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## United States v. Textron, Inc.: A Hollow Taxpayer Victory for Privilege in the First Circuit

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### I. Introduction

Textron Financial Co. ("TFC"), a financing subsidiary of Textron, Inc. ("Textron"), entered into leveraged lease transactions during 2001. In 2005, the Internal Revenue Service ("IRS") issued Notice 2005-13, 2005-9 IRB 630, which designated certain leveraged lease transactions as "listed transactions."<sup>1</sup> Thereafter, the IRS issued a summons to Textron seeking its tax accrual workpapers for 2001.<sup>2</sup> Textron refused to produce the tax accrual workpapers,<sup>3</sup> asserting that they are privileged and that the IRS issued the summons for an improper purpose.

In a case brought before the United States District Court for the District of Rhode Island,<sup>4</sup> Textron argued that its tax accrual workpapers were protected by the attorney-client privilege, the tax practitioner-client privilege created by section 7525 of the Internal Revenue Code of 1986, as amended (the "Code"), and the work-product privilege.<sup>5</sup> The district court found that the IRS established a *prima facie* enforcement case that its summons had been issued in good faith for the legitimate purpose of auditing Textron's tax liabilities and determining TFC's potential involvement in listed transactions. At the same time, the court held that the work-product privilege protected Textron's workpapers because they were prepared in anticipation of possible litigation on an unsettled area of the law.

The government argued that the workpapers were prepared in the ordinary course of business and not protected, but the district court found that the workpapers specifically went to counsel and they would not have been prepared but for the reasonable anticipation of litigation. Although Textron had disclosed the workpapers to its outside auditing firm, Ernst & Young ("E&Y"), which the

court found resulted in a waiver of the attorney-client and tax practitioner privileges, such disclosure did not also waive the work-product privilege because the disclosure was made only to the auditing firm.<sup>6</sup> As such, this did not substantially increase the likelihood of further disclosure to the IRS or others. Moreover, the government did not show a substantial need that would otherwise overcome the work-product privilege. The court therefore denied the government's petition to enforce the IRS summons seeking Textron's workpapers.<sup>7</sup>

On appeal, the Court of Appeals for the First Circuit affirmed in part, vacated in part, and remanded, holding: (1) that Textron's tax accrual workpapers were protected from an IRS administrative subpoena by the work-product doctrine; (2) that Textron did not waive its work-product protection by showing its tax accrual workpapers to its independent auditor, even though the court remanded the question of whether disclosure of E&Y's workpapers would reveal the information contained in Textron's own workpapers; and (3) that the district court should assess on remand the discoverability of E&Y's workpapers by determining whether Textron has the legal right or ability to obtain these documents. *Textron v. United States*, 2009 WL 136752 (1st Cir. 2009).

This article disputes the reasoning and conclusion by the First Circuit in remanding the case. Part II offers a perspective on the development of privilege in the context of tax investigations. Part III analyzes the First Circuit's decision and argues that the remand is inconsistent with the intent of the work-product doctrine and renders the decision a hollow victory for Textron (and other taxpayers). Finally, Part IV provides some practical advice for companies in light of the First Circuit's decision.

### II. Privileges in Tax Litigation

Code section 7602 authorizes the IRS to issue administrative summonses for the production of "any books, papers, records or other data which may be relevant or material" in "ascertaining the correctness of any return,

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... determining the liability of any person for any internal revenue tax ... or collecting any such liability. . . ." The Supreme Court has described section 7602 as a "broad summons authority" reflecting a "congressional policy choice in favor of disclosure of all information relevant to a legitimate IRS inquiry."<sup>8</sup>

Code section 7604 provides that the United States can petition a federal district court for an order compelling compliance in cases where documents requested in a summons are not produced.<sup>9</sup> To obtain such an order, the government must show, pursuant to *United States v. Powell*:<sup>10</sup> (1) that there is a legitimate purpose<sup>11</sup> for the investigation pursuant to which the summons is being sought; (2) that the inquiry of the materials sought may be relevant to that purpose; (3) that the information sought is not already within the government's possession; and (4) that the administrative steps required by the Code have been followed.<sup>12</sup>

Generally, the government must make a *prima facie* showing that the *Powell* requirements have been satisfied. If the government makes the requisite showing, the burden shifts to the party summoned to present evidence to show that the *Powell* requirements have not been satisfied or that there is some other reason why the summons should not be enforced.<sup>13</sup> Satisfaction of the *Powell* requirements, however, is not sufficient to warrant enforcement of an IRS summons if the documents sought are protected by the attorney-client privilege, the work-product privilege, or the tax practitioner-client privilege set forth in Code section 7525.<sup>14</sup>

