



## Tax Talk

by Christine S. Hooks

# The Tax-Related Privilege You May Have Already Waived

**You can be forgiven if you've never heard of the** tax practitioner privilege. After all, it is a statutory privilege created by the U.S. Congress in 1998 that can only be claimed in noncriminal tax-related administrative and judicial proceedings involving the Internal Revenue Service (IRS) or United States.<sup>1</sup> Essentially, it extends the protections of the common-law attorney-client privilege to communications between non-lawyer tax practitioners, such as accountants, and their clients. But like the attorney-client privilege, the tax practitioner privilege may be waived by disclosure of the communications to third parties. While the tax practitioner privilege may only be claimed in tax proceedings, it can be waived in any type of proceeding, including non-tax proceedings. Therefore it is useful for non-tax practitioners to be aware of its protections.

### Relationship to the Attorney-Client Privilege

As noted, through 26 U.S.C. § 7525 Congress extended the protections of the attorney-client privilege to certain communications between tax practitioners and their clients. The statute provides that communications between tax practitioners and their clients are protected in tax proceedings “to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.”<sup>2</sup> There are few cases applying the tax practitioner privilege, but the courts generally apply the same elements that are applied in the context of the attorney-client privilege. The formulation of these elements varies somewhat from circuit to circuit, but generally includes the following:

- (1) Where legal advice of any kind is sought;
- (2) from a professional legal advisor 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 his legal advisor;
- (8) except the protection be waived.<sup>3</sup>

Both privileges are intended to promote full and frank communication by clients in seeking legal or tax advice.<sup>4</sup> Therefore only those communications “which reflect the lawyer’s [or tax practitioner’s] thinking [or] are made for the purpose of eliciting the

lawyer’s [or tax practitioner’s] professional advice or other legal assistance” fall within the privilege.<sup>5</sup> However, because one of the objectives of the privileges is to assist clients in conforming their conduct to the law, litigation need not be pending or anticipated at the time of the confidential communication.<sup>6</sup>

### Who Qualifies as a Tax Practitioner?

Under the statute, the privilege only extends to communications with a “federally authorized tax practitioner.” A federally authorized tax practitioner “means 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, U.S. Code.”<sup>7</sup> 31 U.S.C. § 330 allows the Secretary of the Treasury to regulate the practice of representatives of persons before the U.S. Department of the Treasury. Those authorized to practice before the IRS include attorneys, certified public accountants, enrolled agents, and actuaries.<sup>8</sup> However, the regulations governing tax practitioners in activities before the IRS expressly state that nothing in the regulations shall “be construed as authorizing persons not members of the bar to practice law.”<sup>9</sup> Thus, the tax practitioner privilege applies to confidential communications made in the course of an accountant’s or other tax practitioner’s practice before the IRS, which may include advising on proper tax treatment, representing taxpayers in audits, appearing before the IRS’s Office of Appeals, and corresponding with the IRS. As is true for the attorney-client privilege, both outside practitioners and in-house accountants who are federally authorized tax practitioners are covered by the tax practitioner privilege.<sup>10</sup>

### What Types of Communications Qualify?

The tax practitioner privilege only applies when the tax practitioner is doing the equivalent of lawyer’s work. Even though the tax practitioner is not a lawyer, he or she may have sufficient knowledge and expertise in the area of tax law to be able to provide tax advice regarding the tax treatment of a particular transaction or the likely IRS position in any tax-related dispute. Thus, it is only confidential communications made to a tax practitioner for the purpose of seeking tax advice that are protected by the privi-

*Christine S. Hooks is a tax controversy associate with Mayer Brown LLP in Washington, D.C. She was previously both a trial attorney and counsel to the deputy assistant attorney general for civil matters for the U.S. Department of Justice, Tax Division.*

lege. Courts have held that communications made for the purpose of preparing tax returns do not fall into this category.<sup>11</sup> Even if such communications are made for mixed purposes, preparing tax returns and litigation, they are not protected by privilege.<sup>12</sup> Also not protected are communications related to obtaining accounting advice that is in the nature of business, as opposed to legal, advice. For instance, documents raising issues regarding a corporate taxpayer's inventory methods, compensation packages, or general structure, even if coupled with tax analysis, have been held not protected.<sup>13</sup>

### Exceptions to the Privilege

There are exceptions to the protection of the tax practitioner privilege. Like the attorney-client privilege, the tax practitioner privilege is subject to the crime-fraud exception. Under this exception, no privilege applies to communications made in furtherance of a crime or fraud. In other words, when the communication is made to seek advice relating "not to prior wrongdoing, but to future wrongdoing," the communication is not protected.<sup>14</sup>

