



# Privileges and Workpapers





# Front Matter Items

- ❖ [The IRS Mission Statement](#)
- ❖ [14 General Principles of Ethical Conduct for Federal Employees](#)
- ❖ [Your Rights as a Taxpayer](#)





## Objectives

- ❖ Describe Attorney-Client Privilege
- ❖ Describe Tax Practitioner Privilege
- ❖ Identify Work Product
- ❖ Describe Workpapers & Accounting Papers Policy of Restraint
- ❖ Describe Deliberative Process



# Attorney-Client Privilege (1 of 2)

**(Asserted by Taxpayer and the IRS)**

## Requirements

- ❖ Existence of attorney-client relationship
- ❖ The communication was made in the course of that relationship
- ❖ The communication was made in connection with the provision of legal services
- ❖ The communication was confidential
- ❖ The privilege has not been waived
  - Only communications that the client protects/ does not disclose are protected



## Attorney-Client Privilege (2 of 2)

### Importance to the Service

- ❖ Advice may contain evaluation of merits
- ❖ Advice may reveal litigation strategy
- ❖ Advice may propose alternative theories or courses of action
- ❖ Waiver as to a particular communication may lead to waiver for all communications pertaining to the same subject matter



## Protecting the Attorney-Client Privilege

- ❖ Pay close attention to caveats on communications from Counsel (Attorneys normally mark items that are privileged)
- ❖ See Counsel's advice before disclosing legal memoranda and any other counsel communication including email communications
- ❖ No waiver if advice is shared with Team members/management and others who need to know (e.g. PN SMEs)



# Scope of Attorney-Client Privilege

## Applies only if

- ❖ Asserted by a client or one who sought to become a client
- ❖ The communication was with an attorney:
  - A member of the bar of the court or the member's subordinate and
  - Acting as an attorney
- ❖ The communication occurred without the presence of others, and for the purpose of securing primarily
  - An opinion of law
  - Legal services
  - Assistance with a legal proceeding



# Scope of Attorney-Client Privilege

## Does not apply

- ❖ To communications made for the purpose of obtaining business advice or of committing a crime of fraud
- ❖ The privilege has been waived





## Attorney-Client Privilege (1 of 4)

### Context of Communication

- ❖ Must be in the context of the client seeking legal advice.
- ❖ Tax planning advice provided by an attorney is generally legal advice subject to protection under the attorney-client privilege if the information is not intended to be disclosed on a tax return.
- ❖ Does not apply to ordinary business advice given by the attorney to the client.
- ❖ Privilege may apply to discussions during board of director's meetings.



## Attorney-Client Privilege (2 of 4)

### Context of Communication (cont'd)

#### Privilege does not apply:

- ❖ When the lawyer is acting as a business agent or providing business advice.
- ❖ If the lawyer is employed to find investment opportunities. *United States v. Chen*, 99 F.3d 1495, 1501 (9th Cir. 1996).
- ❖ Legal advice concerning commercial transactions is often intertwined with and difficult to distinguish from business advice.



## Attorney-Client Privilege (3 of 4)

### Context of Communication (cont'd)

#### Privilege does not apply:

- ❖ Exam should not be deterred from requesting transaction decks, communications/emails regarding transactions, term sheets regarding transactions. To withhold requested information, Taxpayer must assert a privilege and establish that the legal standard is met.



## Attorney-Client Privilege (4 of 4)

### Burden of Proof

- ❖ The party asserting the privilege has the burden of proving all elements of the privilege, including the burden of showing that the party has not waived the privilege.
- ❖ If taxpayer claims that documents are privileged, ask for a privilege log to support the claim (discussed in more detail later).



## Attorney-Client Privilege Corporations

- ❖ Communication must be made by a corporate employee for purpose of corporation obtaining legal advice,
- ❖ Concerning matters within the scope of the employee's corporate duties, and
- ❖ Considered confidential when made.
- ❖ Employee must be aware that they were providing information so the corporation could obtain legal advice.
- ❖ Communication must have been kept confidential by company.



# Attorney-Client Privilege Communications

## Communications with Accountants and Other Types of Advisors

- ❖ Privileged if shown that advisors were engaged to assist the attorney in rendering legal advice.
- ❖ Attorney-client privilege extends to non-attorney agents necessary or highly useful to an attorney's work.



