AN ATTORNEY-CLIENT PRIVILEGE FOR EMBATTLED TAX PRACTITIONERS: A LEGISLATIVE RESPONSE TO UNCERTAIN LEGAL COUNSEL

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Nearly five hundred years of judicial decision-making has created evidentiary privileges where the courts are willing to forego the disclosure of evidence in the interest of promoting socially valuable relationships. Tax attorneys often tell their clients that their communications are protected by the attorney-client privilege. In truth, the attorney-client privilege for tax practitioners is much diminished. In recent years, aggressive enforcement campaigns by the federal government, often against tax shelter promoters, have enjoyed great success as a compliant judiciary has granted access to an ever-broader range of documents. Following an analysis of relevant judicial decisions, this Article articulates a public policy rationale and an effective legislative privilege that will limit an increasingly assertive central government and give assurance to tax practitioners and their clients as to when their communications will be privileged.

I. INTRODUCTION

For nearly 500 years, the attorney-client privilege has protected confidential communications between clients seeking legal advice and their attorneys.[1] By shielding the communications, the privilege is generally thought to foster candidness, enhancing the thoughtfulness of the litigation process and allowing attorneys to represent their clients

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1. Bruce Kayle, *The Tax Adviser's Privilege in Transactional Matters: A Synopsis and a Suggestion*, 54 TAX LAW. 509, 510 (2001).

more effectively.[2] Despite being the oldest evidentiary privilege and, perhaps, the best known to non-attorneys, the attorney-client privilege is currently under attack by the Internal Revenue Service ("IRS").[3] Both the scope and reliability of the attorney-client privilege in tax matters are deteriorating.[4]

The financial scandals of recent decades have focused the investigation and enforcement efforts of the IRS on the prosecution of aggressive and fraudulent tax planners.[5] The IRS has increasingly used the § 7602 summons[6] and new tax shelter reporting requirements to discover communications between tax attorneys and their clients.[7]

A good measure of the success of the more aggressive information-gathering by the IRS is an increasing skepticism to assertions of the attorney-client privilege in tax cases.[8] Though the federal courts have not formulated a clear standard for the attorney-client privilege in tax-related cases, the scope of protected communications is clearly narrowing.[9] Several courts have found that the attorney-client privilege

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2. Richard Lavoie, *Making a List and Checking it Twice: Must Tax Attorneys Divulge Who's Naughty and Nice?*, 38 U.C. DAVIS L. REV. 141, 147-48 (2004).

3. *See* B. John Williams, Jr., Former IRS Chief Counsel, Address at the Texas Federal Tax Institute: Enforcement-Related Activities (June 8, 2006), *in* 2006 TAX NOTES TODAY 145-13 (July 28, 2006) ("Some say that the Service has attacked the attorney-client privilege, and some have even suggested that the courts have been growing hostile to assertions of the privilege."). Courts have joined the IRS in their attack on the attorney-client privilege as well. *See* Kate Kraus, *Attorney-Client Privilege Under Fire*, 2004 TAX NOTES TODAY 183-27 (Sept. 21, 2004) (stating that the courts have challenged claims of attorney-client privilege in the tax setting, requiring disclosure of clients' identities and documents). *See generally* Lance Cole, *Revoking Our Privileges: Federal Law Enforcement's Multi-Front Assault on the Attorney-Client Privilege (And Why It Is Misguided)*, 48 VILL. L. REV. 469 (2003) (asserting that the attorney-client privilege is under a multi-front assault). *But see* Williams, *supra*, at 145-13 (arguing that neither the courts nor the IRS are attacking the privilege, but simply have become aware of its limits).

4. *See* Robert T. Smith, *After the Alamo: Taxpayer Claims of Privilege and the IRS War on Tax Shelters*, 98 TAX NOTES 233, 246-48 (2003).

5. *See* Richard Lavoie, *Analyzing the Schizoid Agency: Achieving the Proper Balance in Enforcing the Internal Revenue Code*, 23 AKRON TAX J. 1, 2 (2008) (stating that due to the increase in abusive tax shelters, the IRS has become more aggressive in enforcing the Code); Smith, *supra* note 4, at 234 ("[P]ublic disgust with recent corporate scandals has created an atmosphere in which citizens are demanding that the government crack down on abuses by large corporations.").

6. *See* I.R.C. § 7602 (2006) (giving the IRS summons authority in particular situations).

7. *See infra* Part III.B.

8. *See infra* Part IV.B.

9. Kayle, *supra* note 1, at 515-16; *see also* James M. Lynch, *War of the [Tax] Worlds: Privilege Versus Transparency*, TAXES: THE TAX MAG., Mar. 2004, at 89, 91-92 (2007) (describing that while taxpayers may still believe that the communications they have with their tax attorneys are privileged, and they may have previously been privileged, they are no longer protected); Douglas R. Richmond, *The Attorney-Client Privilege and Associated Confidentiality Concerns in the Post-Enron Era*, 110 PENN ST. L. REV. 381, 382 (2005) ("[T]here seems to be a sense among lawyers that the attorney-client privilege is eroding."). *See generally* Bruce Graves, *Attorney Client Privilege in Preparation of Income Tax Returns: What Every Attorney-Preparer Should Know*, 42

does not apply to communications surrounding the preparation of a client's tax return. Some of these courts see return preparation as an accounting or business service rather than legal advice.[10] Other courts have found that, because the completed return was intended for the IRS, the information used in its preparation cannot have been "made in confidence."[11] While these court rulings are not uniform, tax counsel should appreciate that communicating with a client about what number might go into a tax return may be as unprotected as the number shown on the return.

Several academic and legal commentators have applauded the narrowing of the attorney-client privilege in the tax setting.[12] They argue that the privilege is incompatible with the proper functioning of a tax system based on self-assessment and that tax law is fundamentally different than other areas of law that legitimately require an attorney-client privilege.[13] Absent a Congressional limit to this new IRS aggressiveness, attorneys will face vigorous challenges to any assertion of the attorney-client privilege for tax advice.[14]

This Article argues that the attorney-client privilege should enjoy full protection in the tax law setting. The privilege plays a vital role in the American tax system's reliance on self-assessment.[15] It is central to the ideal of voluntary compliance. This Article calls for a clear, codified attorney-client privilege in tax matters for taxpayers and their attorneys. A Congressional directive on the scope of the privilege should lift the chill that presently dampens communication in tax-related representation.

TAX LAW. 577 (1989) (summarizing recent court cases regarding attorney-client privilege application to attorneys who prepare tax returns). In fact, the scope of the attorney-client privilege is dwindling in general. Stuart M. Gerson & Jennifer E. Gladieux, *Advice of Counsel: Eroding Confidentiality in Federal Health Care Law*, 51 ALA. L. REV. 163, 165 (1999).

10. Graves, *supra* note 9, at 579; *see also* United States v. Millman, 822 F.2d 305, 310 (2d Cir. 1987) (holding that the attorney had the burden of showing that he was acting as an attorney, and not in his capacity as an accountant); United States v. Brown, 349 F. Supp. 420, 428 (N.D. Ill. 1972) ("An attorney should not be allowed to protect work papers used in preparation of income tax returns which an accountant would be required to disclose, nor should they be protected from disclosure by the artificial vehicle of an employment relationship between attorney and accountant.").

11. Kayle, *supra* note 1, at 524-25.

12. *See infra* Part IV.C.

13. Kayle, *supra* note 1, at 551-52.

14. Kraus, *supra* note 3 ("If this trend continues unchecked, clients of tax lawyers and other tax practitioners will be deprived permanently of their rightful privilege to have confidential communications with their lawyers and tax advisers.").

15. *See* Grace M. Giesel, *The Legal Advice Requirement of the Attorney-Client Privilege: A Special Problem for In-House Counsel and Outside Attorneys Representing Corporations*, 48 MERCER L. REV. 1169, 1186-87 (1997) (arguing that if clients are uncertain of the boundaries of the privilege, they will be apprehensive before communicating with their attorneys).

Part II reviews the historical development of the attorney-client privilege, its elements and exceptions. Part III describes the U.S. tax system and the power of the IRS. Part IV responds to the arguments of the IRS, the courts, and legal commentators against the privilege. Finally, Part V offers federal legislation that will address the uncertainties of the tax attorney-client privilege in tax matters.

II. HISTORICAL BACKGROUND

Although seldom codified, the attorney-client privilege has had a long and colorful history.[16] After summarizing the evolution of the policy behind the attorney-client privilege, this Article examines the required elements of the attorney-client privilege, identifies the exceptions to the attorney-client privilege, then explores the recently codified § 7525 tax practitioner privilege.[17]

A. The Attorney-Client Privilege History

With roots in Roman law, the attorney-client privilege is the oldest evidentiary privilege.[18] By the sixteenth century, the attorney-client privilege was well established in England's courts.[19] While the privilege has existed for hundreds of years, its stated purpose and the social policy behind the privilege appears to have changed over time.[20] Originally, the privilege was to support the attorney's honor and his oath to protect the secrets of his clients if called to testify against them.[21] The 1700s, however, brought a new utilitarian justification that continues to the present day.[22]

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16. *See infra* text accompanying notes 18-22.

17. *See* I.R.C. § 7525 (2006) (applying the protections of confidentiality to tax practitioners).

18. United States v. (Under Seal), 748 F.2d 871, 873 (4th Cir. 1984); 1 MCCORMICK ON EVIDENCE § 87, at 386 (Kenneth S. Broun ed., 6th ed. 2006) (stating that the attorney-client privilege is one of the oldest and is rooted in the Roman law's "notion that the loyalty owed by the lawyer to his client disables him from being a witness in his client's case"); *see also* Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) ("The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law."); 8 JOHN HENRY WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2290, at 542 (John T. McNaughton ed., rev. ed. 1961) (asserting that the privilege is the "oldest of the privileges for confidential communications").

19. 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 87, at 387; 8 WIGMORE, *supra* note 18, § 2290, at 542-43; Louis F. Lobenhofer, *The New Tax Practitioner Privilege: Limited Privilege and Significant Disruption*, 26 OHIO N.U. L. REV. 243, 245 (2000).

20. *See* 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 87, at 387.

21. *Id.*

22. *See* Elizabeth G. Thornburg, *Sanctifying Secrecy: The Mythology of the Corporate Attorney-Client Privilege*, 69 NOTRE DAME L. REV. 157, 160-61 (1993).