### **Attorney-Client Privilege**

The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law.<sup>15</sup> It was originally designed to prevent a lawyer from being compelled to testify against his/her client. Today, it still protects confidential communications between clients and their lawyers.<sup>16</sup> It applies equally to legal advice provided by in-house counsel and by outside or retained counsel.<sup>17</sup> The modern public purpose underlying this privilege is to encourage full disclosure without fear that the information will be revealed to others, so that clients receive the best and most competent legal advice and representation.<sup>18</sup> The privilege extends to agents of either the client or the lawyer who facilitate the communication (e.g., paralegals or secretaries).

The attorney-client privilege is fragile, and may be subject to waiver when the content of a confidential communication is disclosed to a third person with no legitimate need to know the information, even in some instances where the disclosure is inadvertent. A waiver can also occur where the communication takes place in public, or in some less than secure environment.

Since the privilege has the potential to prevent the disclosure of relevant evidence, courts construe the privilege narrowly.<sup>19</sup> Generally, in the context of tax investigations

"the congressional policy choice in favor of disclosure of all information relevant to a legitimate IRS inquiry" supports a narrow construction of the privilege.<sup>20</sup>

In addition, the preparation of a tax return is viewed as accounting work so that "[r]outine accountant-client communication[s]" are not "protected by the attorney-client privilege."<sup>21</sup> Accounting functions do not become privileged because they are performed by an attorney.<sup>22</sup> On the other hand, legal advice provided by an attorney could be privileged even if such advice had been given in connection with the preparation of a tax return.<sup>23</sup>

In *United States v. Frederick*,<sup>24</sup> the court explained the distinction, in the context of an IRS audit, by stating that where representation during an audit consists of "merely verifying the accuracy of a return," it is "accountants' work;" but, if the attorney participates in the audit "to deal with issues of statutory interpretation or case law" that may have been raised in connection with examination of the taxpayer's return, "the lawyer is doing lawyer's work and the attorney-client privilege may attach."<sup>25</sup> In *United States v. El Paso Co.*,<sup>26</sup> the court addressed this distinction as it applies specifically to tax accrual workpapers by noting that, although preparation of tax accrual workpapers might be considered an accounting function, "we would be reluctant to hold that a lawyer's analysis of the soft spots in a tax return and his judgment on the outcome of the litigation on it are not legal advice."<sup>27</sup>

### **Work-Product Privilege**

The work-product doctrine originates with *Hickman v. Taylor*.<sup>28</sup> In that case, the Supreme Court held that documents are entitled to work-product protection if they are "prepared in anticipation of litigation." The Court noted that:

[w]ere such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten. An attorney's thoughts, heretofore inviolate, would not be his own. Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial. The effect on the legal profession would be demoralizing. And the interests of the clients and the cause of justice would be poorly served.<sup>29</sup>

The work-product privilege is a qualified privilege that can be overcome by a showing of substantial need.<sup>30</sup> The burden of establishing "substantial need" rests on the party seeking to overcome the privilege. When "opinion work product" consisting of "mental impressions, conclusions, opinions or legal theories" of attorneys is involved, the burden of establishing "substantial need" is greater than it is with respect to documents that are merely obtained by a party.<sup>31</sup> Indeed, some courts have accorded "nearly absolute" protection to work product consisting of opinions or theories.<sup>32</sup>

Like the attorney-client privilege, the work-product

privilege can be waived by disclosure to a third party, either directly or through disclosure to a conduit to an adverse party. As noted by the district court in *Textron*, however, “[s]ince the work product privilege serves a purpose different from the attorney-client or tax practitioner privileges, the kind of conduct that waives the privilege also differs.”<sup>33</sup> The purpose of the attorney-client privilege is to guarantee confidentiality between attorney and client—a purpose that is inconsistent with the notion of disclosing the same information to most third parties. The work-product doctrine, on the other hand, is designed only to prevent a potential adversary from gaining an unfair advantage. As such, “only disclosing material in a way inconsistent with keeping it from an adversary waives the work product protection.”<sup>34</sup> Most courts considering the question have held that disclosure of information to an independent auditor does not waive the work product privilege because it does not substantially increase the opportunity for potential adversaries to obtain the information.<sup>35</sup>

For example, in *Regions Financial Corp. v. United States*,<sup>36</sup> the court considered whether a legal analysis produced for Regions Financial (“Regions”) in connection with the determination of its tax reserve was protected as work product and, if so, whether Regions waived the privilege by transmitting that analysis to a third party. The court concluded that, but for the prospect of litigation with the IRS, Regions would not have needed to create a tax reserve. Therefore, the withheld documents were produced primarily in anticipation of litigation with the IRS and protected from discovery.

