McDermott
Will&Emery

Protecting Privileged Communications in Tax Matters

Kevin Spencer
McDermott Will & Emery LLP
500 North Capitol Street, NW
Washington, DC 20001
202-756-8203
kspencer@mwe.com

Samuel J. Preston
McDermott Will & Emery LLP
500 North Capitol Street, NW
Washington, DC 20001
202-756-8318
spreston@mwe.com

May 13, 2024

Table of Contents

I. Introduction

This memorandum discusses the requirements for establishing and maintaining the attorney-client privilege, the tax practitioner privilege, and the attorney work-product protection with respect to federal tax matters, focused on the business taxpayer. This memorandum is not intended to provide legal advice but presents a generalized summary of the law of privilege. In practice, privilege issues are fact specific, and will be decided based on the circumstances surrounding a particular case.

Because the attorney-client privilege, the tax practitioner privilege, and the attorney work-product protection prevent the discovery of putatively relevant information, courts generally interpret the law of privilege narrowly, and are inclined not to apply a privilege if the party claiming it has not followed the proper procedures for establishing and preserving it. As a result, maintaining privilege often depends on the form, in addition to substance.

Because the conduct of a business's employees will in large part determine whether certain communications or documents are protected, employees should have a basic knowledge of the elements of the two privileges and the work-product doctrine. Parts II, III and IV of this memorandum outline the basic elements of the attorney-client privilege, the tax practitioner privilege, and the attorney work-product doctrine.

Part V applies the general principles to specific issues arising in a tax practice and provides practical guidance for protecting privileged communications.

Please note that this memorandum is for informational purposes only, and is not intended to be legal advice. As such, it cannot be used, for the purpose of: (i) avoiding penalties under the Internal Revenue Code; or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

II. The Attorney-Client Privilege

A. Four Elements of the Attorney-Client Privilege

The purpose of the attorney-client privilege is to encourage full and frank communication between attorneys and their clients, thereby enabling attorneys to provide sound legal advice or advocacy. *See Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981). The four core elements required to establish the existence of the attorney-client privilege are:

(1) a communication,

(2) made between privileged persons,

(3) in confidence,

(4) for the purpose of seeking, obtaining, or providing legal assistance for the client.

Each of these elements is vital to the existence of the privilege, and both attorney and client should take care to ensure that each element is present for each confidential communication. These elements will be discussed in further detail below.

1. A Communication

The attorney-client privilege protects communications from client to attorney and from attorney to client. The communication may be oral, written, or even a wordless gesture, such as a nod in response to an attorney's question. The attorney-client privilege does not protect the facts underlying a communication, however, if such facts are discoverable from some other non-privileged source. *See Adams v. Memorial Hermann*, 973 F.3d 343, 349 (5th Cir. 2020); *United States v. Chevron Texaco Corp.*, 241 F. Supp. 2d 1065 (N.D. Cal. 2002). Thus, a taxpayer may not insulate factual information merely by communicating it to counsel.

2. Between Privileged Persons

a. The Client

Where the client is a business, who is authorized to speak on its behalf for purposes of the privilege? Under the current state of the law, management can speak on behalf of the business. In addition, communications from middle or lower-level employees to counsel in response to counsel's inquiries will be privileged if: (1) the communication was made for the purpose of securing legal advice; (2) the employee making the communication did so at the direction of his superior; (3) the superior made the request so that the business could secure legal advice; (4) the subject matter of the communication was within the scope of the employee's duties; and (5) the communication was not disseminated beyond those persons who, because of the business structure, need to know its contents. *Jacobson Warehouse Co., Inc. v. Schnuck Mkts., Inc.*, 13 F.4th 659, 676 (8th Cir. 2021); *see Upjohn Co. v. United States*, 449 U.S. 383 (1981) (citing *Diversified Indus. Inc. v. Meredith*, 572 F.2d 596, 609 (8th Cir. 1977)).

In certain cases, independent contractors, such as accountants or consultants, may be considered the functional equivalent of employees and may speak to an attorney on the business's behalf under the protection of the attorney-client privilege. *See, e.g., In re Bieter*, 16 F.3d 929 (8th Cir. 1994); *see Berisha v. Lawson*, 973 F.3d 1304, 1318-19 (11th Cir. 2020) (describing the so-called "employee-equivalent doctrine").

b. The Attorney

To be privileged, a communication must be made to a licensed attorney who is acting in his capacity as a lawyer and the communication must be made for the purpose of obtaining or providing legal advice. *United States v. Chevron Texaco Corp.*, 241 F. Supp. 2d 1065, 1076 (N.D. Cal. 2002). The privilege attaches even before the attorney is officially hired and engaged by the putative client. Communications between a client and outside counsel are presumed to be made for the purpose of obtaining legal advice. *Id.*; *Sherwood v. BNSF Railway Co.*, 325 F.R.D. 652, 661 (D. Idaho 2018).

(i) In-House Counsel

In-house counsel are less likely than outside counsel to benefit from the presumption that a communication was made for the purpose of obtaining or providing legal advice. *Oasis Int'l Waters, Inc. v. United States*, 110 Fed. Cl. 97, 98 (Fed. Cl. 2013). This is because, unlike outside counsel, in-house counsel can serve multiple functions within the organization, and may be intimately involved in the day-to-day business activities. *Chevron Texaco Corp*, 241 F. Supp. 2d at 1076. Where the communication is with in-house counsel for a corporation, the corporation must make a clear showing that the speaker made the communication for the purpose of obtaining or providing legal advice, and that the primary purpose of the communication was securing legal advice. *Id.*; *Avianca, Inc. v. Corriea*, 705 F. Supp. 666, 676 (D.D.C. 1989). This requirement prevents corporations from "shielding their business transactions from discovery simply by funneling their communications through a licensed attorney." *Avianica*, 705 F. Supp. at 676.

Communications with in-house attorneys outside the General Counsel's office can also be privileged, but the presumption that such communications relate to legal advice is weaker for such attorneys than for those in the General Counsel's office. *See Oasis Int'l Waters,* 110 Fed. Cl. at 98. The attorney-client privilege can also extend to an attorney's legal advice with respect to the tax consequences of contemplated transactions. *Boca Investerings P'ship v. United States*, 31 F. Supp. 2d 9 (D.D.C. 1998).

(ii) *Kovel* Relationships

The attorney-client privilege protects communications to the agents of the attorney if such agents are acting under the attorney's direct supervision. Agents may include paralegals, secretaries, investigators, messengers, and law clerks. *See United States v. Kovel*, 296 F.2d 918, 921 (2d Cir. 1961); *United States v. Judson*, 322 F.2d 460, 462 (9th Cir. 1963) (privilege may extend to document prepared by accountants that describes client's financial affairs to enable attorney to understand client's financial condition).

The privilege will also extend to communications with agents performing more than ministerial functions, such as accountants or business advisors, if such agents are working under the direct supervision and control of the attorney, and communications with such agents are made for the purpose of facilitating legal advice sought from the attorney. *United States ex rel. Wollman v. Mass. Gen. Hosp.*, 475 F. Supp. 3d 45, 66 (D. Mass. 2020) ("Significantly, in assisting the lawyer, the third party's presence must be 'necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit' and the communication 'must be made for the purpose of obtaining legal advice from the lawyer." (quoting *Kovel*, 296 F.2d at 922)). Ordinarily, communications with agents eligible for privilege are limited to those necessary for the agent to find or interpret facts so as to make them understandable to the attorney who will provide the legal advice. *Cavallaro v. United States*, 284 F.3d 236 (1st Cir. 2002) (finding privilege was waived where a law firm's tax opinion was shared with consultants from an accounting firm, as the consultants did not act in the role of a translator or assist the law firm in providing its legal advice).

Where economists, accountants or consultants are engaged to assist the attorney, they should be retained directly by the attorney. This is especially important in cases where lawyers

use the client's regular accounting firm for assistance because the accounting firm performs many other services for the client that may not be protected by the privilege. In *United States v. Adlman*, 68 F.3d 1495 (2d Cir. 1995), for example, the court found that the lack of contemporaneous documentation, such as a retention letter, suggested that the client's regular accounting firm had not been retained specifically to assist in-house counsel in rendering legal advice regarding the transaction in question, but rather was performing services in its larger capacity as an accountant-advisor. By contrast, in *United States v. Bell*, 1994 U.S. Dist. LEXIS 17408 (N.D. Cal. Nov. 9, 1994), an accountant's report on the client's transfer pricing practices was privileged where the accountant had been retained by the lawyer to assist in preparing a defense to an anticipated IRS challenge to such practices.

(iii) Common Interest Doctrine

The attorney-client privilege is generally waived where the client voluntarily discloses the privileged communication to a third party. But under the common interest doctrine, the privilege is retained when the privilege holder discloses communications to a third party engaged in a "common legal enterprise." *Schaeffler v. United States*, 806 F.3d 34, 40 (2d Cir. 2015). The doctrine requires that the parties share "an identical legal and not solely commercial interest," and is limited to those communications made to further the common interest. *Bennett v. CIT Bank, N.A.*, 432 F. Supp. 3d 1370, 1379 (N.D. Ala. 2020); *see United States v. BDO Seidman, LLP*, 492 F.3d 806, 815-16 (7th Cir. 2007) (common interest doctrine protects memorandum shared by counsel of joint venturers in tax matter); *United States v. Schwimmer*, 892 F.2d 237, 243-44 (2d Cir. 1989) (communications to an accountant hired by co-defendant's attorney were privileged); *United States v. United Technologies Corp.*, 979 F. Supp. 108, 110 (D. Conn. 1997) (consultations and negotiations to minimize tax consequences on formation of a joint venture company were privileged because parties were "collaborators" regarding the tax structure for the joint venture).

The common interest doctrine arises often in cases involving multiple criminal defendants. In such circumstances, parties with common interests should acknowledge their cooperation early in the proceedings and enter into a joint defense agreement before privileged information is shared. The common interest doctrine is also applicable in corporate matters where there is a common legal interest. For example, the common interest doctrine permits parties to a merger to share privileged materials. *United States v. Gulf Oil Corp.*, 760 F.2d 292, 296 (Temp. Emer. Ct. App. 1989).

3. In Confidence

A communication between privileged persons is made "in confidence" if the person communicating reasonably does not expect its contents to be disclosed to anybody outside the attorney-client relationship. *United States ex rel. Barko v. Halliburton Co.*, 74 F. Supp. 3d 183, 190 (D.D.C. 2014). For example, in the context of email communications between and employee and their lawyer exchanged through the employer's email system, the attorney-client privilege obtains only if the employee had "a subjective expectation of confidentiality" which was "objectively reasonable" *Doe 1 v. George Washington Univ.*, 480 F. Supp. 3d 224, 226 (D.D.C. 2020) (noting that if a corporation monitors the use of an employee's email and makes

the employee aware of that monitoring, attorney-client privilege is unlikely to apply); *see also Long-Term Capital Holdings v. United States*, 2003 U.S. Dist. LEXIS 7826, 2003-1 USTC (CCH) 50,304 (D. Conn. 2003) (finding that a tax opinion was never privileged because the taxpayer had intended to eventually furnish the opinion to the IRS).