Today, the privilege seeks to encourage "full and frank communication" between the client and the attorney.[23] When a client believes that the communications with his attorney are protected from disclosure, the resulting confidence and trust will lead to a more honest and open discussion of the underlying facts of the client's state of affairs and the legal issues arising from those facts.[24] Most clients approach tax counsel for assistance in navigating a tax code and a legal system they view as complex and arcane.[25] By talking freely about his situation, the client provides information critical to competent legal advice and

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23. *See Upjohn*, 449 U.S. at 389 (reasoning that the attorney-client privilege's "purpose is to encourage full and frank communication between attorneys and their clients," and that the Court had long recognized candidness as the purpose of the privilege); *see also* United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999) (stating that the "privilege is intended to encourage people who find themselves involved in actual or potential legal disputes to be candid with any lawyer they retain to advise them"); Johnston v. Comm'r, 119 T.C. 27, 34 (2002) (finding that the purpose of the attorney-client privilege is to "encourage full and frank communication between attorneys and their clients" (quoting *Upjohn*, 449 U.S. at 389)); Lloyd B. Snyder, *Is Attorney-Client Confidentiality Necessary?*, 15 GEO. J. LEGAL ETHICS 477, 482 (2002) (stating that the courts recite the purpose of the attorney-client privilege as "promotion of full, open, and candid disclosure"). *But see* Snyder, *supra*, at 485 (citing many reasons clients may withhold information from their attorneys and claiming the threat of limited attorney-client privilege has little relevance); Thornburg, *supra* note 22, at 179 (arguing that the candidness purpose behind the attorney-client privilege is a myth). Another recent purpose stated for the attorney-client privilege, although not widely accepted, is privacy. 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 87, at 388. Additionally, the notion of the attorney as a zealous advocate for his clients has also been touted as a possible purpose for the attorney-client privilege. *See id.* § 87, at 389 ("A strong tradition of loyalty attaches to the relationship of attorney and client, and this tradition would be outraged by routine examination of the lawyer as to the client's confidential disclosures regarding professional business.").

24. *See Johnston*, 119 T.C. at 34; Lobenhofer, *supra* note 19, at 245; *see also* Hunt v. Blackburn, 128 U.S. 464, 470 (1888) (stating that the privilege "is founded upon the necessity, in the interest and administration of justice, of the aid of persons having knowledge of the law and skilled in its practice, which assistance can only be safely and readily availed of when free from the consequences or the apprehension of disclosure"); 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 87, at 387; 8 WIGMORE, *supra* note 18, § 2290, at 543. *But see* Vincent C. Alexander, *The Corporate Attorney-Client Privilege: A Study of the Participants*, 63 ST. JOHN'S L. REV. 191, 194 (1988) (stating that there is little empirical evidence that the attorney-client privilege promotes candidness); Snyder, *supra* note 23, at 505 (arguing that average clients do not understand the attorney-client privilege, and if they are not aware of the protections, then the protections cannot influence their actions to be more forthright with their attorney). Two studies have been conducted to determine the effectiveness of the attorney-client privilege on candidness. *See* Alexander, *supra*, at 193 (conducting "182 interviews in New York City, [that] produced a broad range of information about some of the assumptions underlying the corporate privilege, the forms and processes of corporate attorney-client communications and the adjudication of privilege claims"); Note, *Functional Overlap Between the Lawyer and Other Professionals: Its Implications for the Privileged Communications Doctrine*, 71 YALE L.J. 1226, 1236 (1962) (stating that the results of a 1962 survey "indicated widespread faulty information concerning the attorney-client privilege and even greater inability to distinguish relationships which are privileged by law from those which are not").

25. *See* United States v. (Under Seal), 748 F.2d 871, 873 (4th Cir. 1984) (finding that as society and law grow in complexity, the need for individuals to rely on attorneys has also grown).

accurate tax reporting.[26] Better legal work leads to a client who is better able to comply with the law.[27] The privilege's utilitarian foundation is that candidness fosters truth.[28] Yet, all legal privileges must be balanced against an uneasiness that comes from barring any shred of evidence from the judicial system's search for the truth.[29] The most notable critics of the attorney-client privilege view this potential obstruction to the truth as outweighing the value of the better legal representation coming from confidential client communication.[30]

Presently, the uncertain status of the attorney-client privilege in tax matters significantly harms its effectiveness. An effective privilege requires distinct and certain requirements, consistently enforced by the federal courts.[31] Clients need to be assured that their communications with tax attorneys are privileged.[32] Inconsistent judicial rulings create an environment where attorneys cannot assure their clients that communications will be protected when the clients ask a troubling question or divulge information that might put them in an unattractive light.[33]

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26. *See Upjohn*, 449 U.S. at 390; *see also Frederick*, 182 F.3d at 500 (holding that the privilege will help the attorney provide "good advice").

27. *See Frederick*, 182 F.3d at 500 (stating that the attorney-client privilege helps "bring the client's conduct into conformity with law"); United States. v. Mass. Inst. of Tech., 129 F.3d 681, 684 (1st Cir. 1997) (stating that the candidness the privilege promotes allows the client to "conform his conduct to the requirements of the law").

28. *See* 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 87, at 387.

29. *See id.* (claiming that the need for the attorney-client privilege must be balanced against the need for disclosure, and the benefit of the candor outweighs the detriment to the court's fact-finding function).

30. *Id.* § 87, at 387-88. *See generally* Thornburg, *supra* note 22 (arguing that the attorney-client privilege is based entirely on myths). For example, Jeremy Bentham, an early critic of the privilege, argued that innocent clients have no need for a privilege, for they have nothing to hide, and the guilty do not deserve the benefit of the privilege. 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 87, at 387. Moreover, Bentham argued that "deterring a guilty client from seeking legal advice was not cause for concern, while an innocent client had nothing to fear if the privilege were not available, and thus would not be deterred." Cole, *supra* note 3, at 477-78. Wigmore defended against Bentham's assertion by arguing that in civil cases it was hard to draw a "'*line between guilt and innocence*.'" *Id.* at 478. Wigmore also stressed that an open line of communication between attorney and client can prevent future wrongful conduct. *Id.*

31. *Upjohn*, 449 U.S. at 393; *see also* Giesel, *supra* note 15, at 1173 (arguing that in order to encourage candidness, the client must be able to rely on the protection of the privilege and that "certainty of the parameters of the privilege is critical").

32. *Upjohn*, 449 U.S. at 393; Giesel, *supra* note 15, at 1173.

33. *Upjohn*, 449 U.S. at 393; Giesel, *supra* note 15, at 1173 ("For the privilege to encourage client disclosure to counsel, a high degree of certainty must exist that the privilege will protect what the client says from disclosure in the event litigation ensues.").

B. Elements of the Privilege

Given the importance of the attorney-client privilege to our legal system, it is noteworthy that the attorney-client privilege is not included in the Federal Rules of Evidence.[34] After asking the Supreme Court to promulgate the Federal Rules of Evidence, Congress specifically rejected the rule that created a federal attorney-client privilege when the rules were codified in 1975.[35] Congress saw the proposed rule for an attorney-client privilege not as a procedural rule within the charge to the Supreme Court, but as a modification to a substantive right more properly addressed by legislation.[36] Rather than writing a comprehensive statute, Congress chose to leave the task of defining the parameters of the attorney-client privilege to federal common law or, in civil diversity actions, to state law.[37]

Accepting the Congressional nod, most federal jurisdictions have adopted the requirements for the attorney-client privilege written in John Henry Wigmore's famous treatise on evidence.[38] The treatise's definition of the attorney-client privilege is:

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34. Timothy P. Glynn, *Federalizing Privilege*, 52 AM. U. L. REV. 59, 87-88 (2002).

35. *Id.*

36. *Id.* at 88-90. The Rules Enabling Act, 28 U.S.C. § 2072 (2006), gave the Supreme Court the authority to create procedural and evidentiary rules for the federal courts. The Rules of Evidence were then submitted to Congress for approval. Glynn, *supra* note 34, at 87. Congress rejected the attorney-client privilege rule, and all other privilege rules, due in part to constitutional issues with the Rules Enabling Act. *Id.* at 88-89. Under the Rules Enabling Act, the Supreme Court only possessed authority to promulgate procedural rules and not rules that would "abridge, enlarge or modify any substantive right." 28 U.S.C. § 2072(b).

37. Glynn, *supra* note 34, at 91. Federal Rule of Evidence 501 states:

> Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.

FED. R. EVID. 501. Despite its intention to leave the development of the privilege to federal common law or state law, Congress has addressed the privilege issue occasionally with legislation. For example, I.R.C. § 7525 (2006), created a privilege for communications between authorized tax practitioners and their clients in civil cases before the IRS. Congress also addressed the attorney-client privilege in the Foreign Intelligence Surveillance Act of 1978, 50 U.S.C. § 1806(a) (2006), which states that communications otherwise privileged do not lose the privilege just because they were subject to electronic surveillance, and the Electronic Communications Privacy Act of 1986, 18 U.S.C. § 2517(4) (2006), which protects intercepted but otherwise privileged wire, oral, or electronic communications.

38. *See, e.g.*, Cavallaro v. United States, 284 F.3d 236, 245 (1st Cir. 2002) (citing the Wigmore privilege); United States v. Tratner, 511 F.2d 248, 251-53 (7th Cir. 1975) (applying the Wigmore definition of the privilege); United States v. Schmidt, 360 F. Supp. 339, 346 (M.D. Pa. 1973) (utilizing the eight-prong Wigmore rule); United States v. Schlegel, 313 F. Supp. 177, 178-79 (D. Neb. 1970) (using Wigmore's requirements for the privilege). Some federal courts use the similar elements recited in *United States v. United Shoe Machine Corp.*, 89 F. Supp. 357, 358-59

> (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*.[39]

In applying the eight-prong test, federal court opinions have further defined the requirements of several of the elements. Some courts have reasoned that in order for the privilege to apply, the communications must relate to legal advice.[40] Communications with an attorney that elicit business or accounting advice that use neither legal reasoning nor knowledge of the law, fail the first test of the privilege.[41] If the communications between the attorney and the taxpayer contain a "mix" of legal and business advice, this reasoning holds that the privilege applies solely to the communications that constitute legal advice.[42] Of course, asking either an attorney or a judge to distinguish between legal

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(D. Mass. 1950). *See, e.g.*, NLRB v. Harvey, 349 F.2d 900, 904-05 (4th Cir. 1965) (applying the *United Shoe* privilege requirements); United States v. Lipshy, 492 F. Supp. 35, 41 (N.D. Tex. 1979) (applying the *United Shoe* requirements); United States v. Summe, 208 F. Supp. 925, 927-28 (E.D. Ky. 1962) (using the *United Shoe* requirements); *see also* Lobenhofer, *supra* note 19, at 246 (asserting that the *United Shoe* requirements are "[o]ne of the best, and most quoted, summaries of the requirements" of the privilege). In *United Shoe*, the court stated that:

> The privilege applies only if (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

United Shoe Mach. Corp., 89 F. Supp. at 358-59.