The court also determined that Regions did not waive work product protection by transmitting outside counsel’s analysis to the accountants. Here, the court held that “there is simply no conceivable scenario in which [the accountants] would file a lawsuit against Regions because of something [the accountants] learned from Regions’ disclosures.”<sup>37</sup> It also held that the accountants could not serve as a conduit to an adversary because it entered into a confidentiality agreement with Regions.<sup>38</sup>

With respect to the “anticipation of litigation” requirement, courts have applied two different tests in making the determination whether a document was prepared in anticipation of litigation. Under the “primary purpose” test, documents are held to be prepared in anticipation of litigation “as long as the primary motivating purpose behind the creation of a document was to aid in possible future litigation.”<sup>39</sup>

The First Circuit (and ten other circuits) interpret the “anticipation of litigation” requirement more liberally as a “because of” test, protecting documents “prepared or obtained because of the prospect of litigation.”<sup>40</sup> On the other hand, “documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation” do not receive protection.<sup>41</sup> In *United States v. Adlman*,<sup>42</sup> the Second Circuit,

in finding the “because of” test “more consistent with” the “anticipation of litigation requirements,”<sup>43</sup> gave an example of a work-product-protected document (analogous to those requested in the *Textron* case):

Financial statements include reserves for projected litigation. The company’s independent auditors request a memorandum prepared by the company’s attorneys estimating the likelihood of success in litigation and an accompanying analysis of the company’s legal strategies and options to assist it in estimating what should be reserved for litigation losses.<sup>44</sup>

#### Code Section 7525 Privilege

Code section 7525(a)(1) provides that:

With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner<sup>45</sup> to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

The extension of confidentiality does not, however, extend to communications relating to a “corporate tax shelter.” The specific language of the exclusion is that the confidentiality privilege shall not be applicable to:

any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in section 6662(d)(2)(C)(iii)).<sup>46</sup>

As noted above, Code section 7525 only applies to communications that would be privileged if the practitioner were an attorney.<sup>47</sup> For example, because information disclosed to an attorney for the purpose of preparing a tax return is not privileged, such information is not privileged under Code section 7525 when disclosed to an accountant or enrolled agent.<sup>48</sup> The Code section 7525 privilege also does not protect attorney work-product. In addition, the extension of privilege to authorized Federal tax practitioners is subject to all of the limitations of the attorney-client privilege, including waiver by disclosure.<sup>49</sup>

Prior to the enactment of Code section 7525, the Supreme Court refused to create an accountant-client privilege for tax accrual workpapers in *United States v. Arthur Young & Co.*<sup>50</sup> In *Arthur Young*, the IRS issued a summons to Arthur Young, the taxpayer’s accountant, for the tax accrual workpapers created and held by Arthur Young. In *Arthur Young*, the accountants prepared the workpapers, not attorneys. As such, none of the “traditional privileges” were in dispute; instead, Arthur Young asked the Court to “create a so-called privilege for the independent auditor’s workpapers.”<sup>51</sup> The

Court declined, noting that “no confidential accountant-client privilege exists under federal law,” and holding that none should be created absent direction by Congress.<sup>52</sup> In addition, the Court declined to create for accountants a new “analogue to the attorney work-product doctrine. . . .”<sup>53</sup>

### III. Analysis of First Circuit’s Textron Decision

In *United States v. Textron*, the U.S. Court of Appeals for the First Circuit, in a 2-1 ruling, upheld the district court’s ruling that Textron’s tax accrual workpapers were protected from disclosure to the IRS. Although the court affirmed the district court’s finding that Textron and E&Y were not potential adversaries (so there was not a direct waiver of the privilege), the court vacated the lower court’s ultimate determination that work-product protection was not waived by disclosure to a conduit of a potential adversary.<sup>54</sup> The court remanded the case to the district court to reassess, in a manner consistent with the First Circuit’s opinion, the question of whether disclosure of E&Y’s workpapers would reveal the information contained in Textron’s own workpapers. The First Circuit also indicated that the district court should assess the discoverability of E&Y’s workpapers by determining whether Textron has the legal right or ability to obtain those documents.