The presence of a third party at a client-attorney meeting will generally waive the privilege unless the third party meets the requirements for a *Kovel* relationship or the common interest doctrine applies. And where the client makes a communication to the attorney so that the attorney in turn can communicate it to third parties, generally no privilege will attach to that communication. *In re Ampicillin Antitrust Litig.*, 81 F.R.D. 377, 390 (D.D.C. 1978).

With respect to a large organization, the confidentiality of an attorney-client communication can be maintained by sharing such communications on a "need-to-know" basis or with employees who are authorized to speak or act for the company. *Federal Trade Commission v. GlaxoSmithKline*, 294 F.3d 141, 147 (D.C. Cir. 2002). However, to preserve the privilege, a company must limit its distribution of the documents in keeping with the claim of confidentiality. Additionally, the company should provide an admonition to the recipients of the communications that such communications must not be disseminated further. *Id*. at 148; *see In re Busipirone Antitrust Litig.*, 211 F.R.D. 249, 255 (S.D.N.Y. 2002) ("[T]he distribution within a corporation of legal advice received from counsel does not, by itself, vitiate the privilege.").

A party must take reasonable precautions to preserve the confidentiality of a communication. There are at least two situations where this rule is particularly important. First, it may happen that an unauthorized party gains access to the communications and disseminates them. *See Moore v. Commissioner*, T.C. Memo. 2004-259, at *6. Second, it may happen that an authorized party involuntarily discloses the communications. *Gomez v. Vernon*, 255 F.3d 1118, 1131-32 (9th Cir. 2001); Fed. R. Evid. § 502(b). In either situation, the privilege will be waived *unless* the privilege holder is found to have taken reasonable precautions to preserve confidentiality.

4. For the Purpose of Seeking, Obtaining, or Providing Legal Advice

For a communication to be privileged, it must have been made primarily for the purpose of obtaining legal advice from the attorney, and the burden is on the one who would assert the privilege to "clearly demonstrate" that this was the communication's purpose. *Faloney v. Wachovia Bank, N.A.*, 254 F.R.D. 209-10 (E.D. Pa. 2008). It is not necessary, however, that obtaining or providing legal advice was the *sole* purpose of the communication. *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754, 758-59 (D.C. Cir. 2014); *In re General Motors LLC Ignition Switch Litig.*, 80 F. Supp. 3d 521, 530 (S.D.N.Y. 2015). Additionally, a request for legal advice may be implicit, as where the client keeps the attorney apprised of business developments with the expectation that the attorney will render a legal opinion on the basis of the communication. But failure to make the request explicit raises the probability that a privilege claim, if challenged, will be denied. *See North Carolina Elec. Membership Corp. v. Carolina Power & Light Co.*, 110 F.R.D. 511, 516-17 (M.D. N.C. 1986).

As discussed above, communications made to an attorney for the purpose of seeking business advice are not privileged. *Faloney v. Wachovia Bank, N.A.*, 254 F.R.D. 209-10 (E.D.

Pa. 2008). Likewise, when an attorney acts as a negotiator or business agent for the client, confidential communications between them are not privileged. *Georgia-Pacific Corp. v. GAF Roofing Mfgr. Corp.*, 1996 U.S. Dist. LEXIS 671 (S.D.N.Y. Jan. 25, 1996). And where a business proposal prepared by non-lawyers is distributed for simultaneous review by legal and non-legal personnel, courts have generally held that the document is not prepared primarily for seeking legal advice, and is therefore not privileged. *United States v. Chevron Corp.,* 96-1 U.S.T.C. (CCH) ¶ 50,201; *North Carolina Elec. Membership Corp.*, 110 F.R.D. at 514; *In re Vioxx Products Liab. Litig.*, 501 F. Supp. 2d 789 (E.D. La. 2007).

B. Waiver of Attorney-Client Privilege

1. In General

The attorney-client privilege can be lost through express or implied waiver. Since the client is the holder of the privilege, the client can expressly waive it. Where the client is a corporation, the power to claim or waive the privilege resides in the corporation's officers and directors acting subject to their fiduciary constraints. *See CFTC v. Weintraub*, 471 U.S. 343, 348-49 (1985); *SEC v. Alderson*, 390 F. Supp. 3d 470, 479 (S.D.N.Y. 2019) (finding that corporate officer waived privilege on corporation's behalf because, unlike an agent acting in his individual capacity, the officer thought he was "acting to further [the corporation's] business interests").

Waiver of the privilege most commonly occurs when contents of the communication are disclosed to persons outside the privileged relationship. *See In re Sealed Case*, 676 F.2d 793, 809 (D.C. Cir. 1982) (disclosure to SEC pursuant to "voluntary disclosure" program). Disclosure of privileged communications to parent, subsidiary, and affiliated corporations, however, will not result in waiver because such corporations are deemed to be a single "client," and thus not outside the privileged relationship. *United States v. Am. Tel. & Tel. Co.*, 86 F.R.D. 603, 616 (D.D.C. 1979); *Am. Airlines, Inc. v. Travelport Ltd.*, 2012 WL 12884822, at *5 & n.13 (N.D. Tex. 2012) (noting that this rule is more settled for *wholly* owned subsidiaries than for *majority* owned subsidiaries, but nevertheless endorsing the rule for majority owned subsidiaries).

a. Disclosure to Auditors

A classic case of waiver of the attorney-client privilege in a tax context occurs if a copy of the privileged document is provided to the company's financial auditors. *See, e.g.*, *United States v. Sanmina Corp.*, 968 F.3d 1107, 1117-19 (9th Cir. 2020) (privilege waived by providing confidential information to law firm to obtain valuation analysis rather than legal advice); *United States v. Textron, Inc.*, 507 F. Supp. 2d 138 (D.R.I. 2007); *Samuels v. Mitchell*, 155 F.R.D. 195 (N.D. Cal. 1994). Waiver, however, can also occur without disclosure of the privileged document. The privilege for a portion or portions of the document is also waived if the client or attorney, in a writing to the auditor, merely *summarizes* the legal advice that was provided to the client in the privileged document. For example, *In re Pioneer Hi-Bred International, Inc.*, 238 F.3d 1370 (Fed. Cir. 2001) held that Pioneer Hi-Bred waived the attorney-client privilege when it disclosed that it had received favorable tax opinions in a proxy statement even though the tax opinions themselves were not disclosed.

b. Reliance on Counsel as a Defense

Waiver may be implied where a client puts its counsel's advice at issue in the case, such as by claiming that it acted reasonably because it acted on advice of counsel. *See Doe v. Schuylkill Cnty. Courthouse*, 343 F.R.D. 289, 294 (M.D. Pa. 2023) (privilege waived where client "made a conscious decision to inject the advice of counsel as an issue in the litigation"); *Chevron Corp. v. Pennzoil*, 974 F.2d 1156 (9th Cir. 1992) (privilege waived where defendant asserted that its representation on an SEC schedule was reasonable according to tax advice given by legal counsel). As the court in *Chevron Corp. v. Pennzoil* stated, the attorney-client privilege may not be used as both a sword and a shield. *Id*. at 1162. However, the privilege holder must affirmatively place the advice of counsel at issue for implied waiver to apply. By placing the advice in issue, the client has "opened the door" to examination of facts relating to that advice.

Importantly, waiver does not occur simply because a privileged communication is *relevant* to a legally determinative issue. *See, e.g.*, *Rhone-Poulenc Rorer, Inc. v. Home Indem. Co*., 32 F.3d 851, 863-84 (3d Cir. 1994) (finding no waiver where counsel's advice was relevant to whether clients knew certain pharmaceutical products were causing HIV transmission and clients' knowledge was a key issue in the case).

Caution should be taken to prevent waiver when responding to interrogatories or requests for information from the Internal Revenue Service. *In re G-I Holdings, Inc.*, 218 F.R.D. 428 (D.N.J. 2003), G-I Holdings moved to bifurcate the substantive tax and penalty issues to protect privilege during the litigation of the substantive tax issue, with the intent to disclose the privileged communication, if necessary, as part of its penalty defense. G-I Holdings argued that bifurcation was necessary to preserve the attorney-client privilege; otherwise it would be forced to prematurely disclose otherwise privileged advice from attorneys who had structured the transaction at issue. The court denied the motion because it concluded that G-I Holdings waived the attorney-client privilege when it raised the reasonable cause and good faith exception to the Internal Revenue Code ("IRC") section 6662 penalties in its response to interrogatories. In response to the government's interrogatories regarding IRC section 6662 penalties, G-I Holdings said that it was not liable for penalties because it had a reasonable basis for the tax treatment of the transaction, had reasonable cause, and acted in good faith. In explaining its reasonable cause, G-I Holdings stated that it consulted with outside legal counsel and other advisors regarding the tax treatment of the transaction and subsequent events. The court held that these statements constituted a waiver of the privilege, and required G-I Holdings to produce all of the communications regarding the creation of the transaction. Also, in light of its ruling of waiver, the court allowed the government to take the depositions of the attorneys who provided advice for the transaction.

c. Subject Matter Waiver

With respect to voluntary disclosure, courts generally hold that a waiver as to one document waives the privilege with respect to all documents concerning the same "subject matter." *See In re Actos Antitrust Litig.*, 628 F. Supp. 3d 524, 533 (S.D.N.Y. 2022); *Standard Chartered Bank v. Ayala Int'l Holdings, Inc.*, 111 F.R.D. 76, 85 (S.D.N.Y 1986). This rule is also codified in Federal Rules of Evidence ("FRE") 502(a), which explains that an intentional

waiver of attorney-client privilege, either in the context of a federal proceeding or to a federal office or agency, "extends to an undisclosed communication or information" if "the disclosed and undisclosed communications or information concern the same subject matter" and "they ought in fairness to be considered together."

(i) Selective Waiver

The subject matter waiver rule prevents a party from selectively waiving the attorney-client privilege by disclosing favorable communications while preserving the confidentiality of unfavorable communications. *United States ex rel. Wollman v. Mass. Gen. Hosp., Inc.*, 475 F. Supp. 3d 45, 69 (D. Mass 2020). Because the purpose of the rule is to prevent selective disclosures about particular matters, courts tend to limit the waiver to those "communications about the matter actually disclosed," as opposed to lifting the privilege for all documents that touch on the general legal questions involved in the advice. *See United States v. Sanmina Corp.*, 968 F.3d 1107, 1117 (9th Cir. 2020); *see also Dougherty v. Esperion Therapeutics, Inc.*, No. 16-10089, 2020 WL 7021688, at *4 (E.D. Mich. Nov. 30, 2020) ("[C]ourts have generally held that the 'same subject matter' is to be viewed narrowly.").