39. 8 WIGMORE, *supra* note 18, § 2292, at 554.

40. *See, e.g.*, United States v. ChevronTexaco Corp., 241 F. Supp. 2d 1065, 1069 (N.D. Cal. 2002) ("The privilege protects communications between an attorney and her client made in confidence for the purpose of securing legal advice from the lawyer.").

41. *See* Susan W. Crump, *The Attorney-Client Privilege and Other Ethical Issues in the Corporate Context Where There Is Widespread Fraud or Criminal Conduct*, 45 S. TEX. L. REV. 171, 175 (2003) (asserting that in-house communications with corporate attorneys are protected when they are in regard to legal matters, but not business matters); Kayle, *supra* note 1, at 515 (stating that the privilege only applies to legal advice); Lynch, *supra* note 9, at 102 (stating that the attorney-client privilege does not apply to business advice). One court stated that advice is not legal in nature if the lawyer is hired solely to provide business advice and does not use legal reasoning or his knowledge of the law. *See* Segerstrom v. United States, 87 A.F.T.R.2d (RIA) 2001-1153, 2001-1155 (N.D. Cal. 2001).

42. *See supra* note 39 and accompanying text. *But see Segerstrom*, 87 A.F.T.R.2d (RIA) at 2001-1155 (stating that the privilege applies to business advice if it is incorporated into legal advice).

advice and business advice or accounting services can be difficult.[43] Financial and other documents prepared by the taxpayer, even if used in formulating legal advice, are not part of that advice and are not protected.[44]

The privilege only protects legal advice provided by an attorney, and only when he is acting in his capacity as an attorney.[45] However, the federal courts have extended the protection of the privilege to communications with agents of the attorney hired to aid the attorney in giving legal advice.[46] Importantly, the courts have held that the agent extension specifically applies to accountants who aid an attorney in the rendering of legal advice.[47]

The courts have further clarified the meaning of "confidential communications." In order for the court to consider a communication confidential, the client must have the intent at the time of the communication that the communication will remain confidential.[48] If

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43. *See* Andrea I. Mason, *Counsel as Tax Preparer, an Unprivileged Position:* United States v. Frederick*, 182 F.3d 496 (7th Cir. 1999)*, 69 U. CIN. L. REV. 411, 431 (2000) (asserting that for a tax practitioner, legal services and business advice are often "inextricably intertwined," creating a "blurred line between legal and accounting communications"); *see also infra* Part IV.B.1 (citing cases that describe the application of the attorney-client privilege to tax return preparation).

44. Lynch, *supra* note 9, at 102; *see also ChevronTexaco*, 241 F. Supp. 2d at 1069 (stating that underlying facts were not privileged). In the Tax Court, the privilege does not apply to "underlying facts; [b]usiness or other non-legal advice given by the attorney; [i]nformation received from third parties; [i]nformation given to the attorney which the attorney is expected to disclose to a third party . . . . and [t]he identity of a client or the fact that an individual has become a client." Joni Larson, *Tax Evidence II: A Primer on the Federal Rules of Evidence as Applied by the Tax Court*, 57 TAX LAW. 371, 426 (2004) (citations omitted).

45. *See, e.g.*, Olender v. United States, 210 F.2d 795, 806 (9th Cir. 1954); *Segerstrom*, 87 A.F.T.R.2d (RIA) at 2001-1155.

46. *See* United States v. Kovel, 296 F.2d 918, 922 (2d Cir. 1961) (holding that if an accountant is "highly useful" to representation, then communications are protected); *Segerstrom*, 87 A.F.T.R.2d (RIA) at 2001-1157 to -1158 (finding that the privilege applies to papers prepared by a third party if they are prepared at the request of an attorney, contain confidential information, and are for the purpose of advising the client).

47. *See* United States v. Schmidt, 360 F. Supp. 339, 347 (M.D. Pa. 1973) ("[W]hat is vital to the assertion of the privilege by an accountant employed by an attorney is that he assist in providing legal advice rather than merely rendering accounting services; and the specific nature of the proponent's burden is to establish that the accountant's role is essentially consultative." (citation omitted)); Bauer v. Orser, 258 F. Supp. 338, 342-43 (D.N.D. 1966) (holding that workpapers prepared by an accountant at the direction of an attorney are protected by the privilege). *But see Kovel*, 296 F.2d at 922 (reasoning that because accounting concepts can be considered a "foreign language," the "presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated tax story to the lawyer, ought not destroy the privilege, any more than would that of the linguist in the second or third variations of the foreign language theme discussed above"); *ChevronTexaco*, 241 F. Supp. 2d at 1072 (holding that the privilege does not apply "where the accountant is hired merely to give additional legal advice about complying with the tax code even where doing so would assist the attorney in advising the client").

48. *See, e.g.*, United States v. Fisher, 692 F. Supp. 488, 494 (E.D. Pa. 1988).

they contain confidential information, both the client's communications to the attorney and the attorney's communications to the client are protected by the privilege.[49] But confidentiality is lost if the client intends to disclose the information to third parties other than those who are aiding the attorney in representing the client.[50] According to this reasoning, a communication is not confidential if the client intends for the information in that communication to be disclosed to a third party, like the IRS.[51] If a claim of privilege is asserted, the attorney or client must specifically delineate which documents and communications are privileged on a document-by-document basis.[52] A blanket claim of attorney-client privilege will not be accepted by the courts.[53]

C. Exceptions to the Attorney-Client Privilege

Protected communications must not only meet the traditional requirements of the attorney-client privilege, but they must also not fall into one of the several established exceptions.[54] A judge might make a general ruling that finds a communication is protected by the privilege, but then make a second ruling finding that the communication falls

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49. *See ChevronTexaco*, 241 F. Supp. 2d at 1069 (holding that the attorney-client privilege applies to confidential communications from the lawyer to the client in the course of providing legal advice); *Segerstrom*, 87 A.F.T.R.2d (RIA) at 2001-1155 ("The privilege extends to cover both the substance of the client's confidential communications and the attorney's advice in response thereto."); United States v. Bonnell, 483 F. Supp. 1070, 1077 (D. Minn. 1979) ("Communications from the attorney to the client are ordinarily protected only if the communications reveal the substance of the client's own statements.").

50. *See* United States v. (Under Seal), 748 F.2d 871, 874 & n.6 (4th Cir. 1984).

51. *See, e.g.*, Shahinian v. Tankian, 242 F.R.D. 255, 257 (S.D.N.Y. 2007) ("Information conveyed to a lawyer by a client solely for the purpose of retransmission to a third-party is generally not protected by the attorney-client privilege, and the result is no different when the third-party is the IRS and the means of retransmittal is a tax return."); 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 91, at 408.

52. *See* Holifield v. United States, 909 F.2d 201, 204 (7th Cir. 1990) (stating that the court will not find the privilege applicable unless the asserter shows document by document which communications are privileged); United States v. Abrahams, 905 F.2d 1276, 1283 (9th Cir. 1990) (stating that because an attorney did not "make particularized assertions of privilege for any of the other data sought by the summons," the information was not privileged), *overruled on other grounds by* United States v. Jose, 131 F.3d 1325, 1329 (9th Cir. 1997); United States v. Hodgson, 492 F.2d 1175, 1177 (10th Cir. 1974) (stating that the attorney "must normally raise the privilege as to each record sought and each question asked so that at the enforcement hearing the court can rule with specificity").

53. *See* United States v. El Paso Co., 682 F.2d 530, 541 (5th Cir. 1982) (holding that a "general claim" of attorney-client privilege for documents brought to a corporation's tax department is insufficient for claiming the privilege); United States v. Finley, 434 F.2d 596, 597 (5th Cir. 1970) (holding that a "blanket refusal" to testify due to attorney-client privilege was not a valid privilege claim).

54. *See* Cole, *supra* note 3, at 499 (listing the crime-fraud exception, waiver, and the common interest doctrine as exceptions to the attorney-client privilege); *see also infra* Parts II.C.1-2.

within a recognized exception to the general rule and must be disclosed.[55] The two most common exceptions to the attorney-client privilege in tax matters are the crime-fraud exception and waiver.[56]

1. The Crime-Fraud Exception

Communications between a lawyer and his client made with the intent to commit a crime or fraud are not protected by the privilege.[57] The crime-fraud exception allows no protection where the client seeks or the attorney provides legal advice about either future or on-going fraudulent or criminal activity.[58] However, the privilege will apply to communications seeking legal advice regarding a completed crime or in which the client seeks to determine, in good faith, whether a considered course of action will constitute an illegal act.[59] Simply put, the crime-fraud exception is a statement by the courts that promoting candidness between an attorney and a client who intends to use the advice to perpetrate a crime or fraud does not promote overall justice.[60]

In general, the courts apply a two-pronged test in order to determine whether the crime-fraud exception applies to a particular communication.[61] If the IRS asserts the exception, it must make a prima facie showing "that the client was engaged in criminal or fraudulent conduct when he sought the advice of counsel, that he was planning such conduct when he sought the advice of counsel, or that he committed a crime or fraud subsequent to receiving the benefit of counsel's advice."[62] If the court grants that the IRS has successfully made that showing, then the IRS must demonstrate that "the attorney's assistance was obtained in furtherance of the criminal or fraudulent activity or was closely related to it."[63] Generally, the federal trial judge will conduct an in camera review of the alleged criminal or fraudulent communications in order to

55. *In re* Sealed Case, 676 F.2d 793, 807-08 (D.C. Cir. 1982).

56. Alexander Bunin, *Protecting Client Confidences in Criminal Investigations: A Primer for Civil Practitioners*, HOUS. LAW., May-June 1993, at 26, 29; Susan F. Jennison, Comment, *The Crime or Fraud Exception to the Attorney-Client Privilege:* Marc Rich *and the Second Circuit*, 51 BROOK. L. REV. 913, 934-35 (1985).