## Attorney-Client Privilege Waiver

- ❖ Client is the holder of the privilege and is the one who can waive the privilege
- ❖ Privilege can be expressly waived or implicitly waived
- ❖ Attorney can only waive the privilege with the client's consent
- ❖ Client can waive the privilege by implication:
  - Client places the attorney-client relationship directly at issue (e.g. malpractice)
  - Client asserts reliance on an attorney's advice as an element of a defense (e.g. a tax opinion as reasonable cause defense to penalties)



## Attorney-Client Privilege Fraud

- ❖ Communications in furtherance of a contemplated or ongoing crime or fraud are NOT protected.
- ❖ Need a prima facie showing that (1) the client was engaged in (or was planning) a crime or fraud when the attorney-client communications took place, and (2) that the communications were intended by the client to further the crime or fraud.





## **I.R.C. § 7525 Federally Authorized Tax Practitioner Privilege (Asserted by TP)**

- ❖ Extends common law protections of "confidentiality" to communications with respect to "tax advice" between a taxpayer and a federally authorized tax practitioner (FATP), to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.



## FATP Privilege (1 of 5)

- ❖ Applies only to communications:
  - Between a taxpayer and a FATP with respect to Tax Advice
- ❖ A FATP includes:
  - Attorneys
  - Certified Public Accountants
  - Enrolled Agents
  - Enrolled Actuaries



## FATP Privilege (2 of 5)

### ❖ Not applicable to:

- Certain information/communications relating to the preparation of tax returns.
- Accounting advice, even if given by an attorney, is not privileged.



## FATP Privilege (3 of 5)

### Tax Shelter Exception

- ❖ Does not cover written communications between a FATP and any person that are made in connection with the promotion of the direct or indirect participation of the person in any tax shelter, as defined in section 6662(d)(2)(C) (ii).
- ❖ Tax shelter means 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.
- ❖ Listed transactions included in exception.



## FATP Privilege (4 of 5)

### Assertion of Privilege

- ❖ May only be asserted against the Service or United States.
- ❖ May only be asserted in a noncriminal tax matter before the Service, or noncriminal tax proceeding in Federal Court brought by or against the United States.



## FATP Privilege (5 of 5)

### Burden of Proof

- ❖ Taxpayers have the burden of providing the preliminary facts necessary to establish the privilege.
- ❖ The government has the burden of providing the preliminary facts necessary to establish the tax shelter exception.



## Attorney Work Product Doctrine (Asserted by TP and IRS)

Protects materials prepared in anticipation of litigation or for trial, such as documents and notes containing the thoughts of an attorney.

There must be a litigation predicate, for example:

- ❖ Docketed case or designated for litigation
- ❖ Taxpayer or representative affirmatively represented they would litigate
- ❖ Taxpayer has litigious reputation



## Attorney Work Product (1 of 7)

### Federal Rules of Civil Procedure 26(b)(3)

- ❖ Party generally may not discover documents and tangible things prepared in anticipation of litigation or for trial by or for another party of its representative. Fed. R. Civ. P. 26(b)(3)(A).





## Attorney Work Product (2 of 7)

- ❖ May only be discovered if party shows substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.
- ❖ Mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation remain protected. Fed. R. Civ. P. 26(b)(3)(B).

See also Tax Court Rules 70(c)(3) and 70(c)(4)



## Attorney Work Product (3 of 7)

### Scope

- ❖ Broader than attorney-client privilege
- ❖ Protection is qualified and may be overcome
- ❖ Factual or non-opinion work product may be discovered if a party shows that it has a substantial need for the materials to prepare its case and is unable without undue hardship to obtain the substantial equivalent of the materials by other means
- ❖ Litigation need not have actually commenced; rather, litigation must merely be a real possibility at the time the materials in question are prepared



## Attorney Work Product (4 of 7)

- ❖ Applies to material prepared or collected in anticipation of possible litigation.
- ❖ Applies to statements of witnesses and transcripts of witness interviews.
- ❖ Covers documents relating to possible settlements of litigation and final decisions to terminate litigation.
- ❖ Not limited to materials prepared in anticipation of the specific litigation for which the materials are sought.



## Attorney Work Product (5 of 7)

### When is a document prepared in anticipation of litigation?

- ❖ Majority view – simple causation test: documents are protected if prepared or obtained “because of” the prospect for litigation. *United States v. Adlman*, 134 F.3d 1194, 1202-03 (2d Cir. 1998).
- ❖ Minority view – primary purpose test: documents are protected when the primary motivating purpose behind the creation of a document was to aid in possible future litigation. *United States v. El Paso Co.*, 982 F.2d 530, 542-44 543-44 (5<sup>th</sup> Cir. 1982), cert. denied, 466 U.S. 944 (1984); *United States v. Davis*, 636 F.2d 1028, 1040 (5<sup>th</sup> Cir.), cert. denied, 454 U.S. 862 (1981).



