers or their accountant. The IRS issued a narrow summons to the lawyer to get only the accountant's return preparation workpapers, which the accountant had conveyed to Murphy.³¹⁴

In enforcing the summons, the Eighth Circuit implicitly defined the scope of the waived subject matter in a very narrow fashion to include only the worksheets supporting the amended return. Indeed, the court explicitly rejected "too broad" a definition of the waived subject matter "requiring unlimited disclosure by reason of filing an income tax return."³¹⁵ The court warned that adopting such an overly broad definition "might tend to destroy the salutary purposes of privilege which invite confidentiality between attorney and client."³¹⁶

The court's warning was apt. Virtually all tax planning advice is reflected in some sense in how the taxpayer files its return.³¹⁷ To implement such tax planning advice, the tax return must be effected in some way.³¹⁸ If courts apply "too broad" a definition of subject matter waived by virtue of filing the return, then the privilege will be eviscerated in the tax context. Privilege will never protect any confidential tax communications if waiver by return filing extends beyond a very narrowly defined subject matter (i.e., return preparation workpapers).

Indeed, if "too broad" a definition is the rule, then there would be greater need to analyze whether privilege ever attached. If filing a return (a necessity to implement tax planning advice) were always a trigger for a broad subject matter waiver, then it seems doubtful that any communications involving tax advice could be viewed as "confidential." Such an understanding, however, would defy extensive case law.³¹⁹ Further, it would make enactment of section 7525 a meaningless gesture. It is a well-entrenched rule of statutory construction that courts should not supposed that Congress has enacted unnecessary statutes.³²⁰

The Eighth Circuit's warning against "too broad" a definition of

313. *Id.* at 143.

314. *Id.* at 143-44.

315. *Id.* at 145 n.4.

316. *Id.*

317. Sisk & Abbate, *supra* note 18, at 229.

318. *Id.*

319. See Jay L. Carlson & David A. Roman, *The Tax Advice Privilege Is Alive and Well*, Tax Notes Today, LEXIS 2003 TNT 77-28 (Apr. 21, 2003).

320. *Fund for Animals, Inc. v. Kempthorne*, 472 F.3d 872, 877 (D.C. Cir. 2006); *Halverson v. Slater*, 129 F.3d 180, 185 (D.C. Cir. 1997); *Coyne & Delany Co. v. Blue Cross & Blue Shield of Va., Inc.*, 102 F.3d 712 715 (4th Cir. 1996); *Sutton v. United States*, 819 F.2d 1289, 1295 (5th Cir. 1987); *Jackson v. Kelly*, 557 F.2d 735, 740 (10th Cir. 1977).

waived subject matter is also consistent with other precedent. For example, the District Court for the Southern District of New York in 1983 addressed the government's assertion that a corporate taxpayer had waived privilege by filing an amended tax return.³²¹ *In re Grand Jury Subpoena Duces Tecum* instructed:

[The taxpayer did not] disclose the disputed documents themselves; rather, [the taxpayer] simply made public [i.e., in the filed return] certain conclusions which it based on the work incorporated in the disputed documents. No authority has been cited for the proposition that a document loses its privileged nature simply because the owner of the privilege relies on the material contained in the document in making a statement in *another* document."³²²

The court was making an important distinction. A filed tax return does not disclose confidential communications. Instead, a return simply contains conclusions based on the confidential communications. Conveying such conclusions alone does not waive privilege. The court elaborated, "By the mere filing of a tax return, the taxpayer does not agree to disclose to all comers the documentation underlying the deductions claimed."³²³

This rule is logical because it demonstrates an understanding that a broader understanding of subject matter waiver due to return filing would eliminate all privilege protection for tax planning.

The next year, the Third Circuit in *United States v. Liebman* issued a similar holding.³²⁴ The IRS had contended that the taxpayers had waived privilege because they deducted certain fees to a law firm for tax advice.³²⁵ The court rejected this theory: "Since the mere deduction of the fee did not disclose the substance of the communication, it could not constitute a waiver of the privileged substance of the advice received."³²⁶

Indeed, tax returns contain only very summary numerical information. They do not divulge what parties have communicated confidentially about the computation of that summary numerical information.