57. *See, e.g.*, United States v. Zolin, 491 U.S. 554, 563 (1989); Cole, *supra* note 3, at 500.

58. *Zolin*, 491 U.S. at 562-63; Cole, *supra* note 3, at 499.

59. *See Zolin*, 491 U.S. at 562-63.

60. *See id.* at 563; Cole, *supra* note 3, at 500.

61. *In re* Grand Jury Investigation, 842 F.2d 1223, 1226 (11th Cir. 1987). In *United States v. Zolin*, the court held that the court will conduct an in camera review of the communication claimed to be privileged, and in deciding whether to engage in camera, the "judge should require a showing of a factual basis adequate to support a good faith belief by a reasonable person . . . that *in camera* review of the materials may reveal evidence to establish the claim that the crime-fraud exception applies." 491 U.S. at 572 (citation omitted).

62. *In re Grand Jury Investigation*, 842 F.2d at 1226.

63. *Id.*

establish whether the IRS can make the evidentiary showings required by the exception.[64] In recent years, some courts have broadened the scope of the crime-fraud exception.[65] Courts sympathetic to the more aggressive IRS posture have applied the exception to cases where communications "abused" the attorney-client relationship, even though the client did not have a criminal or fraudulent intent at the time of the communications.[66]

Legal commentators, including a former IRS Chief Counsel, have indicated that the IRS is unlikely to pursue the crime-fraud exception to the privilege in tax planning or shelter cases.[67] But the government has shown little reluctance to raising the exception.[68] In *In re Grand Jury Investigation*, the Eleventh Circuit Court of Appeals held that the crime-fraud exception can eliminate the privilege for communications between an attorney and taxpayer client in a straight-forward tax evasion case for failure to accurately report income.[69] In *United States v. BDO Seidman,*

64. *See Zolin*, 491 U.S. at 574.

65. *See* Auburn K. Daily & S. Britta Thornquist, Note, *Has the Exception Outgrown the Privilege?: Exploring the Application of the Crime-Fraud Exception to the Attorney-Client Privilege*, 16 GEO. J. LEGAL ETHICS 583, 588 (2003) (stating that "the crime-fraud exception has broadened over time").

66. *See id.* at 586 (stating that courts in general have expanded the privilege in this manner). However, a few courts have refused to apply the crime-fraud exception to non-criminal tortious acts. *See, e.g.*, Madanes v. Madanes, 199 F.R.D. 135, 149 (S.D.N.Y. 2001); Nowell v. Superior Court, 36 Cal.Rptr. 21, 25 (Cal. Dist. Ct. App. 1963).

67. *See* Lynch, *supra* note 9, at 103. Lynch lists "fraudulent offshore credit card banking arrangement, advising someone on setting up their own church, or some other egregious act" as issues which would raise the crime-fraud exception. *Id.*; *see also* Peter H. Blessing, *Privileged Communications in the Context of U.S. Tax Practice*, *in* 15 TAX PLANNING FOR DOMESTIC & FOREIGN PARTNERSHIPS, LLCS, JOINT VENTURES & OTHER STRATEGIC ALLIANCES: 2007, at 7, 70 (2007) (stating that crime-fraud exception is unlikely to be raised in the general tax planning context).

68. *See* United States v. BDO Seidman, LLP, 492 F.3d 806, 814 (7th Cir. 2007); United States v. Arthur Anderson, L.L.P., 273 F. Supp. 2d 955, 960-61 (N.D. Ill. 2003). In the *BDO Seidman* case, the government outlined what it deemed a fraud that would remove the communications from the privilege due to the crime-fraud exception:

> Indicia of fraud include, among other things, the failure to register or otherwise report a potentially abusive tax shelter transaction, the likely effect of which would be to mislead or conceal an avoidance of tax. In this context, other indicia of fraud include the fact that these transactions employed multiple layers of pass-through entities so that they could not be readily detected by the IRS and the fact that the John Does agreed to share a percentage of the proceeds from these potentially abusive transactions with BDO. If an in-camera inspection of the documents discloses that the taxpayer-investor's purpose in seeking "advice" was to enter into a sham transaction or a transaction which otherwise could give rise to the imposition of a civil fraud penalty, then any right to confidentiality is voided under the crime-fraud exception.

United States' Memorandum of Law in Opposition to Respondent's Claims of Privilege at 14, *BDO Seidman, LLP*, 492 F.3d 806 (No. 02 C 4822).

69. *See In re* Grand Jury Investigation, 842 F.2d 1223, 1226, 1229 (11th Cir. 1987). In this case, the taxpayer hired an attorney who was also an accountant to prepare his income tax returns.

LLP, the government successfully argued that the crime-fraud exception should apply to the § 7525 tax practitioner-client privilege because the advice given was in furtherance of civil tax fraud.[70] Tax practitioners should be prepared for the IRS to pursue the crime-fraud exception in any case where there is a showing of abusive tax posturing by taxpayers.

2. Waiver

The attorney-client privilege will not apply if the client waives it.[71] The client may expressly waive the privilege, or may impliedly waive it by transmitting the communication to a third party.[72] Recently, some courts have extended the waiver of the attorney-client privilege to cases where the client asserts reliance on legal advice as a defense.[73] In *Johnston v. Commissioner*, the Tax Court held that the taxpayer's claim of reliance on the advice of his attorney to defend against a fraud claim required that the privilege be waived in order to determine whether the reliance was unreasonable.[74]

D. The § 7525 Tax Practitioner Privilege

While a detailed analysis of the § 7525 privilege is beyond the scope of this Article, many recent federal opinions are defining important aspects of the attorney-client privilege through their application of the § 7525 tax practitioner privilege.[75] Enacted in 1998, § 7525 extended the attorney-client privilege, as defined by federal common law, to authorized federal tax practitioners.[76] Historically, the

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Id. at 1224. In a tax evasion investigation by a grand jury, the grand jury subpoenaed the attorney to testify and produce documents used in preparing the tax return. *Id.* The taxpayer claimed the attorney-client privilege applied and prevented the attorney from testifying. *Id.* The government argued that the crime-fraud exception applied. *Id.*

70. 492 F.3d at 820.

71. Cole, *supra* note 3, at 499.

72. *See* United States v. Frederick, 182 F.3d 496, 501 (7th Cir. 1999) ("[T]ransmittal [to a third party] operates as a waiver of the privilege."); Kayle, *supra* note 1, at 526; 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 93, at 418.

73. 1 MCCORMICK ON EVIDENCE, *supra* note 18, § 93, at 421 & n.20. The doctrine of implied waiver has three requirements. Johnston v. Comm'r, 119 T.C. 27, 37 (2002). First, the privilege must "be asserted as the result of some affirmative act." *Id.* Second, the affirmative act of claiming the privilege by the asserting party "puts the protected information at issue by making it relevant to the case." *Id.* at 38. Third, "whether allowing the privilege would deny the opposing party access to information vital to its defenses." *Id.* at 39.

74. *Johnston*, 119 T.C. at 40.

75. *See, e.g.*, Doe v. Wachovia Corp., 268 F. Supp. 2d 627, 635 (W.D.N.C. 2003); United States v. Arthur Anderson, L.L.P., 273 F. Supp. 2d 955, 958-60 (N.D. Ill. 2003); United States v. KPMG LLP, 237 F. Supp. 2d 35, 38-39, 43-44 (D.D.C. 2002).

76. I.R.C. § 7525(a) (2006). A federal tax practitioner is defined in § 7525 as "any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice

privilege protected only tax-related communications with an attorney.[77] By extending the privilege to other tax professionals, the tax practitioner privilege leveled the professional playing field for tax accountants who may have substantially the same interaction with their clients as do tax attorneys.[78] Because the tax practitioner privilege is statutorily defined to mirror the common law attorney-client privilege, a legislative change of the attorney-client privilege, such as the one proposed here, will have a major impact on the § 7525 privilege as well.[79]

Two important exceptions specifically limiting this statutory privilege were listed in § 7525.[80] Communications promoting the participation in tax shelters as defined by § 6662 are specifically excluded.[81] Next, the tax practitioner privilege does not apply to criminal cases. The § 7525 privilege applies only in those civil matters heard before the IRS and in the limited range of civil cases in federal courts where non-attorneys are authorized to appear.[82]

III. THE U.S. TAX SYSTEM

While the U.S. tax system has self-assessment as a central feature, the IRS plays a pervasive role in the system.

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is subject to Federal regulation under section 330 of title 31, United States Code." *Id.* § 7525(a)(3)(A).

77. Shane Jasmine Young, Note, *Pierce the Privilege or Give 'Em Shelter? The Applicability of Privilege in Tax Shelter Cases*, 5 NEV. L.J. 767, 779 (2005). Congress enacted the privilege in order to respond to the recent aggressive tactics of the IRS. Michael Hindelang, Note, *The Disappearing Tax-Advisor Privilege*, 49 WAYNE L. REV. 861, 863 (2003).

78. Kayle, *supra* note 1, at 514.

79. For application of § 7525 in court cases, see generally *Wachovia Corp.*, 268 F. Supp. 2d 627; *Arthur Andersen*, 273 F. Supp. 2d 955; *KPMG*, 237 F. Supp. 2d 35.

80. *See* I.R.C. § 7525.

81. § 7525(b)(2). "Tax shelter" is defined in § 6662(d)(2)(C)(ii) as "(I) a partnership or other entity, (II) any investment plan or arrangement, or (III) 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." § 6662(d)(2)(C)(ii).

> [S]heltering income from tax happens in three major ways: deferral to a later period, resulting in lower time value of money when the taxes are actually paid, conversion of income from ordinary (where it is taxed at a high rate) to capital gains (where it is taxed at a lower rate), and leveraging, or the use of loans to reap tax benefits several times larger than possible with cash alone.

Hindelang, *supra* note 77, at 866.

82. I.R.C. § 7525(a)(2). The IRS can obtain documents and communications if prosecuting the taxpayer criminally. Hindelang, *supra* note 77, at 865.