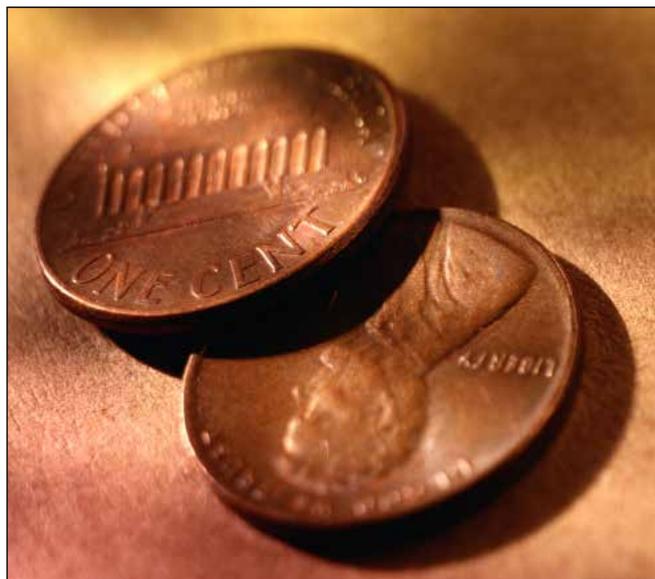
There is also a statutory exception to the tax practitioner privilege. The privilege does not apply to written communications made "in connection with the promotion of the direct or indirect participation of the person in any tax shelter."<sup>15</sup> This language has been interpreted broadly, such that any written communication encouraging participation in a tax shelter prior to the taxpayer's decision to participate is not protected by the privilege.<sup>16</sup> However, the exception does not apply to documents informing a company about various tax shelter arrangements, assessing such plans in a neutral fashion, or evaluating soft spots in tax shelters a taxpayer has used in the past.<sup>17</sup>

Under either exception, the party seeking to abrogate the privilege bears the burden of presenting prima facie evidence that gives "color to the charge" by showing "some foundation in fact."<sup>18</sup>

### Waiver of the Privilege

Because the tax practitioner privilege only extends to communications that would be privileged if they had been between an attorney and client, the tax practitioner privilege is subject to the same rules regarding waiver as the attorney-client privilege.<sup>19</sup> For instance, like the attorney-client privilege, the tax practitioner privilege may be impliedly waived in a proceeding by putting the tax advice at issue. In the tax context this often arises in defending against the imposition of penalties, where penalties may be reduced if the taxpayer had "reasonable cause" for taking a position that resulted in a significant tax understatement. When a taxpayer relies on advice from a tax advisor as this "reasonable cause," it effects a waiver of the tax practitioner privilege for all communications on the same subject.<sup>20</sup>

More importantly for non-tax practitioners, the privilege can also be waived by voluntary disclosure to third parties. This can be a knotty problem for corporate taxpayers, who may have occasion to share information with several internal departments, outside auditors and consultants, third parties on the opposite side of proposed transactions, and government regulators. Disclosure to any of these people or entities may waive the privilege. Many courts have held that voluntary disclosure to government agencies<sup>21</sup> and outside independent auditors<sup>22</sup> will waive the privilege. In most cases, disclosure to a third-party company, even in



the context of due diligence prior to acquisition, will waive the privilege.<sup>23</sup> These waivers will often occur even if a non-waiver agreement<sup>24</sup> or confidentiality agreement<sup>25</sup> is in place. While generally confidential communications can be shared among internal employees whose knowledge is integral to the advice,<sup>26</sup> some courts have held that disclosure outside of a close circle of "need to know" employees may waive the privilege.<sup>27</sup>

### Conclusion

In light of the ease with which the tax practitioner privilege may be waived, it is important, even for non-tax practitioners, to be aware of its protections and limitations. By being cognizant of the various protections and limitations, a procedure can be implemented for identifying privileged materials similar to those employed with respect to the attorney-client privilege. When considering whether to voluntarily disclose documents, those reviewing the documents for privilege claims should become familiar with the authors and recipients who are accountants or other tax practitioners so that they can evaluate whether the documents might convey confidential communications for the purpose of obtaining tax advice. Any such documents should be reviewed by the client's accountant, or in the case of a corporate taxpayer, its tax department, to determine whether the documents relate to tax advice as opposed to business/accounting advice. While it may ultimately be concluded that the benefits of disclosing outweigh the costs of waiver in the particular context, armed with an awareness of the tax practitioner privilege the decision whether to disclose can be an informed one. ©

### Endnotes

<sup>1</sup>26 U.S.C. § 7525(a)(2).

<sup>2</sup>*Id.* § 7525(a)(1).

<sup>3</sup>*In re Grand Jury Subpoena (Mr. S)*, 662 F.3d 65, 71 (1st Cir. 2011) (quoting 8 J.H. WIGMORE, EVIDENCE § 2292, at 554 (McNaughton rev. 1961)).

<sup>4</sup>*See Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

<sup>5</sup>*United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999).

<sup>6</sup>*United States v. BDO Seidman*, 492 F.3d 806, 815 (7th Cir.

2007).

