THE SUPREME COURT PUNTS IN RE GRAND JURY – WHERE DOES THAT LEAVE ATTORNEY-CLIENT PRIVILEGE AND TAX ADVICE

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Holland & Knight

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Overview

- Basics of the Attorney-Client privilege
  - Tax Advisor Privilege
  - Work Product
- Return preparation
- Waiver
- In Re Grand Jury

BASICS OF ATTORNEY-CLIENT PRIVILEGE

Basics: attorney-client privilege

- Attorney-client privilege is part of a longstanding policy protecting certain communications from discovery or use as evidence.
- The policy is "to encourage full and frank communication" between attorney and clients to "promote broader public interests in the observance of law and administration of justice." *Upjohn Co. v. U.S.*, 439 U.S. 383 (1981).
  - [T]he privilege exists to protect not only the giving of professional advice to those who can act on it but also the giving of information to the lawyer to enable him to give sound and informed advice. . . The first step in the resolution of any legal problem is ascertaining the factual background and sifting through the facts with an eye to the legally relevant. *Id* at 390 - 391.

Basics: attorney-client privilege

- The classic formulation of the attorney-client privilege in the U.S. is from Wigmore:
  - "(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived." 8 Wigmore on Evidence §2292 (McNaughton rev. 1961)

Basics: attorney-client privilege

- Note:
  - There are cases on all these elements.
  - Issues: crime-fraud, non-legal purposes, waiver, etc.
  - Although some states have codified it, it is not a rule of evidence in federal courts. FRE 501 expressly says that "the common law… governs a claim of privilege" unless an exception applies.
  - It may be extended to non-lawyers who assist a lawyer in providing legal advice (e.g., investigators, accountants, translators, appraisers). *US v. Kovel*, 296 F.2d. 918 (2d Cir. 1961).

BASICS OF TAX PRACTITIONER PRIVILEGE

Basics: tax practitioner privilege

- There is no common-law privilege for accountant-client communications in the U.S., see *U.S. v. Arthur Young & Co.*, 465 U.S. 805 (1984), although some states have statutory versions.
- Accounting firms sought parity with law firms to have privileged communications with clients.
- In 1998 Congress enacted legislation aimed at extending privilege to communications with Federally Authorized Tax Practitioners ("FATPs").

Basics: tax practitioner privilege

- IRC §7525(a) states:
  - **(1) General rule.** With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

Basics: tax practitioner privilege

- **2) Definitions.** For purposes of this subsection—
  - **(A) Federally authorized tax practitioner.** The term "federally authorized tax practitioner" means any individual who is authorized under Federal law to practice before the [IRS] if such practice is subject to Federal regulation under [31 U.S.C. §330].
  - **(B) Tax advice.** The term "tax advice" means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice described in subparagraph (A).

Basics: tax practitioner privilege

- There are statutory limitations/exceptions:
  - It applies only in noncriminal tax matters before the IRS and noncriminal tax proceedings in Federal court. IRC §7525(a)(2).
  - Thus, it does not apply in state proceedings, other non-tax federal proceedings, or criminal cases.
  - It does not apply to any written communication with a FATP in connection with promotion of a tax shelter (as defined). IRC §7525(b).
  - Once waived, it is waived for all purposes.

BASICS OF WORK PRODUCT DOCTRINE

Basics: work product doctrine

- The work product doctrine derives from *Hickman v. Taylor*, 329 U.S. 495 (1947).
- It is now codified in Fed. R. Civ. Pro. 26(b)(3), and in Tax Court Rule 70(c)(3).
- It is not technically a privilege. It is grounded in the policy or concept of "fairness" to an opponent (in litigation), not based on the protection of confidential communications.
- Thus, it can be overcome if there is a sufficient showing of need.

BASICS OF WAIVER DOCTRINE

Basics: Waiver

- Waiver is the only issue that is elaborated on in the Federal Rules of Evidence. See FRE 502.
- Generally, the production of a document outside the privilege group will waive privilege with respect to that document; i.e., it is no longer “confidential.”
  - Work product is different.
- The Rules may impose requirements on the recipient of the privileged information, not just the sender.
- Note that in some circumstances even inadvertently produced documents must be returned or can be “clawed back.” E.g., Fed. R. Civ. P. 26(b)(5)(B).

Basics: Waiver

- Generally, disclosures waive only privilege with respect to the specific document or communication that is no longer "confidential."
- But there's an exception if the disclosure is made for an "affirmative use" or purpose.
- Then all communications on the subject may become discoverable.
  - *Ad Investment 2000 Fund LLC, et al, v. Comm'r*, 142 T.C. 248 (2014);
  - Same accountant/lawyer representing client before IRS when he/she did prior planning work at issue.

Basics: Waiver

- Courts have refused to allow taxpayers to bifurcate their case to avoid providing a legal opinion to the IRS in discovery on the merits, saving the opinion for the later penalty phase.
- *In re Lehman Bros. Holdings, Inc.*, 108 AFTR 2d 2011-5244 (S.D.N.Y. 2011): Lehman had to choose whether to claim the privilege (and thus be unable to rely on the opinion in the penalty phase) or produce it and waive privilege.
- *Santa Clara v. U.S.*, 110 AFTR 2d 2012-5477 (N.D. Cal. 2012): Denied taxpayer's attempt to bifurcate the jury trial into tax and penalty phases.