A. A System Based on Self-Assessment

The U.S. tax system is one based on voluntary compliance and self-assessment.[83] American tax law requires taxpayers to be familiar with the formidable Internal Revenue Code (the "Code") and the applicable provisions of the Code of Federal Regulations. Taxpayers, then, must assess the tax consequences of their transactions, report their self-assessed tax to the IRS on tax returns, and ultimately pay the taxes due.[84] To foster economic growth, Congress has created many provisions in the Code that encourage taxpayers to structure their income and expenditures to minimize their tax burden.[85]

For a tax system based on voluntary compliance to function properly, taxpayers must respect the system as fundamentally fair and believe that the law is being applied uniformly to all taxpayers.[86] While the U.S. tax system is based on the belief that taxpayers are able to discern their own tax liabilities, the complexity of the Code and its incentives drives many taxpayers to seek the help of tax professionals, including tax attorneys, to determine the tax consequences of their actions.[87] Without the assistance of these tax professionals in applying

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83. 26 C.F.R. § 601.103(a) (2009); *see also* United States v. Arthur Young & Co., 465 U.S. 805, 815 (1984) (stressing that the U.S. tax system is based on self-assessment); Kayle, *supra* note 1, at 552 (stating that the U.S. tax system is a self-assessment system based on voluntary compliance); John Andre LeDuc, *Federal Income Tax: Recent Legislative Developments*, 19 TAX NOTES 1027, 1029 (1983) (stating that "[s]elf-assessment is the core of the federal income tax system").

84. *See* United States v. Bisceglia, 420 U.S. 141, 145 (1975) ("[O]ur tax structure is based on a system of self-reporting. There is legal compulsion, to be sure, but basically the Government depends upon the good faith and integrity of each potential taxpayer to disclose honestly all information relevant to tax liability."); Franklin L. Green, *Exercising Judgment in the Wonderland Gymnasium*, 90 TAX NOTES 1691, 1692 (2001) (asserting that taxpayers need to make judgments regarding their own tax liability); Michael B. Lang, *Commentary on Return Preparer Obligations*, 3 FLA. TAX REV. 128, 128 (1996) (describing the obligation of taxpayers in "ferreting out the provisions of the tax law that apply to them and properly applying those provisions to their factual situations"); Lavoie, *supra* note 5, at 5 ("What emerges . . . is a baseline standard that a taxpayer must have a 'realistic possibility of success' for his position in order to file his tax return on that basis without specifically disclosing the position to the Service."); Richard Lavoie, *Subverting the Rule of Law: The Judiciary's Role In Fostering Unethical Behavior*, 75 U. COLO. L. REV. 115, 176 (2004) (stating that "voluntary compliance is a central pillar supporting the tax system," and that it is up to the taxpayers to apply the Code and properly assess their tax liability).

85. *See* Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934) (stating that "[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes"), *aff'd*, 293 U.S. 465 (1935).

86. Lavoie, *supra* note 84, at 176-77.

87. United States v. Judson, 322 F.2d 460, 468 (9th Cir. 1963); Lang, *supra* note 84, at 128; *see also* Mortimer Caplin, *The Tax Lawyer's Role in the Way the American Tax System Works*, 24 VA. TAX REV. 969, 976 (2005) ("Well over half the public seeks [tax professionals'] help for tax advice and return preparation . . . ."); Green, *supra* note 84, at 1692 (stating that the U.S. tax system

the law to specific situations, many taxpayers would be unable to assess their tax liability with accuracy.[88] It is difficult to overstate the importance of the taxpayers' consultation with tax attorneys and other tax professionals in enforcing our tax laws.[89] Tax attorneys and other tax professionals play a critical role as "gatekeepers" for our tax system.[90]

B. The Expanding Power of the IRS[91]

While taxpayers have the right and the duty to assess the tax consequences of their transactions and determine their tax liability, the IRS has the right and the duty to ensure that they have evaluated their liability correctly.[92] The IRS audits and investigates few taxpayers.[93] But, to ensure that taxpayers and tax professionals are accurately assessing tax liability, the IRS has several powerful tools to aid its investigation and to challenge suspicious transactions.[94]

First and foremost, the IRS has the power to issue summonses under § 7602.[95] Through the use of the summons, the IRS has the authority to request both materials and testimony in order to investigate returns (or the lack of a return), to determine taxpayer liability, and to aid in the collection of taxes.[96] According to § 7602, the IRS has the comprehensive power to summon paper records and other data,[97] the power to summon the taxpayer or anyone controlling the taxpayer's data

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is "extraordinarily complex and sophisticated" and would be "unworkable without the guidance provided by tax professionals"); Brian E. Holthus, Comment, *Caveat Taxpayer: How and Why the Internal Revenue Service May Examine Your Books, Your Accountant and Even Your Attorney*, 12 PEPP. L. REV. 769, 769 (1985) (stating that "[t]he reality . . . is that the average American taxpayer is ill-equipped to analyze the voluminous and complicated tax laws of the United States," and this requires the taxpayer to utilize the services of a tax professional). In *United States v. Judson*, the court stated that tax law is a "bramble bush," and that "[t]he very nature of the tax laws requires taxpayers to rely upon attorneys, and requires attorneys to rely, in turn, upon documentary indicia of their clients' financial affairs." 322 F.2d at 468.

88. *See* Lavoie, *supra* note 5, at 5 ("Every tax return thus requires legal judgments regarding both the meaning of the Code and its application to specific situations.").

89. Green, *supra* note 84, at 1692.

90. *Id.*; *see also* Caplin, *supra* note 87, at 976.

91. For a detailed history of the IRS, see Caplin, *supra* note 87, at 972-76.

92. Holthus, *supra* note 87, at 788; Lavoie, *supra* note 5, at 12-13.

93. Lavoie, *supra* note 84, at 176.

94. *See* Young, *supra* note 77, at 768 (outlining the three main tools the IRS uses to enforce the Code and prevent abusive transactions as "(1) enforcement of reporting, registration, and list maintenance obligations; (2) application of settlement programs, litigation resources and penalties; and (3) broad summons power to expose individuals and organizations").

95. *See* I.R.C. § 7602(a) (2006).

96. *Id.*; United States v. Euge, 444 U.S. 707, 712 (1980); Holthus, *supra* note 87, at 772.

97. I.R.C. § 7602(a)(1). The IRS has the authority to "examine any books, papers, records, or other data which may be relevant or material to such inquiry." *Id.*

to produce that data,[98] and the power to compel the testimony of the taxpayer and anyone else involved in the taxpayer's affairs.[99] If the taxpayer or other person summoned under § 7602 refuses to comply with the summons, § 7604 gives the federal courts clear authority to enforce the § 7602 summons sought by the IRS.[100] Courts have interpreted the § 7602 summons power broadly,[101] reasoning that the taxpayer, and not the government, holds the critical, relevant facts needed to assess tax liability.[102] Although the IRS's power is broad, courts have held that the attorney-client privilege can limit the reach of a § 7602 summons.[103] However, the assertion of the privilege has been met with a peculiar mix of responses from federal judges.[104]

Supporting the § 7602 summons, new legislation has given the IRS a second powerful tool to gain access to taxpayer information—the reporting and listing requirements of the tax shelter provisions of the Code.[105] The tax shelter reporting statutes, §§ 6111 and 6112, require any tax practitioner who aids in the creation of what the IRS deems a questionable and potentially abusive transaction to complete a return identifying and explaining that transaction.[106] These statutes have so

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98. *Id.* § 7602(a)(2). The summons power also extends to the following:

> the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry.

Id.

99. *Id.* § 7602(a)(3). Finally, the statute gives the IRS the right to request the "testimony of the person concerned, under oath, as may be relevant or material to such inquiry." *Id.*

100. *See id.* § 7604.

101. *See* United States v. BDO Seidman, 337 F.3d 802, 810 (7th Cir. 2003) (arguing that the "IRS' investigatory powers are essential to the proper functioning of the tax system" and that "courts are reluctant to restrict the IRS' summons power, absent unambiguous direction from Congress"); United States v. McKay, 372 F.2d 174, 176 (5th Cir. 1967) (likening the § 7602 summons power to the grand jury's subpoena power); Holthus, *supra* note 87, at 777 (stating that courts believe the IRS requires broad power under § 7602 in order to effectively administer the tax system).

102. *McKay*, 372 F.2d at 176.

103. United States v. Arthur Young & Co., 465 U.S. 805, 816 (1984); United States v. Euge, 444 U.S. 707, 714 (1980); Reisman v. Caplin, 375 U.S. 440, 449 (1964); Kayle, *supra* note 1, at 513; *see also*, B. John Williams, Jr., IRS Chief Counsel, Address at the Texas Federal Tax Institute: Privilege and Shelters (June 6, 2002), *in* 2002 TAX NOTES TODAY 110-29 (June 7, 2002) (reporting that a response to the increasing issuance of summonses is an assertion of the attorney-client privilege).

104. *See infra* Part IV.B.

105. Young, *supra* note 77, at 768.

106. *See* I.R.C. §§ 6111-6112 (2006); *see also BDO Seidman*, 337 F.3d at 809 (stating that the listing and reporting requirements of the tax shelter statutes aid the IRS in easily identifying abusive

increased the number of required disclosures to the IRS that some commentators claim that the IRS no longer has the resources necessary to analyze these tax shelters and identify those that are abusive.[107] Importantly, the IRS can pursue aiding and abetting penalties under § 6701[108] against attorneys and others who promote and provide assistance to taxpayers engaging in tax shelter transactions.[109] The IRS has used this new power to demand increasingly detailed reports on the structure and participation in what they suspect may be abusive tax shelters.[110] As a consequence, more taxpayers and attorneys are asserting the attorney-client privilege to prevent the IRS from reaching what are viewed as confidential communications.[111]

IV. IRS, COURTS, AND ACADEMICS ATTACK

Taxpayers assert the attorney-client privilege as a response to a § 7602 summons or an IRS investigation of a tax shelter reported under §§ 6111 and 6112.[112] The IRS, more than a few courts, and several legal commentators have been less than enthusiastic to the assertion.[113] This Article will identify the IRS's arguments against a broad tax attorney-client privilege, explore the reasoning of the federal courts where the assertion of the privilege was unsuccessful, and summarize the

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tax shelters and their participants); Kristy Brewer, Note, *Tax Shelter Information and How the Confidentiality Rule Protects Clients: The Relevance of Recent Changes to ABA Model Rule of Professional Conduct 1.6*, 13 U. MIAMI BUS. L. REV. 31, 32 (2004) (stating that the IRS uses the tax shelter disclosure requirements to prevent abusive shelter transactions that abuse the federal tax system). For a definition of a tax shelter, see Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 YALE J. ON REG. 77, 78 (2006) ("During the financial boom of the 1990s, a substantial market emerged in abusive tax shelters. These shelters, which typically involved complex financing devices, esoteric legal instruments, and multiple layers of corporations, partnerships and trusts, took advantage of the complexity of the Internal Revenue Code to create enormous paper losses that corporations could use to offset their taxable income.").

