IRS Win In Law Firm Summons Row May Undermine Privilege, 2021 Law360 278-167

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Summary

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Body

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The U.S. Supreme Court left in place a Fifth Circuit decision allowing the IRS to proceed with a summons to obtain a client list from Taylor Lohmeyer Law Firm PLLC. (AP Photo/J. Scott Applewhite)The Supreme Court on Monday declined to examine (*2021 Law360 277-15*) a Fifth Circuit opinion that allowed the Internal Revenue Service to proceed with a summons to obtain Taylor Lohmeyer Law Firm PLLC's client list for people the service believed may have received advice about stashing income offshore. That April 2020 opinion supported a lower court's finding that the IRS can enforce the summons because the agency properly established that the request for information was made with the legitimate purpose of combating tax evasion by the firm's clients.

Laura Gavioli, a partner in Alston & Bird LLP's federal and international tax group and tax controversy team member, said allowing the Fifth Circuit's decision to stand was "very disconcerting" because the ruling seems to create a new standard that is favorable for the IRS.

"I definitely think it will enable the IRS to pursue this option more often, where I think in the past they were very hesitant to go out and issue these types of summonses to accounting and to law firms," Gavioli said. "It's going to be an additional investigative tool and what the Fifth Circuit's standard essentially says is, as long as the summonses isn't seeking the specific substantive advice, then they can go after the clients' names or they can seek to disclose the clients' names."

The ruling also could deter people from coming forward to tax attorneys or accountants because it seems to suggest even the act of calling the lawyer puts them on a client list, which could then subject their identity to be disclosed to the government, she said.

"Essentially if their names could be turned over just from making a call to a lawyer, then it may be a deterrent for people to come forward if they haven't already been found by the IRS through their normal audit channels," Gavioli said.

The IRS first sought the identities of the Taylor Lohmeyer clients after investigating a hedge fund manager who, using the firm's advice, failed to report about $5 million in offshore income, according to court documents. The government believed the firm gave similar advice to other clients who may have failed to report taxable income, according to the original complaint filed in November 2018.

The Fifth Circuit in December voted 9-8 to not reconsider the case, with six of the eight judges who voted in the minority indicating that reconsidering the case might have clarified the boundaries of legal privilege when a firm receives a summons.

In the original three-judge panel decision, the Fifth Circuit said the case was similar to a 2003 case called U.S. v. *BDO Seidman (United States v. BDO Seidman, 337 F.3d 802*) in the Seventh Circuit that found the identities of clients of accounting firm BDO Seidman LLP weren't protected by the federally authorized tax practitioner privilege under *Internal Revenue Code Section 7525* (*26 U.S. Code § 7525*). BDO was under investigation for allegedly promoting abusive tax shelters, and the Seventh Circuit supported the IRS' summons for BDO's client list, but the government in that case targeted the accounting firm's compliance with tax laws, not its clients.

However, the Section 7525 privilege is different from attorney-client privilege, and the Fifth Circuit's decision didn't seem to distinguish between the two, according to Kevin Packman, a partner at Holland & Knight LLP.

"The [Fifth Circuit] accepted it without any indication as to how and why the two privileges are very different … [but the accountant privilege] is nowhere near as broad," he said.

Usually accountants refer certain matters to lawyers because attorneys can be protected by attorney-client privilege, and then the attorneys retain the accountant under what's called the Kovel standard, created by the Second Circuit in a decision from 1961. In that case *(296 F.2d 918 (2d Cir. 1961))*, the court found accountants hired by attorneys to help provide legal advice and create work product may also be covered under the attorney-client privilege.

Packman said he did not believe the Fifth Circuit's decision will cause accountants to less frequently refer matters to attorneys, since the attorney-client privilege is still stronger than the accountant privilege, but the decision could discourage clients from seeking legal advice.

"If a client believes going to a lawyer to discuss violations of tax law can be discovered by the IRS, you may indirectly encourage clients not to fix mistakes or play the audit game," he said.

Gavioli, who said she represented a client involved in the BDO case, said Section 7525 serves to extend the attorney-client privilege to accountants if they are giving civil tax advice. But now under the Fifth Circuit's ruling, the IRS can take aggressive action by issuing a John Doe summons to a law firm or an accounting firm, which can deter clients from voluntarily complying with tax laws.

"If people are discouraged from coming forward before the IRS finds them … you're going to have much stiffer penalties and interest, and much less cooperation with the IRS to figure out the underlying issues," she said.

What's more, if the IRS ramps up its use of summons against law firms to obtain their client lists, that may impose additional disclosure burdens for attorneys, Gavioli said.

In June, a group of tax attorneys told the Supreme Court in an amicus brief that the Fifth Circuit decision should be reviewed (*2021 Law360 168-59*) because it may undermine the attorney-client privilege. Lawrence M. Hill of Steptoe & Johnson LLP, one of the authors of the amicus brief submitted by the American College of Tax Counsel, said he believes the Fifth Circuit's decision does in fact undermine the confidentiality of communications between lawyers and their clients, but only in certain contexts.

"I don't think it's going to ultimately discourage confidential communications between clients and their lawyers, but I do think that there are opportunities for the John Doe summons authority of the IRS to be potentially abused," Hill said.

If the IRS uses such summonses on a more regular basis, that would be highly problematic, Hill said. However, he said he expects the IRS to be circumspect in how it uses its John Doe summons power against law firms and will limit that use to situations it regards as egregious.

"I don't think this is going to become de rigueur," he said. "I think that the IRS will be careful in monitoring the use of this John Doe summons in the law firm context and will reserve it for situations that it regards as exceptional."

The IRS has shown discretion in the past when it has had access to other types of privilege-related documents, according to Megan L. Brackney, a partner at Kostelanetz & Fink LLP.

In a 2009 decision in *U.S. v. Textron Inc. and Subsidiaries (577 F.3d 21 (1st Cir. 2009))*, a majority of the full First Circuit found the work product doctrine, which protects documents created in anticipation of litigation, did not shield (2009 Law360 226-58) Textron's audit work papers from an IRS summons. The next year, the Supreme Court shot down (2010 Law360 144-40) Textron's request to review the work product privilege case, which attorneys said had far-reaching consequences on their ability to candidly assess their clients' risk of being sued.

Even though the IRS won that case and essentially can get tax accrual papers anytime it wants, the agency also has a policy stating it will only seek those documents in certain circumstances, such as when a taxpayer engages in a certain number of listed transactions, Brackney said. This forbearance policy attempts to provide a balance between enforcement and privilege, she said.

Under an update to the Internal Revenue Manual made in December, revenue agents make summonses for tax accrual papers under what's called the unusual circumstances standard. That standard can be met when a specific issue has been identified by the examiner for which there exists a need for additional facts, or when the examiner has sought from the taxpayer and available third parties all the facts known to them relating to the identified issue, according to the manual.

The IRS could do something similar regarding the application of its John Doe summons power to law firms, Brackney said.

"I don't know if they're going to run around and summons every law firm," she said. "I hope they'd forbear doing this unless there were any indication that they really needed to do that, from an enforcement perspective."

Gavioli agreed it is possible the IRS will adopt some type of internal policy regarding its John Doe summons power, but currently there is no written guidance for front-line examining agents about when such client list summonses should be used.

"I expect certainly after this decision the IRS will consider whether it will have guidance for front-line agents about when to use this," she said. "I expect Chief Counsel to be very heavily involved in that decision too."

The IRS did not immediately respond to questions from Law360.

--Additional reporting by Eli Flesch, David Hansen and Natalie Olivo. Editing by Tim Ruel and Neil Cohen.