In dissent, Judge Boudin argued that precedent established that tax accrual workpapers are not protected because they are prepared for reasons independent of the need to prepare for or conduct litigation.<sup>55</sup> In Judge Boudin’s view, the subject matter should not control; instead, whether the documents at issue were prepared in the ordinary course of business or were otherwise independently required should determine whether such documents receive work-product protection. In this case, he noted, the tax accrual workpapers were mandated by accounting requirements.

As noted in Part II, the First Circuit follows the “because of” test to determine whether documents were prepared in anticipation of litigation. This test does not protect documents, however, that are prepared in the ordinary course of business or that would have been created in essentially similar form regardless of the litigation. In its decision, the court held that the presence of a business purpose does not defeat the work-product protection.<sup>56</sup>

In reaching this decision, the court first set forth the law regarding the work-product doctrine.<sup>57</sup> The court then turned to whether tax disputes are litigation.<sup>58</sup> There the court found that although the preparation of tax returns is not an adversary process, the anticipation of audit disputes related thereto can constitute anticipation of litigation.<sup>59</sup>

The more significant question in this case related to whether Textron’s tax accrual workpapers (which analyzed positions taken on Textron’s tax return) were prepared in anticipation of litigation. The IRS argued that Textron’s tax accrual workpapers were not entitled to work-product protection because the workpapers would have been prepared, even in the absence of the prospect of litigation,

to comply with Textron’s public reporting requirements under the securities laws.<sup>60</sup> As such, in the IRS’s view, these public reporting requirements meant that the tax accrual workpapers were prepared in the ordinary course of business and not entitled to work-product protection.<sup>61</sup>

Textron disagreed with the IRS’s view, relying on *Adlman* for the proposition that “work-product protection should not be denied to a document that analyzes expected litigation merely because it is prepared to assist in a business decision.”<sup>62</sup> In preparing its tax accrual workpapers, Textron’s attorneys advised the company on the merits of tax law issues and determined the hazards of litigation should the IRS challenge Textron’s conclusions.

Furthermore, Textron’s attorneys regularly made legal assessments of potential liabilities posed by anticipated litigation on numerous legal issues and those assessments were reflected in the company’s contingency reserves. From Textron’s perspective, tax contingency reserves are indistinguishable from other contingency reserves and the legal analysis contained in Textron’s tax accrual workpapers should be indistinguishable from the legal analysis in other types of documents. For example, in *Simon v. G.D. Searle & Co.*,<sup>63</sup> the court held that documents prepared by the Searle company to reflect product liability risk assessments “were not themselves prepared in anticipation of litigation, [but] they may be protected from discovery to the extent that they disclose the individual case reserves calculated by Searle’s attorneys.”<sup>64</sup> Analogously, Textron asserted that the reasoning in *Searle* should apply to shield its tax accrual workpapers from discovery.

In its decision, the First Circuit adopted Textron’s view that its workpapers “were prepared ‘because of’ the risk of disputes and litigation. . . .”<sup>65</sup> The court also rejected the IRS’s argument that the “mere presence of a business or regulatory purpose defeats work-product protection.”<sup>66</sup> In Textron’s case, the court found, “the business purpose derives from and is inextricably related to anticipating litigation.”<sup>67</sup>

As previously noted, the dissent disagreed with the majority’s legal conclusion.<sup>68</sup> The majority noted, however, that adopting the dissent’s view would imply that “all documents prepared with some business purpose in mind are necessarily unprotected.”<sup>69</sup> In short, work-product protection should be available for “dual purpose documents where one business purpose is present.”<sup>70</sup>

Having concluded that the tax accrual workpapers were entitled to work-product protection, the court turned to the question of whether Textron waived that protection by disclosing the workpapers to E&Y, its independent auditor. The general principle is that work-product protection is lost only if disclosure is made to an “adverse” party.<sup>71</sup> Although the IRS asserted that E&Y and Textron were potential adversaries, Textron argued that E&Y is not an adverse party so that disclosure of its workpapers does not waive work-product protection.<sup>72</sup>