## Attorney Work Product (6 of 7)

### Does not Apply to

- ❖ Documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation
- ❖ Documents assembled pursuant to public requirements unrelated to litigation



## Attorney Work Product (7 of 7)

### Waiver

- ❖ Work product privilege belongs to both the client and the attorney
- ❖ Not automatically waived by voluntary disclosure to third parties
- ❖ Waived by voluntary disclosure to adversary or by any disclosure that is inconsistent with keeping work product from an adversary
- ❖ May be waived if a party puts the work product at issue by relying on it to support a claim or defense



## Privilege Considerations: Tax Opinions

- ❖ Tax opinions may be subject to attorney-client privilege, work product doctrine, or 7525 privilege
- ❖ If shared with a third party, privileges may be waived
- ❖ Some tax opinions may never have been intended to be confidential
  - Penalty protection (used to demonstrate reasonable cause)
  - Transfer pricing documentation (opinion or related attorney-client communications)



## Attorney Client, FTAP, and Attorney Work Product Privileges (1 of 3)

### **If taxpayer asserts any privileges during exam, ask for a privilege log**

- ❖ A brief description or summary of the document or communication and its content
- ❖ Date the document/communication was prepared
- ❖ Name(s) of the person(s) (including titles) who prepared the document/communication
- ❖ Name(s) of person(s) to whom the document/communication was directed, or for whom it was prepared (including titles)





## Attorney Client, FTAP, and Attorney Work Product Privileges (2 of 3)

**If taxpayer asserts any privileges during exam, ask for a privilege log (cont'd)**

- ❖ Recipients of the document/communication and their titles
- ❖ Purpose for preparing the document /communication
- ❖ Privilege(s) asserted for the document/ communication and
- ❖ How the document or communication satisfies each element of the asserted privilege or privileges



# Attorney Client, FTAP, and Attorney Work Product Privileges (3 of 3)

## Privilege Log

- ❖ Seek Counsel assistance with evaluating the adequacy of the privilege log and the asserted privileges



## Tax Accrual Workpapers (1 of 5)

### Definition

- ❖ “Tax accrual workpapers” includes audit workpapers prepared by the taxpayer, the taxpayer’s accountant, or the independent auditor, that relate to the tax reserve for current, deferred and potential or contingent tax liabilities reported on financial statements or footnotes.
- ❖ At a high level they reflect an estimate of a company’s tax liabilities.
- ❖ Other terms used: tax pool analysis, tax liability contingency analysis, tax cushion analysis, or tax contingency reserve analysis.



## Tax Accrual Workpapers (2 of 5)

### Definition (cont'd)

- ❖ The name given the workpapers by the taxpayer, the taxpayer's accountant, or the independent auditor is not determinative.
- ❖ [IRM 4.10.20.1.5\(2\)](#)



## Tax Accrual Workpapers (3 of 5)

### United States v. Textron, Inc. and Subsidiaries

- ❖ Tax accrual work papers prepared by lawyers and others in Textron's Tax Department to support Textron's calculation of tax reserves for its audited corporate financial statements were not protected by attorney work product doctrine.
- ❖ The Court concluded that the papers were
  - Prepared in the ordinary course of business with the sole purpose of preparing financial statements, and
  - That there was no evidence that the papers were prepared for potential use in litigation or would in fact serve any useful purpose for Textron in conducting litigation if it arose.

577 F.3d 21, 29-31 (1st Cir. 2009) (en banc), cert. denied, 130 S. Ct. 3320 (2010)



## Tax Accrual Workpapers (4 of 5)

- ❖ The total amount of the reserve established on a company's general ledger for all contingent tax liabilities of the company for a specific reporting period is not considered a part of the company's tax accrual workpapers.
- ❖ Examiner may ask about the existence and the total amount of a reserve for all contingent tax liabilities as a matter of routine examination procedure, without a showing of unusual circumstances and without seeking executive approval for the request.

[IRM 4.10.20.1.5\(2\)\(b\)](#)



## Tax Accrual Workpapers (5 of 5)

- ❖ A request to reveal the existence or amount of a tax reserve established for any specific known or unknown transaction is the same as asking for a description of the contents of the tax accrual workpapers.
- ❖ Requests for a description of the contents of the tax accrual workpapers are covered by the same policy of restraint as requests for the actual documents that make up the tax accrual workpapers.