The District Court for the Northern District of California issued a similar opinion in 1996.³²⁷ The government had asserted that the taxpayer waived privilege as to certain tax credits at issue by claiming

321. *In re Grand Jury Subpoena Duces Tecum*, 566 F. Supp. 883, 883–84 (S.D.N.Y. 1983).

322. *Id.* at 884.

323. *Id.*

324. *United States v. Liebman*, 742 F.2d 807 (3d Cir. 1984).

325. *Id.* at 808.

326. *Id.* at 810 n.4.

327. *United States v. Chevron Corp.*, 77 A.F.T.R. 2d 1548 (N.D. Cal. 1996).

those credits on its filed return.³²⁸ The court rejected this theory and held there was no implied waiver associated with the claimed tax credits.³²⁹

Moreover, beyond the tax setting, other cases have produced analogous holdings to support a narrow scope of waived subject matter from filing a tax return. For example, in *Natta v. Hogan*, private litigants disputed the applicability of privilege to certain documents in a patent dispute.³³⁰ Montecatini argued that the requirement of “full disclosure” in patent proceedings undercut any privilege protection Phillips might have otherwise enjoyed.³³¹ The Tenth Circuit rejected this assertion:

In our opinion this does not foreclose the assertion of a claim of privilege in a patent proceeding. The attorney–client privilege is designed ‘to facilitate the administration of justice,’ in order ‘to promote freedom of consultation of legal advisors by clients.’ We see no reason why this long-established principle should not be applied to patent cases. The public interest is in the development of the truth, both in patent proceedings and in ordinary litigation. The duty of full disclosure differs from the freedom of consultation with lawyers.³³²

The court went on to explain:

We agree with Phillips that an automatic waiver of the privilege does not occur when a patent controversy is presented The record contains no waiver of the privilege by Phillips. It undoubtedly gave information to its attorneys so that they could act on it in the preparation of papers used in the patent proceedings. The situation is like that where a client gives general information to his lawyer so that the lawyer may prepare a complaint in any ordinary civil action. The fact that some of the information is thus publicly disclosed does not waive the privilege.³³³

This analysis from the patent context and its analogy to civil complaints are helpful to understanding the extent of waiver caused by the filing of tax returns. In all three settings, a client shares information that will undoubtedly be made public (i.e., in patent filings, a civil complaint or a tax return, respectively). However, in each example, the motivation in seeking the attorney’s advice is the need to understand what information should be made public and how that information should be conveyed to comply with the law. If the subsequent publication of some of the conveyed information triggered a broad subject matter waiver of all

328. *Id.* at *2.

329. *Id.* at *4–5.

330. *Natta v. Hogan*, 392 F.2d 686 (10th Cir. 1968).

331. *Id.* at 691.

332. *Id.*

333. *Id.* at 692.

confidential communications in the matter, then there would be a huge disincentive to ever consult an attorney. That would defeat the purpose of the attorney–client privilege, which is to encourage more (not less) consultation with lawyers to ensure our country’s laws are properly obeyed and implemented.

In 1980, the United States Court of Claims issued its opinion in another patent case, *Knogo Corporation v. United States*.³³⁴ The defendant filed a motion for the production of documents, which the plaintiff resisted by asserting the attorney–client privilege.³³⁵ The defendant raised issues of confidentiality to defeat the assertion of privilege.³³⁶

The court noted this type of issue was not uncommon in patent cases:

“Some of the most difficult discovery questions presented in patent litigation relate to the assertion of attorney–client privilege with respect to communications containing primarily or exclusively technical information”

[The documents at issue provide technical explanations, not explicit discussions of legal issues.] However, it is clear that they were each prepared to provide the attorney with the information necessary to assess the invention’s patentability, prepare and file a patent application which led to the patent in suit, and prosecute that patent application through the Patent Office.³³⁷

This description will sound familiar to tax practitioners. Tax lawyers (and federally authorized tax practitioners) are often consulted by taxpayer-clients who provide financial data or information about transactions with a request for assistance in properly reporting their tax liability. Sometimes, clients also request assistance in defending their tax reporting when the IRS challenges those reports. Like the patent lawyer who must sift through technical information to “assess the invention’s patentability” and “prepare and file a patent application,” a tax lawyer is frequently called on by clients to sift through financial data and other factual information to assess the tax repercussions and advise on the preparation of a return to be filed with the IRS.³³⁸

The Court of Claims instructed:

The privilege only applies to the communication that takes place between the attorney and the client. It does not apply to the technical information itself, so long as that technical information is sought by other discovery

334. *Knogo Corp.*, 213 U.S.P.Q. 936, 938 (Ct. Cl. 1980).