107. Williams, *supra* note 3 (arguing that while the new tax shelter legislation has improved the battle against abusive tax shelters, the IRS does not have the infrastructure or resources in order to "parse through tax planning ideas disclosed to it").

108. *See* I.R.C. § 6701 (imposing penalties for any one who aids or abets in the understatement of tax liability).

109. *See* Williams, *supra* note 103 ("In appropriate and egregious circumstances, we are considering aiding and abetting penalties under *section* 6701.").

110. *See id.*

111. *See id.* (recounting that the privilege has been a response to the reporting requirements of tax shelter legislation); *see also* Camilla E. Watson, *Legislating Morality: The Duty to the Tax System Reconsidered*, 51 U. KAN. L. REV. 1197, 1231 (2003) ("The Service has been frustrated by what it calls 'unmerited claims of privilege' and the significant obstacles that these claims have posed to its enforcement efforts.").

112. Colleen Conti Walsh, *The Attorney-Client Privilege and the Tax Practitioner*, VT. B.J. & L. DIG., Feb. 1994, at 14, 14.

113. *See infra* Part IV.

arguments against the privilege of a number of academics and other legal critics.

A. An Emboldened IRS

While the IRS has a long history of resisting the assertion of the attorney-client privilege where the information impacted tax returns,[114] their recent success in prosecuting abusive tax shelters has emboldened their disposition.[115] Commentators anticipate increasing use of the § 7602 summons by the IRS and, consequently, taxpayers more frequently asserting the attorney-client privilege.[116]

A telling indication of the IRS's hardening attitude toward the attorney-client privilege can be found in the speech of Former Chief Counsel of the IRS John B. Williams.[117] In a speech declaring that the IRS would aggressively pursue tax shelters and abusive tax transactions of any kind, Williams saw no merit in allowing the attorney-client privilege to constrain these investigations.[118] Williams argued that increasingly complex tax strategies demand more information from taxpayers, and that to identify and penalize what may be abusive tax transactions, the IRS must challenge the assertion of the attorney-client privilege.[119] By issuing "sweeping summonses" to tax attorneys creating tax shelters for their clients,[120] and by denying the applicability of the privilege to the information sought by the summonses, the IRS seeks to

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114. See Williams, *supra* note 103 (stating that the privilege does not apply to any communications used in preparing a tax return); *see also infra* Part IV.B.1 (highlighting cases that date back to the 1950s in which the IRS has challenged the assertion of the privilege when it relates to tax returns).

115. *See* Young, *supra* note 77, at 767 ("Over the past few years, the United States Internal Revenue Service (IRS), supported by the other parts of the Treasury Department and occasionally impelled by Congress, has developed and employed increasingly effective tools for identifying and challenging tax-advantaged transactions entered into by corporations and high income individuals."); *see also* Williams, *supra* note 103 ("The battle against abusive tax avoidance transactions is a high priority for the Office of Chief Counsel.").

116. *See, e.g.*, Graves, *supra* note 9, at 577 (stating that the IRS is more frequently using the § 7602 summons in order to prevent tax evasion).

117. *See generally* Williams, *supra* note 103 (discussing the IRS's increasingly aggressive efforts to limit the scope of the attorney-client privilege in tax evasion cases).

118. *Id.* (stating that ending abusive tax transactions is a "high priority"); *see also* Blessing, *supra* note 67, at 15 ("The Internal Revenue Service has staged a coordinated and effective counterattack in the face of aggressive claims of privilege in the context of tax shelters.").

119. Williams, *supra* note 103 (arguing that access to information is the best means for ferreting out abusive tax transactions).

120. David A. Dorth, *"What's Said in the Room Stays in the Room . . .": The Court's Loose Interpretation of the Attorney-Client Privilege as it Applies to Tax Documents*, CBA REC., May 2004, at 62, 62; Young, *supra* note 77, at 768; *see also* Williams, *supra* note 103 (admitting that the IRS will continue to issue summonses to "law firms, accounting firms, investment banks and others who may have been involved in the promotion of questionable transactions").

either force a settlement with the taxpayer or move the dispute into the courts.[121] With the Code and supporting regulations now requiring tax shelters to maintain registration numbers, lists of investors, and promotional materials and much of their transactional data, the IRS is well positioned to fight the assertion of privilege claims on a broad range of documents.[122]

Bolstered by its initial successes in the tax shelter cases, the IRS has broadened its assault against the attorney-client privilege.[123] For example, the IRS contends that communications with an attorney acting as a tax shelter promoter cannot be confidential because the marketing efforts "promote" the shelter to many taxpayers.[124] Equally dramatic, the IRS contends that, if a shelter is promoted to several potential investors, then all of the communications surrounding the transaction are simply business advice and not protected legal advice.[125] Yet another aggressive IRS position argues that when a taxpayer's defense is that, based on legal advice, he had reasonable cause for a good-faith belief that he did not violate the law, that he has waived the privilege for opinions stated by either the taxpayer or the attorney and for all supporting communications used to support that defense.[126] If opinions are intended to be later divulged to independent auditors, the IRS asserts that these opinions lack the confidentiality required for the attorney-client privilege.[127] Only when the opinion is given to a client by an attorney, acting in his capacity as an advisor on a legal question, will the IRS defer to a privilege claim.[128]

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121. *See* Dorth, *supra* note 120, at 62. Former IRS Chief Counsel John B. Williams has stated that the federal tax shelter legislation and the IRS's aggressive attack against questionable transactions has not led to an increase in cases before the courts, but has increased the complexity of the cases and has led to more settlement of cases, even if the taxpayer could and should have won. Williams, *supra* note 3.

122. *See* Williams, *supra* note 103 ("Finally, as a general rule, the privilege does not protect the name, address, or whereabouts of the investor who receives the tax advice. It does not protect pre-existing facts, documents, or intra-corporate communications unrelated to the seeking of legal or tax advice. It does not protect the existence of the attorney-client or practitioner-client relationship or the fees paid. Nor does it protect communications made in connection with providing non-legal services, such as accounting or tax preparation activities or investor promotions, or for non-legal advice, such as business or accounting advice."); *see also* Smith, *supra* note 4, at 234 (stating that the IRS is attempting to combat the tax shelter problem by stripping away the attorney-client privilege which promotes secrecy).

123. *See* Dorth, *supra* note 120, at 62 (stating that the IRS has taken firms to court in order to enforce summonses seeking information regarding possible tax shelters).

124. Williams, *supra* note 103.

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

B. Inconsistent Rulings by the Courts

Several federal courts have been quite receptive to the IRS's initiatives to narrow the scope of the privilege.[129] Yet, even the courts most receptive to the IRS position have not been able to agree on either the definition of the narrower privilege or the underlying reasoning for denying the privilege.[130] Although the decisions reached differ from jurisdiction to jurisdiction, some general statements about the courts' standards employed as well as their reasoning can be identified for the applicability of the privilege to communications surrounding tax returns, audit investigations, accrual workpapers, and, more recently, tax shelters and the broad area of tax planning.[131]

1. Documents Used in the Preparation of Tax Returns

Several courts have held that communications that form the basis for the preparation of tax returns are not privileged.[132] Central to these decisions is the notion that, because the information is intended to be divulged to a third party—the IRS—it is not confidential, and hence not privileged; or, alternatively, it is the act of transmission to the IRS that waives the privilege for information used in preparing the returns.[133] A

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129. This seems to be in direct opposition to what most individuals believe. *See* Lynch, *supra* note 9, at 91-92 ("The public perception, of course, is that the scope of the privilege is very broad and that it is held almost sacrosanct by the courts.").

130. *See In re* Grand Jury Subpoena Duces Tecum, 697 F.2d 277, 280 (10th Cir. 1983) (finding that the issue of whether the attorney-client privilege protects communications relating to tax returns and tax worksheets has not been uniformly resolved by the courts); *see also* Kayle, *supra* note 1, at 515 (arguing that the courts do not seem to have formulated one clear test for determining whether communications are legal advice or accounting or business advice). The sole tax case concerning the attorney-client privilege's application to tax attorneys and their clients to reach the U.S. Supreme Court was decided on procedural, rather than substantive, grounds. *See* Reisman v. Caplin, 375 U.S. 440, 450 (1964).

131. These are the most common cases, but there have been other privilege issues in the tax context, including whether the attorney-client privilege applies to attorneys' fees paid by the taxpayer. *See* United States v. Hodgson, 492 F.2d 1175, 1177 (10th Cir. 1974) (holding that the privilege does not apply to records regarding money received from the taxpayer client).

132. *See* United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999) (holding that the attorney-client privilege does not apply to information furnished in order to prepare the client's tax returns); *In re* Grand Jury Investigation, 842 F.2d 1223, 1225 (11th Cir. 1987) (holding that the attorney-client privilege does not apply to communications relating to tax return preparation); Olender v. United States, 210 F.2d 795, 806 (9th Cir. 1954) (holding that the attorney-client privilege does not apply to communications to an attorney to prepare a tax return); United States v. Merrell, 303 F. Supp. 490, 492-93 (N.D.N.Y. 1969) (holding that while the attorney-client privilege does apply to tax returns and the giving of tax advice, it does not apply to copies of the tax return because the returns were not intended by the client to be confidential).