(ii) Scope of the Waiver

FRE 502(a)(3) provides that waiver extends to undisclosed communications only where disclosed and undisclosed communications "ought in fairness to be considered together." Courts analyze fairness with an eye to whether the privilege holder is attempting to use the privilege offensively and the extent to which the holder's selective disclosure prejudices the opposing party. It is often said that the attorney-client privilege may not be used as "both a sword and a shield." *Ironburg Inventions Ltd. v. Valve Corp.*, 64 F.4th 1274, 1294 (Fed. Cir. 2023); *United States v. Sanmina Corp.*, 968 F.3d 1107, 1117 (9th Cir. 2020).

In this regard, some courts have applied a fairness test to determine the appropriate scope of the subject matter waiver. *See Consol. Litig. Concerning Int'l Harvestor's Disposition of Wisc. Steel (II)*, 1987 U.S. Dist. LEXIS 10912, at *15 (N.D. Ill. 1987) (declining to impose subject matter waiver when disclosure was made to non-litigant because adverse party was in no worse position); *United States v. Rockwell Int'l*, 897 F.2d 1255, 1265 (3d Cir. 1990) (acknowledging disagreement as to the extent of waiver resulting from disclosure to auditor). Also, some courts limit the waiver to reasonably contemporaneous documents, thereby not extending the scope of the waiver to legal advice rendered at a later date, such as a post-transaction evaluation. *In re Pioneer Hi-Bred Int'l, Inc.*, 238 F.3d 1370 (Fed. Cir. 2001); *Long-Term Capital II,* 2003 U.S. Dist. LEXIS 7826, 2003-1 USTC (CCH) 50,304 (D. Conn. 2003).

FRE 502 imposes limits on the subject matter waiver of attorney-client privilege and attorney work-product protection in a federal proceeding or to a federal agency. FRE 502 provides that subject matter waiver only applies if the waiver is intentional and fairness requires additional disclosure. The rule further provides that when the disclosure is made in a state proceeding and is not the subject of a state-court order concerning waiver, the disclosure does not operate as a waiver in a federal proceeding if the disclosure (1) would not be a waiver under Rule 502 if it had been made in a federal proceeding; or (2) is not a waiver under the law of the state where the disclosure occurred.

If a taxpayer waives the attorney-client privilege, the waiver is with respect to all adversaries, including parties in an unrelated action. *See United States v. Bergonzi*, 216 F.R.D. 487 (N.D. Cal. 2003); *McMorgan & Co. v. First Cal. Mortg. Co.*, 931 F. Supp. 703 (N.D. Cal. 1996). Accordingly, a waiver in a IRS audit will mean that the waiver exists for all purposes, even outside of the IRS audit, for example a shareholder derivative suit.

In light of the subject matter waiver rule, a company should avoid disclosing any privileged documents, even documents it is not concerned about revealing. Disclosure of a harmless privileged document could lead to waiver of the privilege for other more sensitive documents concerning the same subject matter. Furthermore, a company may not simply declare that its voluntary disclosure of certain documents does not constitute a waiver with respect to other documents or other parties. However, a company may enter into a binding agreement with an opposing party in order to limit the scope of a waiver of the privilege. *See Eutectic Corp. v. Metco, Inc*., 61 F.R.D. 35, 42-43 (E.D.N.Y. 1973). But note: an agreement with an opposing party is not binding on non-parties to the agreement unless the agreement is incorporated into a court order under FRE Rule 502(e).

d. Inadvertent Waiver

Under Federal Rule of Evidence 502(b)(3), inadvertent disclosure does not waive attorney-client privilege if the holder of the privilege "took reasonable steps to prevent disclosure" and "the holder promptly took reasonable steps to rectify the error." This is a codification of a long-standing common law doctrine. *See Gomez v. Vernon*, 255 F.3d 1118, 1131-32 (9th Cir. 2001) (no waiver if privilege holder took "reasonable precautions" to preserve confidentiality); *United States v. De La Jara*, 973 F.2d 746, 750 (9th Cir. 1992) (no waiver if privilege holder made efforts "reasonably designed" to protect and preserve the privilege). Inadvertent disclosure, even if it waives privilege, will not result in subject matter waiver. *See S.E.C. v. Welliver*, 2012 WL 8015672, at *5 (D. Minn. 2012).

What constitute reasonable steps to prevent disclosure? First, courts consider whether the communications were labeled as privileged. *Carlson v. Carmichael*, 91 Fed. R. Evid. Serv. 1337, at *3 (E.D. Pa. 2013). Courts are also more reluctant to treat the privilege as waived when the attorney, rather than the client, was the one to inadvertently disclose. *See, e.g.*, *United States v. Rickets*, 2015 WL 9478136, *9 (E.D. La. 2015). When files are sent in bulk and only some of the files are privileged, courts consider the volume of total files sent relative to the volume of privileged files, reasoning that a very small number of privileged files in a very large pool of disclosures is consistent with reasonable efforts to prevent disclosure. *See Bd. of Trs., Sheet Metal Workers' Nat. Pension Fund v. Palladium Equity Partners, LLC*, 722 F. Supp. 2d 845, 851 (E.D. Mich. 2010) (excusing production of 184 privileged documents where 63,000 files were disclosed). Courts also consider what screening efforts were employed to catch privileged documents and prevent their distribution. *Id.*; *United States v. Citgo Petroleum Corp*., 2007 WL 1125792, at *4-5 (S.D. Tex. 2007).

The duty to rectify an inadvertent disclosure only arises when the opposing party can prove actual knowledge of the disclosure. *United States ex rel. Heath v. Wisconsin Bell Inc.*, 272 F. Supp. 3d 1094, 1098 (E.D. Wis. 2017). But taking steps to *prevent* future disclosure is not the

same as taking steps to *rectify* an erroneous disclosure. *Id.* Action should be promptly taken to communicate that the disclosure was inadvertent and that the the recipient must return or destroy the accidental disclosures. *Carmody v. Bd. of Trs. of Univ. of Ill.*, 893 F.4d 397, 406 (7th Cir. 2018). Cases from across jurisdictions "hold that once a party realizes a document has been accidentally produced, it must assert privilege with virtual immediacy." *Sikorsky Aircraft Corp. v. United States*, 106 Fed. Cl. 571, 585 (Fed. Cl. 2012).

III. The Tax Practitioner Privilege

Congress created the tax practitioner privilege by enacting IRC section 7525 as part of the IRS Restructuring and Reform Act of 1998. IRC section 7525(a)(1) provides that:

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

IRC section 7525(a)(1).

A federally authorized practitioner is one who is eligible to practice before the Internal Revenue Service under Circular 230, including CPAs, enrolled agents and enrolled actuaries. Note that transfer pricing economists would not ordinarily meet the "eligible to practice" standard but can assist an attorney under a *Kovel* arrangement). A company's in-house tax advisor can provide section 7525 privileged advice to the company. *United States v. Eaton Corp.*, 110 AFTR2d 2012-5638 (N.D. Ohio 2012). Since the tax practitioner privilege incorporates the same limitations that apply to the common-law attorney-client privilege, the tax practitioner privilege is limited to communications by tax practitioners who are acting as tax advisors as opposed to auditors, return preparers, financial or business advisors.

The tax practitioner privilege extends privilege protections to communications between clients and certain non-lawyers, but unlike the common-law attorney-client privilege, the tax practitioner privilege is not absolute in its application. The tax practitioner privilege is restricted to non-criminal tax matters before the Internal Revenue Service, and non-criminal tax proceedings in Federal court brought by or against the United States. *See* IRC section 7525(a)(2). Thus, it does not prevent disclosures, for example, to the SEC or to state authorities. Moreover, to the extent that the SEC or a state authority obtains information that is otherwise protected by IRC section 7525, such disclosure would likely operate as a waiver of the privilege if the IRS later sought the same information. *See, e.g.*, *United States v. Mass. Inst. of Tech.*, 129 F.3d 681, 687 (1st Cir. 1997).

In addition, the tax practitioner privilege does not apply to written communications made "in connection with the promotion of" a "tax shelter." A tax shelter is defined as a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a *significant purpose* of such partnership, entity, plan, or arrangement is the *avoidance or evasion* of Federal income tax. *See* IRC sections 6662(d)(2)(C)(iii); 7525(b). In *Valero Energy Corp.*

v. United States, 569 F.3d 626 (7th Cir. 2009), for example, the Seventh Circuit defined "promotion" broadly to mean *furtherance or encouragement* of a tax shelter and rejected an interpretation which would limit the exception to prepackaged shelter products rather than an individualized tax reduction plan. *But see Countryside Ltd. P'ship v. Comm'r*, 132 T.C. No. 17 (2009), in which the Tax Court held that the exception for tax shelter promotion was ambiguous, and based on the legislative history, pronounced the exception inapplicable to "routine relationships" between advisors and taxpayers.

In *Salem Financial, Inc. v. United States*, 109 AFTR2d 2012-604 (Fed. Cl. 2012), the court held that the taxpayer's post-transaction communications with its tax advisors were not subject to the exception for communications in connection with the promotion of a tax shelter. However, the privilege was also waived because the taxpayer had indicated that it intended to rely on such advice as a defense to penalties.

Because of the limitations described above, the tax practitioner privilege under IRC section 7525 provides less protection and certainty than the common law attorney-client privilege.

IV. The Work-Product Doctrine

A. Background

The work-product doctrine differs from the attorney-client privilege in several respects and provides a potentially broader scope of protection for confidential materials. The work-product doctrine is based on the premise that attorneys must be able to carefully and thoroughly prepare their clients' cases for litigation without undue interference from adversaries. *See Hickman v. Taylor*, 329 U.S. 495, 511 (1947). Unlike the attorney-client privilege, which protects only confidential communications between attorney and client, the work-product doctrine protects a broader range of materials, many of which do not involve client communications (such as research memoranda, factual investigations, and notes from in-house strategy meetings).

The work-product doctrine, however, provides only a qualified immunity from discovery, while the attorney-client privilege is absolute. An adversary may obtain work product if it can establish substantial need for the information contained therein and undue hardship in obtaining the information from other sources. But even if the adversary establishes these factors, the doctrine grants a special protection from disclosure of the attorney's thoughts, mental impressions, conclusions, opinions, and legal theories. Fed. R. Civ. P. 26(b)(3).

The attorney-client privilege and the work-product protection can both apply to the same document and communication. The existence of both for the same document can be important if one is waived but the other remains intact.

The work-product doctrine is codified in Rule 26(b)(3) of the Federal Rules of Civil Procedure ("FRCP"). FRCP 26(b)(3) provides a qualified immunity from discovery for materials that meet the following requirements:

(1) documents and tangible things otherwise discoverable,

(2) prepared in anticipation of litigation, and

(3) prepared by or for a party or by or for that party's representative.

As with the essential elements of the attorney-client privilege, care should be taken to ensure that each element of the work-product doctrine is present for materials intended to be covered by the doctrine.