335. *Id.* at 938.

336. *Id.* at 938–39.

337. *Id.* at 939.

338. *Id.* at 939.

techniques outside of the context of the attorney–client communication. In other words, the client cannot assert the privilege if asked how the invention works, but he can assert the privilege if he is asked to recount what he told his attorney concerning how the invention works. The expectation of confidentiality applies to the communication, but not to the information contained in the communication.³³⁹

Similarly, in the tax setting, financial data or other factual information is never privileged.³⁴⁰ Privilege extends only to confidential communications about the financial data or other factual information.³⁴¹ As a result, including such non-privileged information has no bearing on the continuing privilege protection that extends to confidential communications associated with it.

Explaining the application of waiver principles in the patent context, the Court of Claims explained:

The client does not waive the privilege by bringing a suit which places the validity of the patent in issue. Waiver does not occur until the client places in issue the communication itself. This most frequently occurs in suits between a client and his attorney or where there is a prima facie case of fraud based upon the dealings between the client and his attorney.³⁴²

In this explanation, the court clarified that a suit based on the patent lawyer’s advice does not itself disclose the confidential communication or place it at issue.

Another insightful case involving neither tax nor patents is *Schenet v. Anderson*, which was a 1988 case decided by the District Court for the Eastern District of Michigan.³⁴³ The plaintiff sought production of draft purchase offers that had been prepared by the defendant’s attorneys.³⁴⁴ The defendants opposed this by asserting attorney–client privilege.³⁴⁵ The plaintiff claimed that privilege was inapplicable because the defendant had communicated information to the attorneys for their “use in preparing a document to be disclosed to the public.”³⁴⁶

The court resolved the dispute with the following analysis:

Accordingly, the attorney–client privilege applies to all information conveyed by clients to their attorneys for the purpose of drafting documents to be disclosed to third persons and all documents reflecting such information, to the extent that such information is not contained in

339. *Id.* at 940 (internal citations omitted).

340. Sisk & Abbate, *supra* note 18, at 229.

341. *Id.*

342. *Knogo*, 213 U.S.P.Q. at 941 n.6.

343. *Schenet v. Anderson*, 678 F. Supp. 1280 (E.D. Mich. 1988).

344. *Id.* at 1281.

345. *Id.*

346. *Id.* at 1282.

the document published and is not otherwise disclosed to third persons. With regard to preliminary drafts of documents intended to be made public, the court holds that preliminary drafts may be protected by the attorney–client privilege. Preliminary drafts may reflect not only client confidences, but also the legal advice and opinions of attorneys, all of which is protected by the attorney–client privilege. *The privilege is waived only as to those portions of the preliminary drafts ultimately revealed to third parties.*³⁴⁷

Thus, in light of the weight of authorities from tax and other disciplines, *Cote* was correct to limit its waiver holding to the accountant’s workpapers supporting the filed return, and not to extend waiver to a broader subject matter such as attorney communications.

In sum, when faced with an assertion that filing a return has triggered a waiver of privilege, courts should be careful to not jump to a waiver analysis prematurely before clearly determining privilege has first attached. If a waiver analysis is necessary, courts should follow the advice and example of the Eighth Circuit in narrowly defining the scope of the waived subject matter to supporting return preparation workpapers.

2. The Need for a Common Sense Approach for Disclosures to Return Preparers

Long-Term Capital Holdings v. United States has had significant repercussions despite its status as a mere unpublished opinion.³⁴⁸ Unpublished opinions are not uncommon in the tax context; they can be quite impactful.³⁴⁹

Long-Term Capital Holdings received a lot of attention within the tax professions because of the earth-shattering determination that the disclosure of tax advice to a return preparer contributed to a waiver of privilege. To date, the case has been cited more than a hundred times.³⁵⁰ Most of the citations have appeared in secondary sources (including several well-known treatises), which undoubtedly increased visibility of the case.³⁵¹ Three courts have relied upon it in their opinions.³⁵²

347. *Id.* at 1283–84 (emphasis added).