In its opinion, the court first concluded that Textron and E&Y were not actual adversaries.<sup>73</sup> Furthermore, the court found that the purpose of E&Y's audit was not to identify disputes that it would have with Textron, but rather, to decide if it could certify Textron's financial statements.<sup>74</sup> Although the court contemplated circumstances where there could be an adversarial relationship, it found no such circumstances here.<sup>75</sup>

Waiver can also occur upon disclosure to a conduit to a potential adversary.<sup>76</sup> Although E&Y has professional confidentiality obligations, the IRS argued that E&Y could be required to turn documents over to the Securities and Exchange Commission and, in certain circumstances, could have a duty to disclose information to protect shareholders.<sup>77</sup> Furthermore, the court noted that E&Y could be required to disclose Textron's tax accrual workpapers in response to a valid subpoena.<sup>78</sup>

Under the facts of this case, E&Y did not receive copies of Textron's workpapers. As such, there is almost no possibility that E&Y would have to disclose those papers. In fact, the court states that "the only remaining documents which could be subjected to a risk of discovery are E&Y's own assessments, which incorporate Textron's analysis."<sup>79</sup> Citing *Arthur Young*, the court cursorily suggested that E&Y's workpapers might be discoverable, even though Textron's workpapers themselves are protected from disclosure.<sup>80</sup>

Since E&Y's workpapers could be discoverable, the question arises as to whether disclosure of those workpapers substantially increased the risk that the contents of Textron's workpapers would be disclosed to an adversary, thereby waiving Textron's work-product protection.<sup>81</sup> Because the district court did not address this question, the First Circuit remanded the issue to the district court.<sup>82</sup> The court also remanded the factual question of whether Textron can obtain copies of E&Y's workpapers.<sup>83</sup>

#### **IV. Implications of *Textron* Holdings**

The determination that Textron's tax accrual workpapers are subject to work-product protection is a significant decision and, at first blush, appears to be a victory for Textron (and taxpayers in general). On the other hand, the court's remand of the case to the district court to address the waiver issue is a hollow victory for taxpayers and inconsistent with the First Circuit's articulation of the purpose of the work-product doctrine as promoting fairness in the adversarial system.<sup>84</sup>

On remand, the district court should continue to follow the First Circuit's holding that Textron's tax accrual workpapers are protected by the work-product doctrine. If the district court finds that Textron has waived its work-product protection for the tax accrual workpapers by disclosure to E&Y, which itself is not an adversary, but would have to be found to be a conduit to an adversarial party, the government will have obtained the requested documents through the backdoor.<sup>85</sup> Such a ruling would upset the fairness in the

adversarial system that the First Circuit's opinion seemed intended to protect.

Despite the remand, the decision offers some guidance from a practical perspective. First, the First Circuit's decision should be helpful to tax departments because the court found that companies do not need to prepare tax accrual workpapers that demonstrate the potential for litigation (or past history of litigation). Moreover, tax accrual workpapers need only contain an analysis because of the anticipation of litigation, even if there are other business reasons for the preparation of that analysis.<sup>86</sup>

Since Textron ruled on the IRS's ability to obtain tax accrual workpapers prior to the release in 2006 of FASB Interpretation No. 48 ("FIN 48"), the question arises as to how the issues raised by this case will be resolved in the context of FIN 48.<sup>87</sup> For example, the IRS has issued a Chief Counsel Memorandum<sup>88</sup> that concludes that workpapers prepared to support a company's compliance with FIN 48 are subject to the IRS's policy of restraint set forth in section 4.10.20.2(2) of the Internal Revenue Manual ("IRM"). At the same time, the IRS has prepared extensive training materials for its revenue agents on the use of FIN 48 information.<sup>89</sup> Thus, it would appear that FIN 48 will be an important factor in future taxpayer audits, even if the IRS does not actually request a company's FIN 48 workpapers.

In light of *Textron's* remand to the district court on the issue of waiver, taxpayers should be concerned about whether they are able to protect their workpapers relating to FIN 48 (or otherwise) from discovery. The IRS has significant interest in FIN 48 and will likely scrutinize the public disclosures related thereto. Furthermore, to the extent that companies are subjected to foreign audits, FIN 48 disclosures will likely be fair game for foreign examiners. Although companies should review their FIN 48 practices in light of *Textron*, it is reasonable to conclude that the case provides some assurance that uncertain tax positions established under FIN 48 should also enjoy protection under the work-product doctrine.