Return preparation

- Communications regarding preparation of tax returns are frequently held not to be privileged. Theories for this include:
  - That it's accounting, not "legal" work;
  - That a return was never meant to be confidential;
  - That privilege is waived when the return is filed; and
  - That the tax practitioner privilege may not cover this activity because of cases holding return preparation not to be "practice" before the IRS.
  - *U.S. v. Frederick*, 182 F.3d 496 (7th Cir. 1999)

IN RE GRAND JURY

In re Grand Jury - Facts

- The law firm's client, an early promoter of bitcoin, ("owner"), expatriated from the United States in early 2014.
- Owner retained law firm in 2012 to provide advice on the expatriation process. Owner also retained law firm to prepare the Owner's 2014 tax return, which was filed in mid-2016, along with other tax filings.
- An individual lawyer and law firm were each served with grand jury subpoenas requesting documents and communications related to a criminal investigation. The target of the criminal investigation was the owner's company, as well as the owner, individually.
- In response to the grand jury subpoenas, the law firm produced approximately 1600 documents but withheld 54 documents, citing attorney-client privilege and the work-product doctrine.
- Most of the 54 documents involved communications with the accountant regarding tax positions to be taken or not on the tax return.

In re Grand Jury – Issue

- Whether a communication involving both legal and non-legal advice (i.e., dual purpose) is protected by attorney-client privilege.

In re Grand Jury – Parties' Briefs as to Dual Purpose Communications

- Law Firm's opening brief argued that the appropriate standard is the significant purposes test.
  - In *re Kellogg Brown & Root, Inc.*, 756 F.3d 754 (D.C. Cir. 2014).
- The United States advocated for the primary purpose test.
- The brief of Amicus Curiae filed by the American Bar Association argued:
  - That as to dual purpose documents – the entire document should be protected.
  - The primary purpose, as well as the significant purpose test, should be rejected.
  - That as to new tests – Communications are privileged so long as any purpose of those communications is to obtain or provide legal advice and no other well-established exception applies.

In re Grand Jury – Oral Arguments

- Law Firm advocated for a new test, one a bona fide/good faith test.
  - The significant purpose test protects clients' ability to seek bona fide legal advice, a legitimate legal purpose to the communication, from lawyers in situations where legal and non-legal purposes can't be separated.
- United States raised the concern that a bona fide/good faith test would be free-standing and no matter how minor any non-pretextual legal purpose would suffice.
  - That approach would vastly expand attorney-client privilege and create an accountant-client privilege whenever a taxpayer can afford to hire an attorney to prepare his taxes.
- Primary purpose tests should continue to apply.
  - However, there was minimal difference between significant purpose and primary purpose, just question of semantics.
  - Moreover, Kellog opinion could be adopted.
- Justice Kagan – If it ain't broke don't fix it.

In re Grand Jury – The Decision

- On January 23, the Court issued a one-line dismissal of In re Grand Jury as having been improvidently granted certiorari.

In re Grand Jury – Questions/ Observations

- Is the US correct – no distinction between primary and significant purpose?
- Did Law Firm and Amicus ask for too much?
- Are the U.S. and Justices correct as to no privilege as to tax preparation?
- Are the U.S. and Justices correct as to tax and waiver?
- Fredrick – agree or disagree?
- Where are we now as to dual purpose documents?

PANELISTS



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Denise is a tax attorney in Holland & Knight's Dallas office. Ms. Mudigere focuses her practice on representing individuals and entities in all stages of federal civil tax disputes.

Ms. Mudigere represents clients in Internal Revenue Service (IRS) examinations, administrative appeals and litigation. She has settled multiple tax disputes in administrative proceedings and with IRS legal counsel, avoiding litigation in court when possible.

While in law school, Ms. Mudigere served as editor-in-chief of the SMU Law Review and studied at University College in Oxford.



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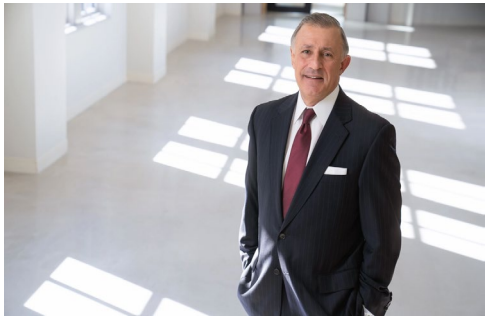
Jim is an experienced tax litigation attorney and tax advisor with extensive knowledge resolving Internal Revenue Service (IRS) controversies in audit, appeals and litigation.

For more than 13 years, he served as staff attorney for the IRS' Office of Chief Counsel, where he developed, prepared and tried complex factual and legal cases for trial before the U.S. Tax Court.

Jim's practice focuses on representing corporations and individual taxpayers in federal tax audits and in federal tax litigation. He has experience appearing in all three of the major tax litigation forums: U.S. Tax Court, U.S. Court of Federal Claims and U.S. District Court.



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Chris represents taxpayers in all types of federal civil and criminal tax controversy matters. He guides clients through IRS audits, prepares administrative claims and protests of IRS actions, and litigates tax and tax-related cases in U.S. district and appellate courts, the U.S. Court of Federal Claims, and the U.S. Tax Court.

In recent years, he has represented numerous taxpayers, financial entities, and professional firms in connection with IRS examinations of tax shelters and related compliance and professional ethics issues.

Chris has a unique history of government service before joining the firm. From 1984-1988, he was a Trial Attorney with the U.S. Department of Justice, Tax Division, and he received the Outstanding Attorney Award in 1986. From 1995-1998, Mr. Rizek was an Attorney-Advisor and Associate Tax Legislative Counsel with the U.S. Treasury Department, Office of Tax Legislative Counsel, with substantial responsibilities for legislation and regulatory actions involving taxpayer rights, tax practice and procedure, and tax compliance.