348. Search of Westlaw, KeyCite (May 18, 2012).

349. There are many cases illustrating this trend. One is *Rose v. Commissioner*, which was a 2008 unpublished opinion by the Eleventh Circuit. See *Rose v. Commissioner*, No. 07-12245, 2008 WL 1823309 (11th Cir. 2008). Search of, Westlaw KeyCite (May 23, 2012). It has been cited 39 times, including by one court. Another such case is *Hubert Enterprises, Inc. v. Commissioner*, which was an unpublished opinion of the Sixth Circuit in 2007. *Hubert Enterprises, Inc. v. Commissioner*, No. 05-2616, 2007 WL 1244314 (6th Cir. 2007). It has been cited sixty-two times, including in four judicial opinions.

350. Search of Westlaw, KeyCite (May 18, 2012).

351. *Id.*

The district court later granted a motion for rehearing and in a second unpublished opinion modified somewhat its holding with respect to waiver by disclosure to a return preparer.³⁵³ The court accepted partially the taxpayer's assertion that the fairness doctrine should apply to limit the scope of waiver from such an extrajudicial disclosure of attorney–client communications.³⁵⁴ The court ultimately held that the disclosure waived only part of the K&S opinion—the section that “reflects the matters actually disclosed.”³⁵⁵ The court held the other sections of the K&S opinion to remain undisclosed.³⁵⁶

This revised opinion hardly brings much comfort to tax practitioners. Ultimately, a disclosure to a return preparer was deemed to trigger a waiver.³⁵⁷ Due to the ambiguous nature of the court's second opinion, it was difficult to discern how much of the K&S opinion was deemed waived or what that waived portion contained. The revised opinion continued to be poorly reasoned and supports bad policy in discouraging consultation with tax practitioners.

As noted previously, tax planning advice must in some manner be effected via the return and filed with the IRS.³⁵⁸ However, return preparation services are rarely provided by lawyers; more frequently, returns are prepared by professionals with a strong understanding of accounting and the ability to decipher financial data.³⁵⁹ To do his or her job, the return preparer has a clear need to know the conclusion of tax advice provided by a lawyer or federally authorized tax practitioner. It is that conclusion that the return preparer must implement in the tax return.

The tax laws are complicated in theory and in application, so it is not always obvious how lawyers or federally authorized tax practitioners arrive at their conclusion.³⁶⁰ To be confident in the conclusion that he or

352. *Id.*

353. *Long-Term Capital Holdings v. United States*, No. 3:01 CV 1290, 2003 WL 1548770, slip op. at *10 (D. Conn. 2003).

354. *Id.* at *9.

355. *Id.*

356. *Id.*

357. *Id.* at *3.

358. Sisk & Abbate, *supra* note 18, at 299.

359. Phillip E. Hassman, *What Constitutes Privileged Communications with Preparer of Federal Tax Returns So As To Render Communications Inadmissible in Federal Tax Prosecution*, 36 A.L.R. Fed. 686, § 2[a] (1978) (“Accountants frequently prepare others’ tax returns for compensation—that is, they are frequently ‘preparers.’”).

360. 1 BORIS I. BITTKER & LAWRENCE LOKKEN, *Statutory Construction*, in *FED. TAX’N INCOME, EST. & GIFTS* ¶ 4.2.1 (2012) (quoting Judge Learned Hand’s famous observation: “In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at

she is being asked to reflect in the return, the return preparer needs to understand how the conclusion is justified under the tax laws. Often this necessitates explaining the legal analysis to the return preparer. This is a common approach. Return preparers are not mindless automatons. They are professionals with ethical standards that might be compromised if they are unable to get assurance of the legal accuracy of the conclusion they are reporting to the IRS.