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<sup>1</sup>Treas. Reg. § 1.6011-4(c)(3)(i)(A) defines "listed transaction." Designating a transaction as a "listed transaction" means that the IRS intends to challenge such transactions (and that taxpayers are required to disclose such transactions on their U.S. federal income tax returns). As of this writing, no federal court has ruled on the IRS's position regarding the treatment of such transactions as set forth in Notice 2005-13.

<sup>2</sup>See, e.g., Announcement 2002-63, 2002-2 C.B. 72 (announcing intention to expand circumstances under which tax accrual workpapers are requested). The IRS did not issue this summons until June 2005, although its audit of Textron for 2001 had begun in April 2003.

<sup>3</sup>The key document contained in the workpapers is a spreadsheet that lists the issues identified by Textron's tax advisors and, for each issue, the hazards of litigation percentage determined by the tax advisors. For each issue, the spreadsheet uses the hazards of litigation percentage to calculate the tax reserve amount in connection with determining Textron's overall tax provision for

presentation on its financial statements. The tax reserve amounts, however, cannot be determined separately by reviewing the financial statements.

<sup>4</sup>See IRC § 7402(b) (providing jurisdiction to district court for summons enforcement).

<sup>5</sup>*United States v. Textron, Inc.*, 507 F. Supp. 2d 138 (D. R.I. 2007).

<sup>6</sup>Moreover, E&Y had expressly agreed not to disclose the workpapers.

<sup>7</sup>*Textron*, 507 F. Supp. 2d at 155.

<sup>8</sup>*United States v. Arthur Young & Co.*, 465 U.S. 805, 816 (1984).

<sup>9</sup>See also IRC § 7602(b).

<sup>10</sup>379 U.S. 48 (1964).

<sup>11</sup>IRC § 7602(a) provides that “ascertaining the correctness of any return” and “determining the liability of any person for any internal revenue tax” are legitimate purposes of issuing a summons. In contrast, it is improper to “us[e] a civil summons to gather evidence to be used solely in a criminal prosecution,” *United States v. Kis*, 658 F.2d 526, 535 (7th Cir. 1981), or to issue a summons to “harass the taxpayer or put pressure on him to settle a collateral dispute, or for any other purposes reflecting on the good faith of the particular investigation.” *Powell*, 379 U.S. at 58.

<sup>12</sup>*Powell*, 379 U.S. at 57-58.

<sup>13</sup>See *United States v. Freedom Church*, 613 F.2d 316 (1st Cir. 1979).

<sup>14</sup>See *Upjohn Co. v. United States*, 449 U.S. 383, 386 (1981).

<sup>15</sup>8 Wigmore, *Evidence* § 2290 (McNaughton rev. 1961).

<sup>16</sup>See *Trammel v. United States*, 445 U.S. 40, 51 (1980) (“The lawyer-client privilege rests on the need for the advocate and counselor to know all that relates to the client’s reasons for seeking representation if the professional mission is to be carried out.”).

<sup>17</sup>*Upjohn*, 449 U.S. at 389. Sometimes greater scrutiny is applied to determine whether the advice of in-house counsel is truly legal in nature, or more akin to general business advice that might come from any high ranking person in the organization. Only where the advice is predominantly legal does the privilege apply. See, e.g., *North Pacifica, LLC v. City of Pacifica*, 274 F. Supp. 2d 1118, 1127 (N.D. Cal 2003); *Handguards, Inc. v. Johnson & Johnson*, 69 F.R.D. 451, 453 (N.D. Cal 1975).

<sup>18</sup>*Trammel*, 445 U.S. at 51. The Supreme Court has long recognized this rationale for the privilege. See *Hunt v. Blackburn*, 128 U.S. 464, 470 (1888) (privilege “is founded upon the necessity, in the interest and administration of justice, of the aid of persons having knowledge of the law and skilled in its practice, which assistance can only be safely and readily availed of when free from the consequences or the apprehension of disclosure”).

<sup>19</sup>See, e.g., *In re Keeper of Records (XYZ Corp.)*, 348 F.3d 16, 22 (1st Cir. 2003) (“the attorney-client privilege must be narrowly construed because it comes with substantial costs and stands as an obstacle of sorts to the search for truth.”).

<sup>20</sup>See *Cavallaro v. United States*, 284 F.3d 236, 245 (1st Cir. 2002).

<sup>21</sup>*United States v. Bisanti*, 414 F.3d 168, 171 (1st Cir. 2005).