[IRM 4.10.20.1.5\(2\)\(c\)](#)



## Audit Workpapers (1 of 2)

### Definition

- ❖ Workpapers created by or for the independent auditor.
- ❖ Workpapers created by or for the independent auditor.
- ❖ Retained by the independent auditor and may be shared with the taxpayer.
- ❖ Include information about the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to the independent auditor's review of a taxpayer's financial statements.
- ❖ May include work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents, and schedules or commentaries prepared or obtained by the auditor.





## Audit Workpapers (2 of 2)

### Definition (cont'd)

- ❖ Provide important support for the independent auditor's opinion as to the fairness of the presentation of the financial statements, in conformity with generally accepted auditing standards and generally accepted accounting principles.

[IRM 4.10.20.1.5\(3\)](#)



## Policy of Restraint for Tax Accrual and Audit Workpapers

- ❖ General standard for requests for audit or tax accrual workpapers is the unusual circumstances standard, see [IRM 4.10.20.3.1](#).
- ❖ This standard applies to all requests for audit workpapers and requests for tax accrual workpapers that do not involve a listed transaction as defined in 26 CFR 1.6011-4.
- ❖ For the standard on requesting tax accrual workpapers involving a listed transaction, see [IRM 4.10.20.3.2](#).

[IRM 4.10.20.1.5\(3\)](#)



## Audit and Accrual Workpapers Policy of Restraint (1 of 3)

- ❖ In unusual circumstances the Service may request audit/tax accrual workpapers.
- ❖ Taxpayer's records are the primary source of factual data to support tax return positions.
- ❖ Seek audit/tax accrual workpapers only when factual data cannot be obtained from taxpayer's records or from available 3<sup>rd</sup> parties, and then only as a collateral source for factual data.
- ❖ Audit/tax accrual workpapers should be requested with discretion and not as a matter of standard examining procedure.

[IRM 4.10.20.3.1\(1\)](#)



## Audit and Accrual Workpapers Policy of Restraint (2 of 3)

- ❖ Generally, request first from taxpayer (may be directed to the taxpayer, taxpayer's accountant, independent auditor, or all three, based on the location of the workpapers sought).
- ❖ Limit the request to the portion of the workpapers that is material and relevant to the examination.
- ❖ Whether an item is material is based upon the examiner's judgment and an evaluation of the facts and circumstances of the case.

[IRM 4.10.20.3.1\(1\)](#)



# Audit and Accrual Workpapers Policy of Restraint (3 of 3)

## Unusual Circumstances Test

- ❖ A specific issue has been identified by the examiner for which there exists a need for additional facts;
- ❖ The examiner has sought the facts/information from the taxpayer and available third parties;
- ❖ The examiner has sought a supplementary analysis (not necessarily contained in the audit or tax accrual workpapers) of facts relating to the identified issue; and
- ❖ The examiner has performed a reconciliation of the taxpayer's Schedule M-1 or M-3 as it pertains to the identified issue.

[IRM 4.10.20.3.1\(2\)](#)



## Tax Accrual and Audit Workpapers

- ❖ [IRM 4.10.20.3.2](#) sets forth the procedures for requests for tax accrual workpapers involving listed transactions
- ❖ [IRM 4.10.20.4](#) sets forth the procedures for requesting audit and/or tax Accrual workpapers
- ❖ These procedures include coordinating with field counsel and coordination with Procedure & Administration by field counsel
- ❖ See also [CCDM 34.6.3.6.1.1](#), Procedures for Requesting Audit or Tax Accrual Workpapers



## Deliberative Process Privilege (asserted by IRS)

**Sometimes referred to as the governmental privilege or executive privilege.**

- ❖ Applies to Pre-decisional opinions, recommendations and deliberations comprising part of a process by which governmental decisions and policies are formulated.
- ❖ Must be pre-decisional (generated before the agency's final decision on the matter) and deliberative (prepared to help the agency formulate its position). [IRM 11.3.13.5.2.6\(5\)](#)
- ❖ Encompassed within executive privilege (which requires assertion by appropriate delegate of the executive branch).
- ❖ Typically asserted in litigation, FOIA requests, and requests for administrative file.



# Summary

## Now you can:

- ❖ Describe Attorney-Client Privilege
- ❖ Describe Tax Practitioner Privilege
- ❖ Identify Work Product
- ❖ Describe Workpapers & Accounting Papers Policy of Restraint
- ❖ Describe Deliberative Process





# Questions?