B. Three Elements of the Work-Product Doctrine

1. Documents or Tangible Things Otherwise Discoverable

The work-product doctrine applies primarily to tangible things, such as written memoranda, photographs, diagrams, drawings, and computer-generated data. But the doctrine also applies to oral testimony, such as when a party seeks to depose an attorney or seeks testimony from a non-attorney that may reveal an attorney's work product. *Wellin v. Wellin*, 211 F. Supp. 3d 793, 808 (D.S.C. 2016); *Clute v. Davenport Co.*, 118 F.R.D. 312, 315-16 (D. Conn. 1988); *see also Alexander v. Federal Bureau of Investigation*, 192 F.R.D. 12, 17 (D.D.C. 2000) ("To analyze an attorney work-product claim as to intangible work product, courts must look to caselaw under *Hickman v. Taylor*, 329 U.S. 495 (1947), and its progeny and not to Fed. R. Civ. P. 26(b)(3), which applies only to 'documents and tangible things.'").

Regardless of the form of the work product, the key question is the extent to which it discloses attorney thought processes. For example, pre-existing business records may not be protected, but an attorney's evaluation of such records, as recorded in an index or a computerized database, would be protected because such materials reveal important aspects of the attorney's understanding of the case. *See Hanover Ins. Co. v. Plaquemines Parish Gov't,* 304 F.R.D. 494, 500 (E.D. La. 2015); *James Julian, Inc. v. Raytheon Co.*, 93 F.R.D. 138, 144 (D. Del. 1982).

2. Prepared in Anticipation of Litigation or for Trial

The work-product doctrine cannot be used to protect everything in an attorney's file, but rather only those materials prepared "in anticipation of litigation." "Litigation" is defined to include "a proceeding in court or administrative tribunal in which the parties have the right to cross-examine witnesses or to subject an opposing party's presentation of proof to equivalent disputation." *Willingham v. Ashcroft*, 228 F.R.D. 1, 4 (D.D.C. 2005). The materials to which the work-product doctrine applies cannot have been prepared in the ordinary course of business.

Courts employ different tests to determine whether materials were prepared in anticipation of litigation, and some courts do not state a particular test.[1] The common tests used

[1] Privilege claims are typically litigated in connection with IRS summons enforcement actions, which are brought in the district court in which the person resides or where a corporation has its principal place of business. If issued to a third party, a different jurisdiction's precedent could

are the "primarily motivated to assist in litigation" test and the "because of the prospect of litigation" test, the latter of which has become the dominant lens through which court's analyze the work product doctrine.

a. "Primary Motivation" Test

In the Fifth Circuit, although litigation need not be imminent, a document prepared for dual purposes can receive protection only if the "primary" motivation for creating the document was to assist in pending or impending litigation. *See La. Corral Mgmt., LLC v. Axis Surplus Ins. Co.*, 650 F. Supp. 3d 491, 498 (E.D. La. 2023) (noting that if "the document would have been created regardless of whether the litigation was also expected to ensue, the document is deemed to be created in the ordinary course of business and not in anticipation of litigation"); *United States v. El Paso Co.*, 682 F.2d 530, 543 (5th Cir. 1982) (no work-product protection for tax reserve analysis prepared primarily for financial reporting purposes).

b. "Because of" Test

Unlike the Fifth Circuit's "primary motivation" test, the "because of the prospect of litigation" test does not require that the document be produced *primarily* for purposes of litigation. Instead, the test is satisfied "so long as anticipating litigation was one of the purposes for which the document was prepared." *Evergreen Trading, LLC v. United States*, 80 Fed. Cl. 122, 133 (Ct. Fed. Cl. 2007).

The "because of the prospect of litigation" test is illustrated by *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998) ("*Adlman II*"). At issue was the tax analysis of a proposed corporate reorganization that Arthur Andersen prepared. The corporation asserted that it had requested Arthur Andersen's tax analysis in anticipation of litigation because it knew that if it undertook the reorganization, the IRS would likely challenge and litigate the tax consequences. The corporation therefore wanted to assess its litigation risks before committing to the reorganization. The Second Circuit held that a document is prepared in anticipation of litigation when the document, in light of the facts of the case, was obtained because of the prospect of litigation. *Adlman II*, 134 F.3d at 1202-03. It explained that this formulation "withholds protection from documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation." *Id.* at 1202. And it vacated the district court's opinion and remanded because the district court had erroneously asked whether the documents were prepared "principally or exclusively" to assist in litigation.

The "because of the prospect of litigation" test has been followed by a majority of the circuits. *See In re Grand Jury Proceedings*, 604 F.2d 798, 803 (3d Cir. 1979); *United States v. Roxworthy,* 457 F.3d 590 (6th Cir. 2006); *Logan v. Commercial Union Ins. Co.*, 96 F.3d 971, 976-77 (7th Cir. 1996) (quoting *Binks Mfg. Co. v. Nat'*132 T.C. No. 17 *l Presto Indus., Inc.*, 709 F.2d 1109, 1118-19 (7th Cir. 1983)); *Pepsico, Inc. v. Baird, Kurtz & Dobson LLP*, 305 F.3d 813, 817 (8th Cir. 2002) (quoting *Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401 (8th Cir. 1987)); *In re Grand Jury Subpoena*, 357 F.3d 900, 907-08 (9th Cir. 2004); *Senate of Puerto Rico v. United*

---

apply. Additionally, the validity of the privilege could arise in the context of tax litigation in the Tax Court, the Court of Federal Claims or a district court in which the taxpayer is located.

States Dep't of Justice, 823 F.2d 574, 586 n.42 (D.C. Cir. 1987). But several circuits have introduced complications or variations on the "because of test," and in some circuits, only district court cases have commented on the appropriate test. These circuits merit specific discussion.

(i) First Circuit

In *United States v. Textron Inc.*, 577 F.3d 21, 26 (1st Cir. 2009), the *en banc* First Circuit voted 3-2 to reaffirm the "because of" test, which a panel of the court had previously adopted in *Maine v. United States Department of Interior*, 298 F.3d 60, 68 (1st Cir. 2002). But two judges vigorously dissented, arguing that the First Circuit had dispensed with the "because of" test and replaced it with a more demanding test which requires that the documents must be "prepared *for use* in possible litigation." *Id.* at 32-33 (emphasis added) (Torruella, J., dissenting); *see United States v. Deloitte LLP*, 610 F.3d 129, 138 (D.C. Cir. 2010) ("Judge Torruella's dissenting opinion in *Textron* makes a strong argument that while the court said it was applying the 'because of' test, it actually asked whether the documents were 'prepared for use in possible litigation,' a much more exacting standard."). Those who would assert work-product protection within the First Circuit should be wary that *Textron* may have adopted a particularly stringent version of the "because of" test.

(ii) Fourth Circuit

The Fourth Circuit endorses the "because of" test, but adds that the preparer must face "an actual claim or a potential claim following an actual event or series of events that reasonably could result in litigation." *In re Grand Jury 2021 Subpoenas*, 87 F.4th 229, 252 (4th Cir. 2023) (quoting *National Union Fire Ins. Co. v. Murray Sheet Metal Co., Inc.*, 967 F.2d 980, 984 (4th Cir. 1992)). A higher degree of imminence may therefore be necessary to obtain work-product protection in this circuit.

(iii) Seventh Circuit

The Seventh Circuit has adopted the "because of" test, but it endorses stringent, and unique, limitations relevant to the tax context. In *United States v. Frederick*, 182 F.3d 496, 501 (7th Cir. 1999), the court of appeals rejected the claim of work-product protection for a lawyer's documents prepared during an IRS audit even though there were numerous objective facts indicating that litigation was expected. The taxpayers had retained Frederick, who was an attorney and an accountant, to prepare the tax returns of two individuals and their company. The Service issued a summons for all of the documents in Frederick's possession, including Frederick's worksheets. The court's opinion focused on whether the worksheets were privileged. At the time Federick prepared the worksheets, the Service had begun its investigation of the individuals and their company. The court nevertheless viewed the worksheets as "accountant's worksheets" that could not be protected by the attorney-client privilege because such worksheets do not constitute legal advice. And it stated, as a rule, that "a document prepared for use in preparing tax returns and for use in litigation—is not privileged."

Frederick indicates that in the Seventh Circuit, documents prepared for use in preparing a tax return may not be privileged even if they were *also* prepared *because of* impending litigation. However, attorneys retained by large corporate taxpayers do not routinely prepare tax returns for

their clients. The facts and outcome in *Frederick* may be avoided where a large corporation retains a law firm for its legal advice and an accounting firm to prepare its tax returns.

(iv) Tenth Circuit

The Tenth Circuit has not adopted any test. However, at least one unpublished district court case has applied the "because of" test. *S.E.C. v. Nacchio*, No. 05-CV-00480MS, 2007 WL 219966, at *6 (D. Colo. Jan. 25, 2007).

(v) Eleventh Circuit

The Eleventh Circuit "has not established a definitive test for courts to follow" and, in fact, "it appears the Eleventh Circuit has never formally adopted *any* test for assessing the scope of the work product privilege." *Holladay v. Royal Caribbean Cruises, Ltd.*, 334 F.R.D. 628, 632 (S.D. Fla. 2020).

(vi) Federal Circuit

The Federal Circuit has not adopted one of the tests. However, the Court of Federal Claims has held that the "because of" test "is the proper way to determine whether a document was prepared in anticipation of litigation." *Evergreen Trading, LLC v. United States*, 80 Fed. Cl. 122 (Fed. Cl. 2007); *Kansas City Power & Light Co. v. United States*, 139 Fed. Cl. 546, 566-67 (Fed. Cl. 2018) (endorsing the "because of" test and noting that litigation need not be imminent for work-product protection to apply).

(vii) Tax Court

The Tax Court recognizes the work-product doctrine. In July 2012, the Tax Court amended Tax Court Rule 70 to more closely follow FRCP Rule 26(b)(3).

Tax Court Rule 70(c)(3) provides:

> (A) A party generally may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent), unless, subject to Rule 70(c)(4),
>
> > (i) they are otherwise discoverable under Rule 70(b); and
> >
> > (ii) the party shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.
>
> (B) If the Court orders discovery of those materials, it must protect against disclosure of mental impressions, conclusions, opinions, or legal theories of a party's counsel or other representative concerning the litigation.

Tax Court Rule 70(c)(3).

The Tax Court follows the "because of" test. *See Eaton Corp. v. Comm'r*, No. 5576-12, 2015 BL 548796 (T.C. Apr. 6, 2015). It does so because the Tax Court applies relevant holdings of the Court of Appeals for the District of Columbia Circuit in resolving contested privilege claims. *Id.* And *United States v. Deloitte LLP*, 610 F.3d 129, 137 (D.C. Cir. 2010) held that courts should apply "the 'because of' test, asking whether, in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation." The Tax Court has noted that, "[t]o meet this standard, a lawyer must have had a subjective belief that litigation was a real possibility, and that belief must have been objectively reasonable." *See Eaton Corp*., 2015 BL 548796, at *3.