<sup>22</sup>See *United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999), cert. denied, 528 U.S. 1154 (2000) (“a taxpayer must not be allowed, by hiring a lawyer to do the work that an accountant, or other preparer, or the taxpayer himself or herself, normally would do, to obtain greater protection from government investigators than a taxpayer who did not use a lawyer as his tax preparer would be entitled to”).

<sup>23</sup>See *United States v. Chevron Texaco Corp.*, 241 F. Supp. 2d 1065, 1076 (N.D. Cal. 2002).

<sup>24</sup>182 F.3d 496 (7th Cir. 1999), cert. denied, 528 U.S.1154 (2000).

<sup>25</sup>*Id.* at 502.

<sup>26</sup>682 F.2d 530 (5th Cir. 1982)

<sup>27</sup>*Id.* at 539.

<sup>28</sup>329 U.S. 495 (1947).

<sup>29</sup>*Id.* at 511.

<sup>30</sup>See Fed. R. Civ. P. 26(b)(3).

<sup>31</sup>*Upjohn*, 449 U.S. at 401-02, (“we think a far stronger showing of necessity and unavailability by other means ... would be necessary to compel disclosure” of opinion work-product).

<sup>32</sup>See, e.g., *In re Grand Jury Subpoena*, 220 F.R.D. 130, 145 (D. Mass.2004) (collecting cases).

<sup>33</sup>507 F. Supp. 2d at 152.

<sup>34</sup>*United States v. Mass. Inst. of Tech. (MIT)*, 129 F.3d 681, 687 (1st Cir. 1997); see also *Lawrence E. Jaffe Pension Plan v. Household Int’l Inc.*, 237 F.R.D. 176, 183 (N.D. Ill. 2006) (privilege may be waived by disclosure to third parties “in a manner which substantially increases the opportunity for potential adversaries to obtain the information” (quoting *Vardon Golf Co. v. Karsten Mfg. Corp.*, 213 F.R.D. 528, 534 (N.D. Ill. 2003)).

<sup>35</sup>*Frank Betz Assocs., Inc. v. Jim Walter Homes Inc.*, 226 F.R.D. 533, 535 (D.S.C.2005) (disclosure to independent auditor of documents supporting reserve for copyright infringement litigation did not waive work product protection); *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 229 F.R.D. 441 (S.D.N.Y.2004) (even though an auditor “must maintain an independent role,” disclosure to auditor not a waiver of work product privilege because no likelihood that the independent auditors were a conduit to an adversary ... or that accounting rules would “mandate public disclosure” of the documents).

<sup>36</sup>2008 U.S. Dist. LEXIS 41940 (N.D. Ala.).

<sup>37</sup>*Id.* at \*27-\*28.

<sup>38</sup>*Id.* at \*28.

<sup>39</sup>*El Paso*, 682 F.2d at 542.

<sup>40</sup>*Maine v. Dep’t of Interior*, 298 F.3d 60, 67-68 (1st Cir. 2002).

<sup>41</sup>*Id.* at 70.

<sup>42</sup>134 F.3d 1194 (2d Cir. 1998).

<sup>43</sup>*Id.* at 1198, 1205.

<sup>44</sup>*Id.* at 1200.

<sup>45</sup>IRC § 7525(a)(3) defines “federally authorized tax practitioner” as “any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code.”

<sup>46</sup>IRC § 7525(b).

<sup>47</sup>See *Frederick*, 182 F.3d at 502 (“Nothing in the new statute suggests that these nonlawyer practitioners are entitled to privilege when they are doing other than lawyers’ work.”).

<sup>48</sup>*United States v. KPMG LLP*, 237 F. Supp. 2d 35, 39 (DDC 2002), (privilege “does not protect communications between a tax practitioner and a client simply for the preparation of a tax return”).

<sup>49</sup>See IRS Restructuring Act of 1998, P.L. 105-206, § 3411(c).

<sup>50</sup>465 U.S. 805 (1984).

<sup>51</sup>*Id.* at 815.

<sup>52</sup>*Id.* at 817 (quoting *Couch v. United States*, 409 U.S. 322, 335 (1973)).

<sup>53</sup>*Id.*

<sup>54</sup>The First Circuit did not review the district court's decision that Textron waived the attorney-client privilege and tax practitioner-client privilege upon disclosure of its tax accrual workpapers to E&Y.

<sup>55</sup>See generally 2009 WL 136752, at \*16-\*19.

<sup>56</sup>*Textron*, 2009 WL 136752, at \*4.