<sup>7</sup>26 U.S.C. § 7525(a)(3)(A).

<sup>8</sup>31 C.F.R. § 10.3.

<sup>9</sup>*Id.* § 10.32.

<sup>10</sup>*United States v. Textron, Inc.*, 507 F. Supp. 2d 138, 147-48 (D.R.I. 2007), *rev'd on other grounds*, 577 F.3d 21 (1st Cir. 2009).

<sup>11</sup>*In re Grand Jury Proceedings*, 220 F.3d 568, 571 (7th Cir. 2000); *United States v. Lawless*, 709 F.2d 485, 487 (1983).

<sup>12</sup>*In re Grand Jury Proceedings*, 220 F.3d at 571; *United States v. Frederick*, 182 F.3d 496, 501 (7th Cir. 1999).

<sup>13</sup>*Valero v. United States*, 569 F.3d 626, 631 (7th Cir. 2009).

<sup>14</sup>*United States v. Zolin*, 491 U.S. 554, 562-63 (1989). *See also United States v. BDO Seidman*, 492 F.3d 806, 818 (7th Cir. 2007).

<sup>15</sup>26 U.S.C. § 7525(b). A "tax shelter" is defined as any plan or arrangement, a significant purpose of which is the avoidance or evasion of federal income tax. *Id.* § 6662(d)(2)(C)(ii).

<sup>16</sup>*Valero*, 569 F.3d at 632-33. *See also United States v. Textron, Inc.*, 507 F. Supp. 2d 138 (D.R.I. 2007) (holding that exception did not apply to advice given regarding tax shelter transactions entered into in the past).

<sup>17</sup>*Valero*, 569 F.3d at 632-33.

<sup>18</sup>*BDO Seidman*, 492 F.3d at 818; *Valero*, 569 F.3d at 634.

<sup>19</sup>*See Textron*, 507 F. Supp. 2d at 151.

<sup>20</sup>*Salem Fin., Inc. v. United States*, 102 Fed. Cl. 793, 798 (Fed. Cl. 2012).

<sup>21</sup>*See, e.g., In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289 (6th Cir. 2002).

<sup>22</sup>*See, e.g., Textron, Inc.*, 507 F. Supp. 2d at 151-52; *First Fed. Sav. Bank of Hegewisch v. United States*, 55 Fed. Cl. 263, 268-69 (Fed. Cl. 2003).

<sup>23</sup>*Compare Cheeves v. Southern Clays, Inc.*, 128 F.R.D. 128, 130-31 (M.D. Ga. 1989) (finding waiver by disclosure to third party in context of due diligence for an acquisition) *with Rayman v. American Charter Fed. Sav. & Loan Ass'n*, 148 F.R.D. 647, 652 (D. Neb. 1993) (citing benefit of encouraging communication between buyers and sellers as rationale for finding no waiver in context of acquisition).

<sup>24</sup>*See* FED. R. EVID. 502(e) ("An agreement on the effect of disclosure in a federal proceeding is binding only on the parties to the agreement, unless it is incorporated into a court order."); *Bowne v. AmBase Corp.*, 150 F.R.D. 465, 478-79 (S.D.N.Y. 1993) (non-waiver agreement between parties in one case not binding on third party in another civil case).

<sup>25</sup>*See, e.g., Westinghouse Elec. Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1427 (3d Cir. 1991).

<sup>26</sup>*See Upjohn Co. v. United States*, 449 U.S. 383, 391-92 (1981).

<sup>27</sup>*Verschoth v. Time Warner Inc.*, No. 00 Civ. 1339, 2001 WL 286763, at \*\*2-3 (S.D.N.Y. Mar. 22, 2001).

## ***Foundation of the Federal Bar Association Memorials and Remembrances Gift Program***

*With a tax-deductible gift to the Foundation of the Federal Bar Association, members of the legal profession, the public, business organizations, charitable trusts, or other foundations may create a memorial to a deceased person. Gifts may also be made in honor of someone, an anniversary, birthday, or any other occasion. Your gift helps fund educational and charitable programs that promote public understanding of the law and enhance the cause of justice.*

**Gift Given By:** Miles F. Ryan III

**In Honor/Memory Of:** Robyn Spalter

PLEASE DETACH AND MAIL THE COMPLETED FORM TO: FOUNDATION OF THE FEDERAL BAR ASSOCIATION, 1220 N. FILLMORE ST., SUITE 444, ARLINGTON, VA 22201

*In Memory of* \_\_\_\_\_

*Date of Death* \_\_\_\_\_

*In Honor of* \_\_\_\_\_

*Occasion* \_\_\_\_\_

**Please send acknowledgment to:** \_\_\_\_\_

*Address* \_\_\_\_\_

*City, State, Zip* \_\_\_\_\_

**Donation made by:** \_\_\_\_\_

*Address* \_\_\_\_\_

*City, State, Zip* \_\_\_\_\_