The Tax Court generally holds the view that "the audit or examination process is not conducted in anticipation of litigation" unless the matter has been "singled out for litigation." *See, e.g.*, *Bennett v. Comm'r*, T.C. Memo. 1997-505. And, as a corollary principle, the Tax Court has held that the revenue agent's reports, audit workpapers, and district and appellate conference reports are only subject to work-product protection if the agent's work was supervised by counsel or the agent consulted with counsel to support the proposed adjustment. *See, e.g.*, *Branerton Corp. v. Comm'r*, 64 T.C. 191, 198-99 (1975).

c. Case-Specific Applications of the Tests

The determination of whether a document was prepared "in anticipation of litigation" is made on a case-by-case basis. The decisions generally focus on the objective reasonableness of the claim that litigation was anticipated and the subjective purpose for which the document was prepared.

United States v. Chevron Texaco Corp., 241 F. Supp. 2d 1065 (N.D. Cal. 2002) illustrates the factual bases that support a work-product claim under the "because of" test. In *Chevron Texaco Corp.*, the court held that the documents prepared by the company and PricewaterhouseCoopers were prepared in anticipation of litigation:

> The evidence submitted by Chevron supports a finding that, from the start, Chevron reasonably believed that it was a virtual certainty that the IRS would challenge the CEMCO transaction. According to Mr. Marsh, Chevron's General Tax Counsel, the IRS examines all of Chevron's tax returns. Moreover, the CEMCO transaction involved a very substantial amount of tax dollars, and the IRS had previously questioned similar transactions. In addition, Mr. Marsh states that Chevron would not have hired Price Waterhouse but for the imminence of litigation with the IRS. Chevron has shown that Price Waterhouse was acting as its agent when Price Waterhouse prepared the documents in issue here and that it was because Chevron and Price Waterhouse anticipated a vigorous legal challenge by the IRS to the formation of CEMCO that many of the documents were prepared.

Id. at 1082-83 (citations omitted).

More recently, the Court of Federal Claims considered the reasonableness of the government's work-product claim for documents prepared during an audit. In *Deseret Mgmt. Corp. v. United States*, 99 AFTR2d 2007-1891 (Fed. Cl. 2007), the taxpayer sought documents prepared by the IRS during the audit. The government claimed work-product protection because (i) the government reasonably anticipated litigation on the tax issue "almost from the inception of the audit"; and (ii) "once the audit has begun, the likelihood of litigation increases." *Id.* at 93. The court agreed that the government had a reasonable anticipation of litigation: "The court believes that, due to the size of the corporation and the significance of the transaction, both plaintiff and defendant knew or should have known that the auditing process could lead to litigation."[2] *Id.* at 94.

3. By or For a Party or By or For That Party's Representative

The work-product doctrine protects materials prepared by attorneys *and* non-attorneys. *See Spaulding v. Denton*, 68 F.R.D. 342, 344-45 (D. Del. 1975) (explaining that the 1970 amendments to the Federal Rules of Civil Procedure "abolished" "any distinction between attorney 'work product' and non-attorney 'work product'"). However, materials prepared by non-attorneys without prior consultation with counsel, even in anticipation of litigation, are in greater danger of being challenged as prepared in the ordinary course of business. *See Thomas Organ Co. v. Jadranska Slobodna Plovidba*, 54 F.R.D. 367, 372 (N.D. Ill. 1972) (suggesting a presumption that reports or statements made by a non-attorney, without attorney involvement, are made in the ordinary course of business and not privileged); *United States v. Nobles*, 422 U.S. 225, 238-39 (1975) (treating it as relevant that the preparer was not an attorney).[3]

For that reason, non-attorneys, such as economists in a transfer pricing matter, performing duties in preparation for litigation should be retained by, and act solely under the direction of, the client's attorney. *See United States v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010) (work-product protection applied to document prepared by Deloitte tax advisor recording thoughts of taxpayer's counsel regarding the prospect of litigation).

Materials prepared by in-house counsel are entitled to the same protections as those prepared by outside counsel. However, because in-house counsel typically perform legal and

[2] With respect to the assertion of work product for Chief Counsel Advice, the IRS takes the position in a Chief Counsel Notice CC-2002-026, Q&A (37) that the work-product doctrine requires a "litigation predicate," but is not limited to documents prepared in connection with docketed cases or cases in litigation. Also, Chief Counsel Notice CC-2004-012, Q&A (21) provides that an assertion of attorney work product is not limited to documents prepared in connection with docketed cases or cases designated for litigation, but assertion outside of this context should be coordinated with the Associate Chief Counsel. Notice CC-2004-12 identifies two examples in which litigation might reasonably be anticipated: (1) when the taxpayer's representative states an intention to litigate the matter; and (2) the taxpayer has litigated the same issue in prior audit cycles.

[3] *But see Basinger v. Glacier Carriers, Inc.*, 107 F.R.D. 771, 773 (M.D. Pa. 1985) ("The *Thomas Organ* view has been rejected by many courts as contrary to the intent of the 1970 amendments to Rule 26(b).").

non-legal functions, courts may demand proof that the work-product of in-house counsel was not produced in the ordinary course of business or for the purpose of making business and planning decisions. *See, e.g.*, *Hardy v. N.Y. News, Inc.*, 114 F.R.D. 633, 644 (S.D.N.Y. 1987) (denying work-product protection and noting that none of the documents prepared by a corporate manager/attorney were marked "privileged" or "confidential").

C. Waiver of Work-Product Protection

1. Generally

The principles regarding waiver of the work-product protection differ from those regarding the attorney-client privilege. *See In re Kellogg, Root & Brown*, 796 F.3d 137, 145 (D.C. Cir. 2015) (explaining "[i]t is hornbook law" that waiver of attorney-client privilege should be analyzed distinctly from waiver of work-product protection.). First, the attorney-client privilege belongs to the client and cannot be voluntarily waived by the attorney. In contrast, the protection afforded by the work-product doctrine belongs to the attorney and may be voluntarily waived by the attorney. Second, disclosure to third parties does not necessarily result in waiver of the work-product protection. Only those disclosures inconsistent with the purpose of maintaining secrecy from adversaries will constitute waiver (such as revealing work product to an adverse party). The work-product protection may be waived, as may the attorney-client privilege, if a party makes testimonial use of a privileged document or uses it to refresh the recollection of a witness who will testify at a deposition or trial. *See Sporck v. Peil*, 759 F.2d 312, 317-19 (3d Cir. 1985).

The work-product protection must be asserted separately from the attorney-client privilege, and failure to separately assert work-product protection may be treated as waiver. *Carey-Canada, Inc. v. California Union Ins. Co*., 118 F.R.D. 242, 249 (D.D.C. 1986).

The government continues to argue, without success, that the taxpayer waives work-product protection by the mere filing a petition in the Tax Court. *See United States v. Eaton Corp.*, 110 AFTR2d 2012-5638 (N.D. Ohio 2012) where the district court rejected the government's contention that Eaton had implicitly waived its work-product protection by filing a petition in the Tax Court. "The IRS has not persuasively demonstrated that Eaton has affirmatively raised claims that can only be disproven through disclosure of privileged documents." *Id.* at 10.

2. Disclosure to an Outside Financial Auditor

"While disclosure alone can waive the attorney-client privilege, 'it is well-settled that it is more difficult to waive the attorney work-product privilege than it is to waive the attorney-client privilege.'" *Atlanta Channel, Inc. v. Solomon*, No. 15-1823, 2020 WL 6781221, at *3 (D.D.C. Nov. 18, 2020) (quoting *Feld v. Fireman's Fund Ins. Co.*, 991 F. Supp. 2d 242, 252 (D.D.C. 2013)). In the District of Columbia Circuit, for example, disclosure to a third party will generally constitute waiver of the attorney-client privilege, but only disclosure to a *potential or actual adversary* will constitute waiver of work-product protection.

The Court of Appeals for the District of Columbia, in *United States v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010), held that disclosure of communications protected by the work-product doctrine to a financial auditor does not result in waiver of the protection because an independent auditor is not a "potential adversary" to whom disclosure waives work-product protection. The government had subpoenaed documents from Deloitte, Dow Chemical Company's independent auditor. Deloitte produced a number of the documents but refused to produce three documents that Dow identified as work-product. The first document was a draft memorandum prepared by Deloitte summarizing a meeting at which Dow's outside legal counsel was present and recording the legal analysis from Dow's outside counsel about the possibility of litigation over a partnership. The other two documents at issue were created by Dow's counsel but were disclosed to Deloitte so that it could review the adequacy of Dow's contingency reserve.

The *Deloitte* court, after having determined that the second two documents contained protected work product, rejected the government's contentions that the disclosures to Deloitte waived work-product because Deloitte was either a potential adversary or a conduit to an adversary. The court framed the question as whether Deloitte was Dow's adversary in the sort of litigation the documents at issue address and *not* whether Deloitte could be Dow's adversary in a conceivable future litigation. Since the documents prepared by Dow's counsel were prepared in anticipation of litigation with the IRS, not Deloitte, the court held that Deloitte was not a potential adversary. Likewise, the court rejected the contention that Deloitte was a conduit for an adversary. The court found that Dow had a reasonable expectation of confidentiality because Deloitte, as independent auditor has an obligation to refrain from disclosing confidential information. *See also Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 449 (S.D.N.Y. 2004) (declining to construe an auditor as an adversary and to impose a blanket rule of waiver of the applicable work-product privilege that could discourage corporations from conducting critical self-analysis).

But while *Deloitte* is powerful published circuit court precedent, some courts outside the D.C. Circuit have continued to hold that disclosure to independent auditors constitutes a waiver of work-product protection. *See, e.g.*, *First Horizon Nat'l Corp. v. Hous. Cas. Co.*, No. 2:15-cv-2235, 2016 WL 5867269, at *10 (W.D. Tenn. Oct. 5, 2016). These courts instead follow *Medinol, Ltd. v. Boston Scientific Corp*., 214 F.R.D. 113, 115 (S.D.N.Y. 2002), which held that work-product protection is waived by disclosure to any third-party *who does not share a common litigation interest*. Because *Medinol* requires the presence of a common litigation interest, whereas Deloitte merely requires the absence of adversity, disclosure to an independent auditor waives work-product protection under *Medinol* but not under *Deloitte*. *Medinol*'s more demanding rule has been embraced as recently 2018 in *Hedgeserv Ltd. v. Sungard Systems International Inc*., No. 16-CV-05617, 2018 WL 6538197, at *2-3 (S.D.N.Y. Nov. 20, 2018), and it has a long pedigree. *See, e.g.*, *Samuels v. Mitchell*, 155 F.R.D 195, 201 (N.D. Cal. 1994) ("[T]he relationship between public accountant and client is at odds with such a guarantee [of confidentiality] because the public accountant has responsibilities to the creditors, stock holders, and the investing public which transcend the relationship with the client…. Because it appears

that Arthur Young was acting as a public consultant in this case we find the work-product protection is inapplicable to these documents.").[4]

3. Fact versus Opinion Work Product

Courts distinguish between opinion work product and fact work product, recognizing that opinion work product is subject to stronger protections. Under FRCP 26(b)(3)(B), where a court orders discovery of attorney work product, "it must protect against disclosure" of opinion work product, i.e., "the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation." *See Deloitte*, 610 F.3d at 135 (describing opinion work product as "virtually undiscoverable").