<sup>57</sup>*Id.* at \*4-\*5.

<sup>58</sup>*Id.* at \*5-\*6.

<sup>59</sup>*Id.* at \*6.

<sup>60</sup>See, e.g., *Arthur Young*, 465 U.S. at 810-11, n.5-6 (citing laws that "require publicly held corporations to file their financial statements," and requiring that such statements "be audited by an independent certified public accountant in accordance with generally accepted auditing standards").

<sup>61</sup>The IRS also argued that if the court failed to rule in its favor, there would be a circuit split, citing *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982), *cert. denied*, 466 U.S. 944 (1984) for its holding that a company's own tax accrual workpapers were not protected as they were created for the purpose of complying with securities laws. The First Circuit found that no circuit split would be created if it ruled in Textron's favor because the Fifth Circuit applied a different definition of the work-product doctrine.

<sup>62</sup>*Adlman*, 134 F.3d at 1199.

<sup>63</sup>816 F.2d 397 (8th Cir. 1987).

<sup>64</sup>*Id.* at 401.

<sup>65</sup>2009 WL 136752, at \*7.

<sup>66</sup>*Id.*

<sup>67</sup>*Id.*

<sup>68</sup>*Id.* at \*16-\*19.

<sup>69</sup>*Id.* at \*8.

<sup>70</sup>*Id.*

<sup>71</sup>See, e.g., *MIT*, 129 F.3d at 687; see also *supra* text accompanying notes 33-35.

<sup>72</sup>At least one court has held that disclosure to accountants waives work-product protection. See, e.g., *Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113 (S.D.N.Y. 2002).

<sup>73</sup>2009 WL 136752, at \*12.

<sup>74</sup>*Id.* at \*13.

<sup>75</sup>*Id.*

<sup>76</sup>*Id.*

<sup>77</sup>*Id.*

<sup>78</sup>*Id.*

<sup>79</sup>*Id.*

<sup>80</sup>*Id.* (citing *Arthur Young*, 465 U.S. at 815-821). Earlier in its opinion, the First Circuit rejected the IRS's argument that a decision in favor of Textron would be contrary to the precedent of *Arthur Young* since that case did not involve the question of attorney work product. *Id.* at \*8.

<sup>81</sup>*Id.* at \*14.

<sup>82</sup>*Id.*

<sup>83</sup>*Id.* at \*15. The IRS's original subpoena had requested that Textron produce tax accrual workpapers prepared by E&Y that were "within the possession, custody or control of Textron or its accountants." *Id.* at \*14. The district court did not include such workpapers in its definition of the documents sought and so did not rule on their discoverability. *Id.* The IRS asserted that this failure to rule was an error. Textron, on the other hand, argued that the district court's decision should be affirmed because Textron does not have "possession, custody, or control of these documents." *Id.* at \*15.

<sup>84</sup>See, e.g., 2009 WL 136752, at \*5 (stating that the work-product "doctrine is rightly seen as protection for the adversary system. . .").

<sup>85</sup>Such a finding would appear to be contrary to the law. See, e.g., *Regions Financial Corp. v. United States*, 2008 U.S. Dist. LEXIS 41940 (N.D. Ala.) (holding work product protection not waived by transmitting outside counsel's analysis to the accountants because they are neither adversaries nor conduits to adversaries).

<sup>86</sup>Companies should consider labeling their tax accrual workpapers as "Attorney Work-Product." In the Fifth Circuit, the *Textron* decision has much less significance as companies must consider whether anticipation of litigation is the primary purpose for the preparation of the analysis in the tax accrual workpapers, as in *El Paso*.

<sup>87</sup>FIN 48 provides specific guidance on how to account for uncertain tax positions taken or expected to be taken on tax returns and prescribes a recognition threshold and measurement attribute for financial statement treatment of such positions.

<sup>88</sup>See AM 2007-0012 (Mar. 22, 2007). Under the policy of restraint, the IRS will generally request audit or tax accrual workpapers only in unusual situations. See IRM § 4.10.20.3.

<sup>89</sup>See *IRS Releases FIN 48 Training Materials in Response to Industry Group's FOIA Request*, 2007 Financial Reporting Watch 205-7 (Oct. 23, 2007); *IRS Training Auditors to Scrutinize FIN 48 Disclosures*, SEC Correspondence, 16 Tax Mgmt. Transfer Pricing Rep. 211 (July 26, 2007). □

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