Indeed, in the court's revised opinion, the testimony of the taxpayer's return preparer is insightful:

Petitioners' accountant, Brett Yacker, testified at his deposition that he was told by Larry Noe, Petitioners' in-house counsel, that Petitioners had a legal opinion from K&S, upon which they would rely, that says that it is "more likely than not" that the loss can be taken. Specifically, Brett Yacker testified that When Larry Noe went through the transaction . . . telling us that they had a legal opinion from Sherman & Sterling . . . that gave us great comfort. And then on the transaction itself, if it would create a loss, that they have a legal opinion from King & Spalding *that's more likely than not that the loss can be taken*, satisfied our fiduciary duty to make sure that the position could be reported.³⁶¹

Mr. Yacker's testimony is typical of most return preparers who take their fiduciary duty and their professionalism seriously by asking important questions to be assured of the accuracy of the return they prepare.

It is significant to note that if Mr. Yacker had been an employee of the taxpayer, it is very unlikely that there would have been any issue of waiver in sharing the conclusion and underlying legal analysis of the K&S opinion. Within a corporation, legal advice may be shared on a confidential basis with employees on a "need to know" basis.³⁶² As an in-house return preparer would have a need to know the conclusion and underlying legal analysis to implement the K&S tax advice, this type of disclosure would have been permissible and not triggered a waiver. The key in *Long-Term Capital Holdings* was that Mr. Yacker was not the taxpayer's employee and was considered a third party for purposes of testing waiver.

The application of waiver, however, should not turn on whether or not one is an employee. Large corporations may have an in-house staff of return preparers. Other corporations and non-corporate taxpayers hire return preparers to prepare their returns as necessary on a more limited

all, only after the most inordinate expenditure of time").

361. *Long-Term Capital Holdings*, No. 3:01 CV 1290, 2003 WL 1548770, slip op. at *8 n.17 (D. Conn. Feb. 14, 2003) (internal citations omitted).

362. Alexander C. Black, *What Corporate Communications Are Entitled to Attorney-Client Privilege—Modern Cases*, 27 A.L.R.5th 76, § 2 (1995).

basis. Taking the latter approach should not alter the outcome of a waiver analysis.

Courts should take a common sense approach to avoid nonsensical, unprincipled results. For example, broadly accepted principles of privilege indicate protection extends to communications made to or in the presence of the “subordinates of the attorney.”³⁶³ It would be logical and appropriate to view a return preparer as a type of such attorney subordinate because the return preparer is implementing the attorney’s tax advice. This would be so whether the taxpayer or the lawyer technically hired the return preparer.

Regardless of the circumstances under which a return preparer is hired, such professionals have a need to know the conclusion of tax advice to implement it on the tax return, and they have professional duties to ensure they are accurately reporting the taxpayer’s liability. The privilege protection of a taxpayer should not be curtailed because of these needs.

V. CONCLUSION

For too long, waiver of privilege has been misunderstood by many tax practitioners and their clients in part because of the muddled state of the law. Tax practitioners should be aware of certain particularly nasty pitfalls. They should realize the potential to waive privilege by not asserting it when the government poses questions about tax advice. Tax practitioners should also comprehend the risks if they consider a tactical waiver; the scope of waived subject matter may ultimately be deemed much broader than the tax practitioner envisioned. Tax practitioners should also appreciate and plan for the difficulties of working with independent auditors on tax reserve issues.

Further, the courts should take great care in deciding waiver cases in the tax context. Specifically, they should appreciate the limited holding of *Cote* in finding a waiver of privilege due to the filing of a return. Judges should not misapply the *Cote* rule to permit access broadly to confidential communications due simply to the filing of a tax return.

Courts should also be wary of following the questionable precedent of *Long-Term Capital Holdings* that disclosing the “gist” of tax advice to a return preparer triggers a waiver. Such disclosure is necessary to effect the tax advice and to respect the professionalism of the return preparer. A waiver in such contexts has the potential to eviscerate the attorney–client privilege in the tax context. This would be bad policy and would

363. Kent Sinclair, *Rule 501 Privileges: General Rule*, in PLI TRIAL HANDBOOK, RE 95 (2012) (“The privilege also extends to communications made to or in the presence of subordinates of the attorney . . .”).

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go against the long, established history of applying privilege in this context.