Since opinion work product is viewed as being nearly immune from discovery, subject matter waiver for opinion work product is generally limited to those documents actually produced. *See In re Martin Marietta Corp.*, 856 F.2d 619, 627 (4th Cir. 1988). However, like a waiver of the attorney-client privilege, a waiver of fact work-product materials may extend to all fact work product of the same subject. *Id*.; *see* FRE 502 (limiting waiver of disclosed work product under certain circumstances).

Black & Decker Corp. v. United States, 219 F.R.D. 87 (D. Md. 2003), illustrates the differences in scope of subject matter waiver between opinion and fact work product. In *Black & Decker*, the company ("B&D") asserted the work-product and attorney-client privileges to protect documents reflecting communications between B&D's in-house tax counsel and Deloitte & Touche (D&T). In 1998, B&D entered into a contingent liability transaction to manage its health care costs. D&T wrote two opinions for B&D, the short and long opinions. Initially, B&D produced the short opinion to the IRS during the audit. After commencing a refund suit, B&D produced the long opinion after the parties agreed that the disclosure of the long opinion would not give rise to a subject matter waiver. B&D produced the long opinion because it intended to rely on the opinion as a defense to penalties.

Since B&D produced the short opinion to the IRS, the issue before the court was the extent of the waiver of the work-product doctrine. "The case law clearly recognizes that there may be a waiver of the attorney work product doctrine where the information has been placed 'at issue' by the holder of the privilege…. The question here is the breadth of that waiver—whether it is limited to the precise advice given or extends to any and all materials related to the advice." *Id.* at 92. The government conceded, and the court held, that the documents were protected by the work-product doctrine, as they were prepared in anticipation of litigation. However, since B&D placed D&T's advice at issue in the case and had provided the short opinion to the IRS during audit, the government asserted that B&D waived the privilege and that the government was entitled to all communications between B&D and D&T. B&D argued that it did not waive the privilege, because it did not rely on any advice other than that contained in the short and long opinions.

[4] For further discussion of the conflicts within this doctrine, *see* Evan Mulbry, *Closing the Auditor Loophole: Towards a More Perfect Work-Product Waiver Doctrine*, 11 Mich. Bus. & Entrepreneurial L. Rev. 259 (2020).

The court separately compared the scope of the waiver for opinion and fact work product, noting that while a waiver may extend to all fact work product of the same subject, such a waiver will "not extend to opinion work product except in extreme circumstances." *Id*. at 12. As to the opinion work product, the government failed to demonstrate that the circumstances in this case required a complete waiver as to the subject matter. The court further held that the waiver of the short opinion did not constitute a broad subject matter waiver of fact work product because the fact work product did not relate in a substantive way to the short opinion. *But see Salem Financial, Inc. v. United States*, 109 AFTR2d 2012-604 (Fed. Cl. 2012) (finding taxpayer waived work-product protection by contending that it had reasonable cause for its tax reporting and by putting the legal advice at issue).

Fact work product is more vulnerable to subject matter waiver than opinion work product, but some courts nevertheless suggest that subject matter waiver is inapplicable to attorney work product *in general*. *See, e.g.*, *Stern v. Quinn*, 253 F.R.D. 663, 684 (S.D. Fla. 2013). For example, "[t]he Eighth Circuit Court of Appeals has recognized that 'disclosure to an adversary waives work product protection as to items actually disclosed,' but 'disclosure of some documents does not destroy work product protection for other documents of the same character.'" *Benson v. City of Lincoln*, 343 F.R.D. 595, 609 (D. Neb. 2023) (quoting *Pittman v. Frazer*, 129 F.3d 983, 988 (8th Cir. 1997)). Taxpayers should nevertheless be wary of relying on this minority view.

D. Substantial Need Exception

In *Hickman v. Taylor,* 329 U.S. 495, 509 (1947), the Supreme Court acknowledged that the work-product protection is not absolute, but found that the party seeking the production of fact-based work-product materials could not overcome the protection due to the failure to make "any showing of necessity or any indication or claim that denial of such production would unduly prejudice the preparation of [the party's] case or cause him undue hardship." The Court's recognition that an exception might apply to otherwise protected work product has been specifically incorporated into FRCP 26(b)(3)(A)(ii) and Tax Court Rule 70(c)(3)(A)(ii), which provide that otherwise protected materials may be discovered if "the party shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means."

With respect to opinion work product, discussed at FRCP 26(b)(3)(B) and Tax Court Rule 70(c)(3)(B), the Supreme Court has stated that it is discoverable only upon a showing of "more than substantial need and undue hardship," a standard sometimes described as "between high and absolute." *Upjohn Co. v. United States,* 449 U.S. 383, 400-02 (1981); *see United States v. Sanmina Corp.*, 968 F.3d 1107, 1125 (9th Cir. 2020) (explaining that in the Ninth Circuit, opinion work product is discoverable "only when mental impressions are at issue in a case and the need for the material is compelling"). Thus, discovery of opinion work product is allowed, if at all, only in rare and exceptional circumstances. The classic example of a need sufficient to overcome the opinion work-product protection is where the opposing party has withheld an interview memorandum for a witness who is dead or unavailable. *See e.g., In re Grand Jury Investigation*, 599 F.2d 1224 (3d Cir. 1979).

V. Application of the Privileges

A. Tax Return Preparation

The majority view regarding the preparation of tax returns is that all information furnished to an attorney for this purpose is discoverable because an attorney acts outside the scope of the attorney-client privilege when preparing a company's tax return. *See In re Grand Jury*, 23 F.4th 1088, 1095 n.5 (9th Cir. 2021) (amended Jan. 27, 2022) ("[N]ormal tax return preparation assistance—even coming from lawyers—is generally *not* privileged, and courts should be careful to not accidentally create an accountant's privilege where none is supposed to exist."); *United States v. Bohonnon*, 628 F. Supp. 1026, 1029 (D. Conn. 1985), *aff'd*, 795 F.2d 79 (2d Cir. 1985). Most courts view the preparation of a tax return as the rendition of accounting or financial services rather than legal services. *See United States v. Willis*, 565 F. Supp. 1186, 1189 (S.D. Iowa 1983).

Other courts have reached the same conclusion on the theory that information given to an attorney for the purpose of tax return preparation was not intended to be kept confidential because it was intended to be disclosed to the Internal Revenue Service. *See United States v. Windfelder*, 790 F.2d 576, 579 (7th Cir. 1986).

The attorney-client privilege may exist, however, where outside accountants actually prepare the return and seek legal advice from counsel regarding return positions. Some courts have accepted the argument that the implementation of legal advice requires that it be shared with the tax return preparer. Other courts, however, hold to the position that any disclosure to outside parties results in waiver. Thus, disclosure of legal advice to outside accountants for return preparation, or to accountants who are involved in return preparation, should be made with caution. Disclosure should be limited to a strict need-to-know basis and with the understanding that the legal advice is to remain confidential.

B. Internal Tax Memoranda

Communications with in-house counsel for tax planning purposes, for example, will be privileged if they meet the four-part test for establishing attorney-client privilege. There is no blanket privilege available to all documents emanating from a corporate tax department. The most important element of the privilege in this area is the requirement that the communications involve legal rather than business advice. Because in-house counsel often perform a variety of functions, communications to and from in-house counsel will only be privileged if the attorney acts in his or her "professional legal capacity." *See Boca Investerings P'ship v. United States*, 31 F. Supp. 2d 9 (D.D.C. 1998).

The line between business and legal advice, however, is not always clear. *In re Grand Jury Subpoena Duces Tecum*, 731 F.2d 1032 (2d Cir. 1984), the court held that a client's request for tax advice regarding employee compensation plans constituted a privileged request for legal advice. The court also held that tax advice with respect to a corporate reorganization was privileged, despite the fact the advice would affect both the structure of the corporate realignment and alternative business strategies. *Id*. at 1037-38; *see In re Vioxx Products Liability Litigation*, 501 F. Supp. 2d at 797 (finding it necessary "to determine the purpose behind both

the seeking of assistance from in-house counsel and the responsive services that were rendered by in-house counsel").

C. Tax Reserve Documents

Tax reserve documents analyze the legal strengths and weaknesses of a taxpayer's return position for the purpose of determining the reserve necessary to cover contingent tax liabilities. The documents are usually prepared by attorneys and may be provided to independent auditors who use the documents to comply with generally accepted accounting principles.

In *United States v. Arthur Young, Inc.*, 465 U.S. 805 (1984), the Supreme Court upheld the right of the IRS, under its broad summons authority, to obtain tax accrual workpapers prepared by the taxpayer's independent auditors. In 1981, after the district court in *Arthur Young* held in favor of the IRS, and in response to serious concerns that unlimited access from the IRS to tax accrual workpapers would have an adverse effect on the preparation of accurate financial statements, the IRS adopted a policy of restraint. Under this policy, the IRS would not seek tax accrual workpapers absent unusual circumstances, such as when the examiner has not been able to obtain necessary facts from the taxpayer. IRM 40234.3 (May 14, 1981). After its 1984 Supreme Court victory in *Arthur Young*, the IRS reaffirmed its policy of restraint. Announcement 84-46 (April 30, 1984).

In 2002, the IRS announced that it was modifying its historic policy of restraint. Announcement 2002-63 (June 17, 2002). Under the modified policy (IRM 4.10.20), the examiner must request the taxpayer's tax accrual workpapers for a listed transaction claimed on a return. *See* Treas. Reg. § 1.6011-4(b)(2) (listed transactions are transactions the IRS identifies as tax avoidance transactions). Moreover, if a taxpayer claims two or more listed transactions on a return, the examiner must request the tax accrual workpapers for all items reported on the return.

United States v. Textron, *Inc.*, 577 F.3d 21 (1st Cir. 2009), was the first case testing the IRS's new, more aggressive posture for requests for tax accrual workpapers. In earlier cases, courts generally refused to grant work-product protection to tax accrual workpapers prepared by the taxpayer on the grounds that the documents were not prepared in anticipation of litigation. *See United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982); *United States v. Rockwell Int'l*, 897 F.2d 1255 (3d Cir. 1990) (following *El Paso*). However, these courts suggested that a lawyer's analysis of soft spots on a return and his judgments on the outcome of litigation would constitute protected legal advice.