133. *See In re Grand Jury Subpoena Duces Tecum*, 697 F.2d at 280 (holding that information communicated to a tax attorney to be included in the tax return is not confidential because it was intended to be disclosed to the IRS); United States v. Lawless, 709 F.2d 485, 488 (7th Cir. 1983) (holding that tax return preparation communications are not privileged because they are not

dramatic statement of this position is found in *In re Shapiro*, where the court held that workpapers used to prepare a taxpayer's income tax returns were not privileged.[134] The *Shapiro* court found that the information contained in the workpapers for the returns was "of a non-confidential nature" because the taxpayer intended to disclose the essence of the information contained in the workpapers to the IRS.[135] This court reasoned that written summaries of income and expenses, workpapers, and schedules "by definition" contained information the taxpayer intended to include on the tax returns, and therefore were not confidential.[136]

Of course, the schedules that comprise the heart of the tax return are intended to be disclosed to the IRS.[137] Taxpayers and their counsel have no reasonable expectation of confidentiality for the myriad of financial documents collected and compiled by the taxpayer that are the basis for the attorney's legal advice.[138] But the *Shapiro* court's inclusion of an attorney's workpapers as documents intended to be included in a tax return oversimplifies legal counseling in tax preparation. Workpapers can memorialize the confidential client discussion where the attorney and taxpayer formulate a legal strategy so that the information subsequently forwarded in the tax return cogently expresses the taxpayer's position.[139] Workpapers can include far more than journal entries of revenues and expenses—they often record the essence of the attorney's legal advice of a confidential conversation preceding civil

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intended to be confidential); United States v. Cote, 456 F.2d 142, 145 (8th Cir. 1972) (holding that because the information provided in an accountant's workpapers was included in the amended returns and filed with the government, the privilege was waived, and this included not only information included in the actual return, but also the "details underlying that information"); United States v. Bohonnon, 628 F. Supp. 1026, 1029 (D. Conn. 1985) (holding that a list of clients for whom the attorney prepared tax returns or actual copies of clients' tax returns prepared by an attorney were not privileged because the client intended to file the returns with the IRS); *In re* Shapiro, 381 F. Supp. 21, 23 (N.D. Ill. 1974) (holding workpapers used to prepare tax returns were not privileged because they were not intended by the client to be confidential); United States v. Schoeberlein, 335 F. Supp. 1048, 1057-58 (D. Md. 1971) (holding that items given to an attorney were intended to be disclosed on the client's tax return and were thus not confidential or privileged); United States v. Threlkeld, 241 F. Supp. 324, 326 (W.D. Tenn. 1965) (stating that information intended to be included on the tax return is not privileged). *But see Frederick*, 182 F.3d at 500-01 (disagreeing with the IRS's claim that the attorney-client privilege applies to communications regarding the preparation of tax returns because the underlying information was intended to be divulged to the IRS, and thus had no expectation of confidentiality).

134. *In re Shapiro*, 381 F. Supp at 23.

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. *See* United States v. Frederick, 182 F.3d 496, 501 (7th Cir. 1999).

litigation, a criminal proceeding, or the submission of the information required on a form like a tax return.[140]

There are also courts that take the position that attorney-client communications preceding the filing of a tax return are not privileged because tax return preparation is not the practice of law.[141] These courts hold that this is accounting work or business advice, rather than legal advice.[142] In *United States v. Frederick*, the Seventh Circuit Court of Appeals enforced a § 7602 summons against an attorney, who was also an accountant, that sought information relevant to the preparation of tax returns.[143] The court distinguished the communications between an attorney and client in the preparation of a tax return as not comparable to the "preparation of a brief or an opinion letter."[144] The court reasoned that because tax returns are generally completed by accountants and the documents needed to complete the returns are usually created by an accountant or the taxpayer himself, the documents are not legal work and the communications could not meet the legal advice requirement of the attorney-client privilege.[145] Interestingly, the court stressed that allowing the privilege to apply would give an unfair advantage to clients who used an attorney rather than an accountant to prepare their tax returns.[146] As the attorney knew the IRS was conducting an investigation of the client's prior returns, the *Frederick* court further held that dual-purpose documents, those the attorney anticipated would be used both in the preparation of the tax returns and subsequently used in litigation, were also not privileged.[147] In another decision dismissing an assertion of the attorney-client privilege, a court went so far as to describe tax return preparation as "mere scrivener's work."[148]

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140. *See id.*

141. *See, e.g.*, *id.* at 500; United States v. Willis, 565 F. Supp. 1186, 1189 (S.D. Iowa 1983); *see also Shapiro*, 381 F. Supp. at 22-23 (stating that tax returns prepared by an attorney should not be protected because they would not be privileged if prepared by an accountant).

142. *See Frederick*, 182 F.3d at 501; *see also In re* Grand Jury Investigation, 842 F.2d 1223, 1225 (11th Cir. 1987) (stating that while tax return preparation does include some legal analysis, it is not privileged because tax returns are generally completed by accountants); Olender v. United States, 210 F.2d 795, 806 (9th Cir. 1954) (stating that the hiring of an attorney to prepare tax returns could not be privileged because the attorney was engaged simply as an accountant and not to render legal advice).

143. *Frederick*, 182 F.3d at 499.

144. *Id.* at 500.

145. *Id.* The documents at issue in *Frederick* included tax return drafts, schedules, "worksheets containing the financial data and computations required to fill in the returns, and correspondence relating to the returns." *Id.*

146. *Id.* at 501.

147. *Id.*

148. *See* Canaday v. United States, 354 F.2d 849, 857 (8th Cir. 1966) (holding that communications between a client and his tax return preparer attorney were not privileged because

Fortunately, not all courts have made these blanket statements banishing privilege from the information assembled in tax return preparation.[149] Some courts have ruled that only the information actually used in the return is not privileged.[150] Another court found a communication to be privileged when a client disclosed information to the attorney so that the attorney could decide whether or not to include the information in the return.[151] Other courts have recognized that merely because a client sought advice from an attorney for tax return preparation does not mean that all of the communications were related to information included on the return.[152] In *United States v. Davis*, the court

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the attorney acted "merely as a scrivener" and therefore there was not an attorney-client relationship).

149. *See* Colton v. United States, 306 F.2d 633, 637 (2d Cir. 1962) ("There can, of course, be no question that the giving of tax advice and the preparation of tax returns . . . are basically matters sufficiently within the professional competence of an attorney to make them prima facie subject to the attorney-client privilege."); Segerstrom v. United States, 87 A.F.T.R.2d (RIA) 2001-1153, 2001-1156 to -1158 (N.D. Cal. 2001) (holding that handwritten notes, telephone conversations, financial calculations, valuations, and drafts of legal documents that contain legal as well as business information used in estate planning and in the preparation of an estate tax return, were privileged, even if disclosed to third parties who aided in the rendering of the legal advice); *In re* Shapiro, 381 F. Supp. 21, 22-23 (N.D. Ill. 1974) (asserting that while income tax return preparation communications are not privileged in and of themselves, if the returns are prepared as part of a "bona fide attorney-client relationship evidenced by significant other legal services," then the communications may be privileged); United States v. Long, 328 F. Supp. 233, 235-36 (E.D. Mo. 1971) (holding that while general questions about the legal nature of the services the attorney provided in an IRS enforcement proceeding regarding business expenses deducted on the client's tax return were not privileged, the testimony related to the subject matter of the legal services was privileged); United States v. Higgins, 266 F. Supp. 596, 596 (S.D. W. Va. 1966) (holding that "work papers, schedules or information prepared or used in completing" a tax return were privileged).

150. *See* United States v. Schlegel, 313 F. Supp. 177, 179 (D. Neb. 1970) (reasoning that a client gives all information to the attorney with the intent that the attorney will decide what to include on the return, and thus the client does not intend that all information will necessarily be disclosed to the IRS); *see also* United States v. Cote, 456 F.2d 142, 145 n.4 (8th Cir. 1972) ("Too broad an application of the rule of waiver requiring unlimited disclosure . . . might tend to destroy the salutory purposes of the privilege which invite confidentiality between the attorney and his client."); United States v. Bohonnon, 628 F. Supp. 1026, 1029 (D. Conn. 1985) (noting that while actual copies of the return are not privileged, "underlying papers or legal advice" regarding the tax returns are privileged); United States v. Willis, 565 F. Supp. 1186, 1193 (S.D. Iowa 1983) (adopting the *Schlegel* reasoning); United States v. Jeremiah, 37 A.F.T.R.2d (RIA) 76-1285, 76-1288 (D. Or. 1975) (holding that work papers and conversations between attorney and client were privileged). In *Schlegel*, the court reasoned that if the client intended that all information disclosed to the attorney in preparation of the tax return would also be disclosed to the IRS, then the client would not be completely forthcoming with the attorney. *Schlegel*, 313 F. Supp. at 179.

151. *In re* Grand Jury Subpoena Duces Tecum, 697 F.2d 277, 280 (10th Cir. 1983) ("[I]t may well be that the attorney-client privilege is applicable when a client provides information to an attorney and leaves the decision whether to include that information in the return to the attorney's discretion."); United States v. Threlkeld, 241 F. Supp. 324, 326 (W.D. Tenn. 1965).

152. *See* United States v. Abrahams, 905 F.2d 1276, 1284 (9th Cir. 1990) ("Although communications made *solely* for tax return preparation are not privileged, communications made to acquire legal advice about what to claim on tax returns may be privileged."), *overruled on other*

held that copies of amended tax returns in the attorney's possession were not protected from a § 7602 summons, but a worksheet and adding machine tape were protected by the attorney-client privilege.[153] Following its in camera review of the documents, the court found that the worksheet and adding machine tape were protected because the taxpayers consulted the attorney for "legal advice in the area of tax law," and the attorney was acting in his capacity as a lawyer and not solely as an accountant.[154]

2. Communications Preparing for an IRS Audit

While the decisions in the tax return cases are mixed, the courts have generally found the privilege present when a tax attorney is representing a client during an IRS audit dealing with the application of a tax law.[155] Whether or not the privilege applies to information gathered prior to an audit turns on whether the attorney is acting as an attorney or acting as an accountant.[156] If the attorney is acting in his capacity as an attorney and providing legal representation during the audit, then courts will uniformly find the communications are protected.[157]

3. Tax Accrual Workpapers

Like the tax return cases, decisions on whether tax accrual workpapers are privileged are mixed.[158] One recent opinion has provided

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*ground*s *by* United States v. Jose, 131 F.3d 1325, 1329 (9th Cir. 1997); *In re* Grand Jury Investigation, 842 F.2d 1223, 1225 (11th Cir. 1987) (stating that "[o]bviously a lawyer who prepares a tax return can provide legal advice on tax matters unrelated to the preparation of that return" and that advice is protected by the privilege); *see also* Shahinian v. Tankian, 242 F.R.D. 255, 258 (S.D.N.Y. 2007) (asserting that while information intended to be retransmitted to the IRS on the tax return is not privileged, not necessarily all information related to tax advice is denied the privilege's protection).