The district court in *Textron*, 507 F. Supp. 2d 138 (D.R.I. 2007), found that the tax accrual workpapers prepared by in-house attorneys and accountants were protected by (1) attorney-client privilege, (2) tax practitioner privilege under Code section 7525, and (3) work-product protection. With respect to the claim of work-product protection, the court distinguished *El Paso* because the holding that the workpapers were not prepared in anticipation of litigation was based on the "primary purpose" test. By comparison, the district of Rhode Island follows the majority "because of" test. *See id.* at 149-51.

The *Textron* district court found that the tax accrual workpapers were prepared in anticipation of litigation because:

> it is clear that the opinions of Textron's counsel and accountants regarding items that might be challenged by the IRS, their estimated hazards of litigate percentages, and their calculation of tax reserve amounts would not have been prepared at all "but for" the fact that Textron anticipated the possibility of litigation with the IRS.

Id. at 150. Furthermore, the district court held that while the disclosure of the workpapers to the taxpayer's independent auditor waived the attorney-client and tax practitioner privileges, it did not waive the work-product protection.

On appeal, the First Circuit in *Textron*, 553 F.3d 87 (1st Cir. 2009), upheld the work-product protection afforded to Textron's tax accrual workpapers. The First Circuit reasoned that "the resolution of disputes through adversary administrative processes, including proceedings before the IRS Appeals Board, meets the definition of litigation." The court rejected the IRS's argument that "the mere presence of a business or regulatory purpose defeats work product protection," on the grounds that "dual purpose documents created because of the prospect of litigation are protected even though they were also prepared for a business purpose." The First Circuit held that the disclosure to the auditor was not a disclosure to an adversary that would result in waiver of the work product-protection. The court also held, however, that the auditor might be a conduit to Textron's adversary (the IRS) if the taxpayer's analysis was reflected in the auditor's workpapers, which are not protected by the work-product doctrine. The court remanded the case to the district court for further proceedings to determine whether the auditor's workpapers would reveal the information contained in Textron's own workpapers.

Both the taxpayer and government filed petitions for rehearing, and the panel decision was vacated by the en banc court as discussed *supra*, Section IV.B.2. *See United States v. Textron Inc.*, 577 F.3d 21, 26 (1st Cir. 2009) (*en banc*). The *en banc* court held that the tax accrual workpapers were not protected under the work-product doctrine because the workpapers were not prepared for use in litigation.

Regions Financial Corp. v. United States, 2008 U.S. Dist. LEXIS 41940 (N.D. Ala. 2008), followed much of the legal reasoning of the *Textron* district court decision although the facts differ somewhat. During the audit of *Regions*, the IRS issued a summons to the outside auditor seeking information about two transactions. The auditor produced the documents that it prepared but withheld several documents prepared by the taxpayer's outside counsel and tax advisors based on the taxpayer's assertion of work-product protection.

In *Regions*, the parties asked the court to decide which test ("because of" or "primary purpose") the Eleventh Circuit Court of Appeals would apply in determining whether the withheld documents were created in anticipation of litigation. The court held that applying either test would have the same result: the documents were created in anticipation of litigation and were protected work product. According to the *Regions* court, were it not for the anticipated litigation, *Regions* would not have to worry about contingent liabilities and would have no need to elicit opinions regarding the likely results of litigation.

The Court of Appeals for the District of Columbia, in *United States v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010), rejected the IRS's position that work-product protection cannot apply

to documents prepared in connection with a financial audit. The D.C. Circuit adopted a broad view regarding the application of the work-production protection to dual-purpose documents, i.e., documents developed in anticipation of litigation, but also used for business purposes. The court found that work-product protection applied to work papers prepared by Deloitte, an independent auditor who had recorded the mental impressions of the taxpayer's counsel regarding anticipated litigation. In this regard, the court found unconvincing the precedent of the Fifth Circuit, *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982), and the First Circuit, *United States v. Textron Inc.*, 553 F.3d 87 (1st Cir. 2009), both of which held that tax accrual workpapers that are prepared by the taxpayer and reflect a lawyer's analysis of the likelihood of success in litigation were *not* prepared in anticipation of litigation because such work papers were created as part of an independent audit.

In *Salem Financial,* 109 AFTR2d 2012-604 (Fed. Cl. 2012), the Court of Federal Claims avoided the debate over whether tax reserves and associated workpapers are prepared in anticipation of litigation, but noted that it is sympathetic to public policy considerations counseling toward application of the work-product doctrine to tax reserve documents.

The IRS once again modified its policy of restraint in 2010. *See* Announcement 2010-67. It explained, "If a document is otherwise privileged under the attorney-client privilege, the tax advice privilege in section 7525 of the Code, or the work-product doctrine and the document was provided to an independent auditor as part of an audit of the taxpayer's financial statements, the Service will not assert during an examination that privilege has been waived by such disclosure."

Taxpayers should note that the benefits of this policy are exceptionally limited. The announcement is not binding on the Service; the policy applies only "during an examination," not in the litigation following it; and nothing in the policy would prevent *other agencies or adversaries* from asserting that the taxpayer waived privilege by providing the document to the auditor. Taxpayers should be wary of relying, to any extent, on this policy of restraint.

D. Internal Investigations/Audits

When a corporation performs internal evaluations of its operating procedures to determine compliance with applicable law, such as reviewing the administration of a qualified plan or reviewing employment practices, certain procedures should be followed in order to protect the results of such investigations. While courts have discussed the notion of a "self-critical analysis" privilege, the doctrine is not widely recognized by courts and it is rarely asserted successfully by defendants. *See Dowling v. Am. Hawaii Cruises, Inc*., 971 F2d 423, 425 n.1 (9th Cir. 1992); *but cf. Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 449 (S.D.N.Y. 2004) (declining to impose a blanket rule of waiver in the work product context because it could "very well discourage corporations from conducting critical self-analysis"). Courts have rejected the notion of a "self-evaluative" privilege to protect the findings of internal evaluations when the documents are being sought by a government agency. *See F.T.C. v. TRW, Inc*., 628 F.2d 207, 210-11 (D.C. Cir. 1980). It is also unlikely that such evaluations would be covered by the work-product doctrine unless litigation is pending or has been threatened. Therefore, communications made during the course of an internal investigation must satisfy the requirements of the attorney-client privilege to be protected from discovery.

Because the purpose of internal investigations is to determine compliance with applicable law, any such investigations should be conducted under the direction of the legal department. A corporation should make clear that the corporation is seeking the advice of counsel regarding its compliance with applicable law. *See United States v. Rowe*, U.S. App. LEXIS 25257 (9th Cir. Sept 20, 1996) (internal investigative work and fact-finding by attorneys acting as in-house counsel to law firm protected).

Additionally, internal investigations and audits undertaken in anticipation of litigation may be protected under the work-product doctrine. In *United States v. Bergonzi*, 216 F.R.D. 487 (N.D. Cal. 2003), a law firm conducted an investigation and drafted a report in response to securities fraud suits filed against McKesson Corporation. The court held that the report and accompanying documents were protected work product.

The legal department may direct agents, such as the human resources department, to assist it in conducting the investigation. The agents must be working under the direct supervision and control of counsel, and communications to the agents must be made for the purpose of obtaining legal advice from the lawyer, not the agent. In communicating with non-management personnel, employees should be made aware that they are being questioned in order that the corporation may obtain legal advice, and should be instructed to keep all communications confidential.

E. Electronic Communications

FRCP Rule 34(a)(1) provides for the discovery of paper and electronically stored information, including writings, drawings, graphs, charts, photographs, sound recordings, images, and other data or data compilations, stored in any medium from which information can be obtained either directly or, if necessary, after translation by the responding party into a readily usable form. The electronic form may contain information (known as metadata) regarding distribution list, date and time documents were sent and read, and other information not disclosed in a printed copy.

Email should therefore be subjected to the same precautionary measures as any other oral or written communication. Employees should be instructed to treat email as a conversation that is written down and stored, and they should recognize that courts have endorsed increasingly sophisticated technologies to efficiently find those emails in discovery.[5] Employees should be

[5] Because discovery of electronically stored information can be burdensome and expensive, FRCP 26(b)(2)(B) provides a limited exception to discoverability of electronically stored information where that information is "not reasonably accessible because of undue burden or cost." The Tax Court has sanctioned numerous techniques to facilitate the discovery of exceptionally large quantities of electronically stored information, including so-called "predictive coding," which relies on sophisticated algorithms. *See Dynamo Holdings LP v. Comm'r*, 143 T.C. 183 (2014) (explaining and endorsing the method) (citing Andrew Peck, *Search Forward: Will Manual Document Review and Keyboard Searches be Replaced by Computer Assisted Coding?*, L. Tech. News (Oct. 2011)).

aware of the corporation's archiving policy so they will appreciate the extent to which electronic messages are recorded and stored. Email should be archived separately from other more formal corporate records, and subject to a shorter retention policy, such as a week or even one or two days.

To establish the attorney-client privilege or work-product privilege for communications by email, the same procedures as those outlined below for oral and written communications should be followed. This includes clearly establishing that the communication is between privileged persons and for the purpose of obtaining or rendering legal advice, or that it was prepared in anticipation of litigation. The email should include appropriate legends. Distribution of privileged communications within the corporation should be limited to a need-to-know basis.

F. Foreign Documents

The applicability of attorney-client privilege or work-product protection to foreign documents implicates issues of foreign law. When analyzing foreign documents, courts have adopted the comity or "touching base" approach and applied a traditional choice of law contacts analysis to determine the law that applies to claims of privilege involving foreign documents. The working standard in these cases has been that any foreign documents involving U.S. matters will be governed by U.S. privilege law, while foreign documents related to matters solely involving foreign matters will be governed by the applicable foreign law. *See, e.g.*, *Astra Aktiebolag v. Andrx Pharmaceuticals, Inc.*, 208 F.R.D. 92 (S.D.N.Y. 2002) (foreign communications relating to U.S. patent application governed by U.S. law; foreign documents relating to German and Korean proceedings governed by foreign nation's privilege law); *In re Philip Services Corp. Sec. Litig.*, 2005 U.S. Dist. LEXIS 22998 (S.D.N.Y. 2005) (U.S. law governed where Canadian professional in Canada advised on public offering in the U.S.).

G. Document Retention

The duty to preserve documents arises when a party is on notice of a claim. Consequently, the duty to preserve records, including electronic documents and emails, is likely to arise contemporaneously with the determination that the communications are made in anticipation of litigation. *See Trigon Ins. Co. v. United States*, 204 F.R.D. 277 (E.D. Va. 2001); *Wm. T. Thompson Co. v. General Nutrition Corp.*, 593 F. Supp. 1443, 1455 (C.D. Cal. 1984). A company should ascertain and follow its corporate document retention policy with respect to

---

While the availability of such techniques may expand the scope of potential discovery, they also provide taxpayers with additional routes to resist discovery. For example, after the Tax Court sanctioned the predictive coding method in *Dynamo Holdings LP* and Dynamo provided discovery using that method, the IRS identified additional relevant documents that predictive coding had failed to return. The Tax Court rejected the IRS's motion to compel production of those documents on the ground that document review results are never perfect, and "our Rules do not require a perfect response," but only "a reasonable inquiry." *Dynamo Holdings LP v. Comm'r*, 2016 BL 235588 (T.C. July 13, 2016) (citing what is now Tax Court Rule 70(g)(1)).

documents, including electronic documents and emails, if it determines that it wishes to establish a work-product claim.

Failure to preserve documents can result in the imposition of sanctions, including fines, dismissal of claims, or an instruction that the finder of fact may draw an adverse inference. *See Trigon*, 204 F.R.D. at 284*; In re Oracle Corp. Sec. Litig.*, 627 F.3d 376, 386-87 (9th Cir. 2010).

H. Legal Bills

The Internal Revenue Service often seeks bills from tax advisors regarding specific transactions. The attorney-client privilege extends to "correspondence, bills, ledgers, statements, and time records which also reveal the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided." *Clarke v. Am. Commerce Nat'l Bank*, 974 F.2d 127, 129 (9th Cir. 1992); *see The Diversified Group, Inc. v. Daugerdas*, 304 F. Supp. 2d 507 (S.D.N.Y. 2003). To preserve the privilege, a company might consider requesting that its tax advisors submit two separate documents—a one page bill statement for the accounting department, and a detailed description of the tax legal services provided for the legal department (the "narrative"). To minimize a risk of waiver, the company should limit distribution of the narrative.

I. Draft Expert Witness Reports and Communications with Counsel

In Tax Court litigation an expert witness's report serves as the expert's direct testimony, and additional direct testimony may be allowed only "to clarify or emphasize matters in the report, to cover matters arising after preparation of the report, or otherwise at the discretion of the Court." Tax Court Rule 143(g). The report must contain "the qualifications of the expert witness and shall state the witness's opinion and the facts or data on which the opinion is based" and must "set forth in detail the reasons for the conclusion." The parties are required to exchange copies of any expert witness reports expected to be submitted into evidence at trial.

In 2010, FRCP Rule 26(b)(4) was amended to provide that drafts of expert witness reports and certain pretrial communications between experts and counsel were not subject to discovery. Limiting discovery related to draft expert witness reports was intended to counteract "undesirable effects" stemming from courts routinely allowing discovery of all draft reports. These effects included rising costs, impediments to effective communication and interaction between counsel and experts, and the adoption of strategies by experts to protect against discovery that interfered with their work. The limitations were also "designed to protect counsel's work product and ensure that lawyers may interact with retained experts without fear of exposing those communications to searching discovery."

In 2012, the Tax Court amended Rule 70 to provide protection comparable to FRCP Rule 26(b)(4)'s discovery protection. Tax Court Rule 70(c)(4) provides:

> (A) Rule 70(c)(3) protects drafts of any expert witness report required under Rule 143(g), regardless of the form in which the draft is recorded.

> (B) Rule 70(c)(3) protects communications between a party's counsel and any witness required to provide a report under Rule 143(g), regardless of the form of the communications, except to the extent the communications:
>
> > (i) relate to compensation for the expert's study or testimony;
> >
> > (ii) identify facts or data that the party's counsel provided and that the expert considered in forming the opinions to be expressed; or
> >
> > (iii) identify assumptions that the party's counsel provided and that the expert relied on in forming the opinions to be expressed.

Tax Court Rule 70(c)(4).

The IRS, in its comments to the proposed amendment, expressed several concerns with this change.[6] The thrust of these concerns was that foreclosing the opportunity to explore reports through discovery would prevent parties from identifying whether any ghostwriting was occurring. However, as noted above, in the Tax Court an expert's report is treated as his or her direct testimony and it must be complete and clear as to the conclusions reached therein because the proponent will typically not be able to ask the expert to expand on the opinion. Moreover, as the Advisory Committee's Note recognizes:

> [c]ounsel are also free to question expert witnesses about alternative analyses, testing methods, or approaches to the issues on which they are testifying, whether or not the expert considered them in forming the opinions expressed. These discovery changes therefore do not affect the gatekeeping functions called for by *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), and related cases.

Thus, the opposing party has the opportunity at trial to question the expert witness about the formulation of his or her report if there are any ghostwriting concerns.

Additionally, the IRS suggested that the Court provide the same "substantial need and undue hardship exception" for protected expert reports and attorney-expert communications. Ultimately, the Tax Court did not adopt the IRS's approach.

J. Appeal of Privilege Determinations

A claim of privilege can be raised and litigated in two different procedural contexts. The right to an appeal depends upon the context.

A privilege dispute may arise because the IRS issues an administrative summons seeking documents for which the taxpayer or third party have a claim of privilege. A summons is not self-enforcing. If the summoned party does not produce based on a claim of privilege, the U.S.

[6] *See* Deborah A. Butler, Associate Chief Counsel, *IRS Comments on U.S. Tax Court Proposed Amendments to Rules of Practice, Procedure* (Feb. 29, 2012).

Department of Justice Tax Division may bring a summons enforcement action in the federal district court to which the summoned party "resides."

The government bears the initial burden to show that the summons is valid. *United States v. Powell*, 379 U.S. 48 (1964), established the four-factor test for legitimacy of the summons: (1) it must be issued for a legitimate purpose; (2) the requested information may be relevant; (3) the information is not already in the possession of the IRS; and (4) the summons satisfies all the administrative requirements for service and notice.

Once the government satisfies the *Powell* requirements, the burden shifts to the summoned party to prove that the requested documents are protected by privilege and the privilege has not been waived. The summoned party cannot assert a blanket claim of privilege but must provide a privilege log. *See Eaton Corp.*, 110 AFTR2d 2012-5638 (N.D. Ohio 2012) (failure to provide a privilege log fatal to taxpayer's claim). The privilege log should include the following information:

- Type of document withheld.
- Authors and recipients, cc's of the document along with their capacities.
- Indication of redaction if applicable.
- Date of document creation.
- The nature of the privilege asserted.

  The subject matter of the document (without revealing the confidential communication).

In addition to the privilege log, the summoned party should prepare affidavits to support the privilege claims and suggest an *in camera* document inspection. The district judge's determination on the privilege claim is appealable as a matter of right to the Court of Appeals.

Alternatively, a privilege dispute may result from a discovery dispute in tax litigation—i.e., a tax refund suit or a Tax Court case. A judge's ruling on a privilege issue is not immediately appealable as a matter of right. In *Mohawk Industries, Inc. v. Carpenter*, 130 S. Ct. 599 (2009), the Supreme Court resolved a split in the circuits and held that an order ruling against a claim of privilege is not immediately appealable as a matter of right because the ruling could be effectively reviewed on appeal after final judgment. The court noted that other means of immediate appeal remain open to the parties. First, a party can request from the district court certification of an interlocutory appeal. Second, a party can bypass the district court and seek a writ of mandamus. Third, a party can disobey the lower court's ruling, incur court-imposed sanctions, and in certain situations, appeal the basis of those sanctions.

K. Maintaining the Attorney-Client Privilege

As discussed above, a business waives the attorney-client privilege and tax practitioner privilege by disclosure to its financial auditor. If the business does not intend to disclose the document to its financial auditor, then the following steps should be taken to prevent waiver of the attorney-client privilege and tax practitioner privilege.

1. Legend. Any documents created by an attorney should include a legend indicating that the document is subject to the attorney-client privilege. We recommend the following legend:

PRIVILEGED AND CONFIDENTIAL
ATTORNEY-CLIENT PRIVILEGE

2. No Third-Party Disclosure. To avoid waiver, there should be no disclosure of oral or written communications to third parties. Prohibited disclosure includes orally communicating the conclusions reached in any document to any third parties, such as the financial auditor or investment banker.

3. File Segregation. Privileged documents should be segregated and maintained in secure and separate restricted files so that confidentiality can be maintained. Privileged documents should not be placed in the tax return preparation files or the tax reserve files.

4. Need to Know Distribution Only. To avoid waiver of attorney-client privilege, the company should restrict distribution within the company of documents created in connection with the project to those working on the project or to those within the company who need to know about the project's details.

L. Steps for Work-Product Protection

1. Any documents created by in-house counsel in connection with a project should include a legend indicating that the documents are subject to work-product protection. We recommend the following legend:

PRIVILEGED AND CONFIDENTIAL
ATTORNEY WORK PRODUCT

Any documents created by nonlawyers (including outside consultants) in connection with a project should include a legend indicating that the documents are subject to work-product protection. We recommend the following legend.

PRIVILEGED AND CONFIDENTIAL
WORK PRODUCT PREPARED AT THE REQUEST OF COUNSEL

2. Any engagement letter or confidentiality agreement used in connection with this project should indicate in the initial paragraph that the purpose of the engagement is to provide litigation risk analysis.

3. A corporation should review its work product position with its attorneys, any other parties providing advice to the corporate tax department, as well as with its staff, to assure that no actions are taken that are inconsistent with the work-product doctrine.

4. A corporation should take steps to assure that any documents produced during the project, including the opinions, are kept confidential to avoid possible waiver of work-product protection. Accordingly, we recommend (1) restricting distribution of documents within the company to those working on the project or to those within the company who need to know about a project's details, and (2) requiring company personnel and the outside firms to maintain secure files for project documents.

5. To avoid possible waiver of work-product protection, a company should not disclose the opinions, or orally communicate the conclusions reached in the opinions, to any third parties. Because the law is unclear about whether disclosure to auditors constitutes a waiver of work product (except in the D.C. Circuit), we strongly advise against providing copies of the opinions to auditors.

6. Even if the work-product doctrine applies, a corporation may decide for various reasons to disclose the opinions to the IRS at some future date. Accordingly, members of a project team should be advised to take care when creating documents, including emails, to avoid using unnecessarily colorful language which could be misinterpreted if disclosed in the future. One way to put this point is that those working on the project should assume that anything they write (including and especially emails) may be published on the front page of the Wall Street Journal.

7. A company should document as early as possible that it anticipates litigation with respect to a particular project or transactions. A senior person within the tax department should draft a memorandum or declaration explaining why litigation is anticipated (e.g., aggressive transaction, aggressive examination team). Such documents will assist outside counsel in establishing work-product protection.

8. Consider document retention obligations, as discussed in Section G, above. To comply with document retention obligations, we suggest that the company send out litigation hold notices to all persons who may have relevant information, advising them to preserve all records, in paper and electronic form.

* * * * *

Please note that this memorandum is for informational purposes only and is not intended to be legal advice. As such, it cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

For further information, please contact:

Kevin Spencer
McDermott Will & Emery LLP
500 North Capitol St., NW
Washington, DC 20001

Tel. 202-756-8203

Email: kspencer@mwe.com