153. 29 A.F.T.R.2d (RIA) 72-887, 72-889 (E.D. Mich. 1972). In *Davis*, an attorney was hired to give legal advice regarding a tax return the taxpayers filed after the deadline. *Id.* The attorney advised the clients to file an amended return, and he prepared the amended return. *Id.*

154. *Id.* The court also held that the worksheet and the adding machine tape were protected because they were not intended to be included on the amended tax return. *Id.*

155. Blessing, *supra* note 67, at 47.

156. *See* United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999).

157. *See id.* ("If . . . the taxpayer is accompanied to the audit by a lawyer who is there to deal with issues of statutory interpretation or case law that the revenue agent may have raised in connection with his examination of the taxpayer's return, the lawyer is doing lawyer's work and the attorney-client privilege may attach.").

158. *See In re* Newton, 718 F.2d 1015, 1016, 1021 (11th Cir. 1983) (holding that tax accrual workpapers were subject to IRS summons); Blessing, *supra* note 67, at 24 (stating that in general, tax accrual workpapers are not privileged); John K. Cook, Jr., *IRS Tax Accrual Workpapers Requests: An (Un)Limited Expansion?*, PRAC. TAX STRATEGIES, May 2006, at 260, 266 ("Many documents prepared in the process of accruing taxes for financial accounting purposes (and therefore arguably falling within the definition of tax accrual workpapers found in the IRM [Internal

thoughtful arguments for those arguing that the information in tax accrual workpapers should be privileged.[159] In *United States v. Textron*, the IRS sought enforcement of a summons seeking the taxpayer's tax accrual workpapers.[160] The IRS argued that the workpapers were not privileged because they provided accounting advice, while the taxpayer claimed that, because they included the legal conclusions of the corporate taxpayer's legal counsel, they were privileged.[161] Central to the district court's finding that the tax accrual workpapers were protected by the attorney-client privilege was the conclusion that they consisted of "nothing more than counsel's opinions regarding items that might be challenged because they involve areas in which the law is uncertain."[162] The district court also found that the attorney's assessment in the workpapers of the taxpayer's "chances of prevailing in any ensuing litigation" was privileged.[163] However, after finding the tax accrual workpapers to be privileged, the district court ultimately denied the privilege claim because legal counsel, having disclosed the workpapers to the taxpayer's independent auditors, waived the

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Revenue Manual]) will not be privileged, either because they are not communications between the taxpayer and its attorney, they were not prepared in anticipation of litigation, or they were disclosed to a third party (e.g., the taxpayer's attest firm)."). *But see* United States v. Adlman, 134 F.3d 1194, 1195 (2d Cir. 1998) (holding that documents created because of anticipated litigation do not lose work-product protection merely because they are also intended to assist in making business decisions); United States v. Textron Inc., 507 F. Supp. 2d 138, 147 (D.R.I. 2007) (holding that tax accrual workpapers are protected by the attorney-client privilege, though the privilege is waived when workpapers are disclosed to an independent auditor), *vacated and remanded*, 577 F.3d 21 (1st Cir. 2009); Tax accrual workpapers are used to "assess a corporation's contingent tax liability and determine whether it is great enough to require the corporation to reveal the potential liability on its balance sheet." *In re Newton*, 718 F.2d at 1019. For a further description of accrual workpapers, see the Supreme Court's discussion in *United States v. Arthur Young & Co.*, 465 U.S. 805, 810-13 (1984). For a description of the tax accrual workpaper process, see *Textron*, 507 F. Supp. 2d at 143.

159. *See generally Textron*, 507 F. Supp. 2d 138. In *Textron*, the district court held that while the attorney-client privilege is waived by disclosure to the independent audit firm, the tax accrual workpapers are protected by the attorney work-product privilege. *Id.* at 154. A three to two majority of the First Circuit bench disagreed and vacated the decision. *See* United States v. Textron, 577 F.3d 21, 22, 32 (1st Cir. 2009), *vacating and remanding* 507 F. Supp. 2d 138.

160. *Textron*, 507 F. Supp. 2d at 141. The IRS sought the taxpayer's spreadsheet that included:

> (a) lists of items on Textron's tax returns, which, in the opinion of Textron's counsel, involve issues on which the tax laws are unclear, and, therefore, may be challenged by the IRS;
>
> (b) estimates by Textron's counsel expressing, in percentage terms, their judgments regarding Textron's chances of prevailing in any litigation over those issues (the "hazards of litigation percentages"); and
>
> (c) the dollar amounts reserved to reflect the possibility that Textron might not prevail in such litigation (the "tax reverse amounts").

Id. at 142-43. The summons also sought similar materials from the previous tax year. *Id.* at 143.

161. *Id.* at 146.

162. *Id.* at 147.

163. *Id.*

privilege.[164] On appeal, the First Circuit Court of Appeals vacated the trial court's finding of work-product privilege and remanded the case to district court.[165] The court held that the work-product privilege did not apply because tax accrual workpapers are prepared for financial statements, not for litigation.[166]

4. Tax Planning and Tax Shelters

When ruling on an assertion of the attorney-client privilege, courts have looked more favorably on tax planning communications than the mixed results found in tax return and tax accrual workpaper cases.[167] In *United States v. Willis*, the court distinguished tax planning from tax return preparation as tax planning generally required true legal advice.[168] The court felt a presumption of privilege should apply to tax planning communications as they are forward-looking and require both legal analysis and research to provide the advice.[169] However, because tax planning can include tax shelters, there has been substantial litigation

164. *Id.* at 152. In addition to the attorney-client privilege, the taxpayers also asserted work-product privilege, and the court ultimately held that the tax accrual workpapers were protected from disclosure by the work product doctrine. *Id.* at 153.

165. United States v. Textron, 577 F.3d 21, 32 (1st Cir. 2009).

166. *Id.* at 31-32. *But see* United States v. Adlman, 134 F.3d 1194, 1195 (2d Cir. 1998) (holding that documents created because of anticipated litigation do not lose work-product protection merely because they are also intended to assist in making business decisions).

167. *See* Marc Rich & Co. v. United States (*In re* Grand Jury Subpoena Duces Tecum), 731 F.2d 1032, 1037 (2d Cir. 1984) ("Tax advice rendered by an attorney is legal advice within the ambit of the privilege."); United States v. Willis, 565 F. Supp. 1186, 1190 (S.D. Iowa 1983) ("[T]he Court is of the opinion that where tax *planning* advice is sought from a lawyer, the 'legal advice' prong of the Wigmore formula is satisfied."); United States v. Tel. & Data Sys., Inc., 90 A.F.T.R.2d (RIA) 2002-5828, 2002-5830 (W.D. Wis. 2002) (reviewing documents in camera and holding that a letter to a law firm requesting a tax opinion, an opinion from a law firm that examined legal issues of proposed transactions, and a memorandum and markup by a law firm of an opinion prepared by an accounting firm were privileged); Jay L. Carlson & David A. Roman, *The Tax Advice Privilege is Alive and Well*, 99 TAX NOTES 399, 402 (2003) (citing *March Rich & Co.*, 731 F.2d at 1037; United States v. Cote, 456 F.2d 142, 144 (8th Cir. 1972); Colton v. United States, 306 F.2d 633, 637 (2d Cir. 1962)); Walsh, *supra* note 112, at 15 (asserting that while tax return preparation communications are not protected, attorney-provided tax advice, planning, and opinions are protected). In *Marc Rich & Co.*, the court reviewed whether consulting an attorney for tax advice on a potential reorganization was protected by the attorney-client privilege. 731 F.2d at 1037-38. The court stated that the documents relating to the reorganization were privileged, but the crime/fraud exception to the privilege applied. *Id.* at 1038-39.

168. 565 F. Supp. at 1190.

169. *Id.* ("Tax planning is concerned with current or future tax periods. It entails advising a client on how best to structure contemplated financial transactions, decisions, or occurrences from a tax consequences standpoint; the identification of the various means by which a particular tax objective of the client can be achieved; and other before-the-fact research and advice.").

where the IRS challenges the assertion of the attorney-client privilege in its efforts to prevent "abusive tax transactions."[170]

The IRS has successfully challenged the peculiar argument made by tax shelter promoters that the participating taxpayer's identity is protected by the attorney-client privilege.[171] As Congress has passed laws requiring reporting of participants in these tax shelters, the courts have predictably held that the identity of the taxpayer is not protected by the privilege.[172] In *United States v. BDO Seidman*, the Seventh Circuit Court of Appeals dismissed the assertion that the identities of an accounting firm's clients participating in "potentially abusive tax

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170. Tax shelter transactions "were often intentionally structured to be highly complex so their purpose would not be immediately obvious to an examining agent, or were crafted in such a manner as not to be readily apparent on the face of the taxpayer's tax return." Lavoie, *supra* note 2, at 170-71.

171. The identity of the client has also been held not privileged in other types of tax cases. *See* United States v. Leventhal, 961 F.2d 936, 941 (11th Cir. 1992) (holding that the attorney-client privilege did not apply to the client's identity in regards to a Form 8300 request); United States v. Goldberger & Dubin, P.C., 935 F.2d 501, 505 (2d Cir. 1991) (stating that a Form 8300 request for client identity does not constitute privileged information); United States v. Tratner, 511 F.2d 248, 253 (7th Cir. 1975) (holding that the identity of a client who paid an attorney $10,000 which the attorney deposited into his escrow client account was not privileged). *But see* Tillotson v. Boughner, 350 F.2d 663, 666 (7th Cir. 1965) (holding that a taxpayer's identity is protected by the privilege because "disclosure of the identity of the client in the instant case would lead ultimately to disclosure of the taxpayer's motive for seeking legal advice").

172. *See e.g.*, United States v. BDO Seidman, 337 F.3d 802, 811 (7th Cir. 2003); Doe v. Wachovia Corp., 268 F. Supp. 2d 627, 636 (W.D.N.C. 2003); United States v. Jenkens & Gilchrist, P.C., No. 03 C 5693, 2005 WL 1300768, at *3 (N.D. Ill. March 10, 2005); Lavoie, *supra* note 2, at 176. In general, a client's identity is not considered privileged because it is not considered to be a communication, one of the required elements of the attorney-client privilege. *BDO Seidman*, 337 F.3d at 811. However, the privilege will cover the client's identity if disclosing the identity will disclose the underlying confidential communication that has already been disclosed. *Id.* The identity of a client will also be privileged if it is considered "the last link in an existing chain of incriminating evidence likely to lead to the client's indictment." United States v. Aronson, 610 F. Supp. 217, 221 (D.C. Fla. 1985), *aff'd*, 781 F.2d 1580 (11th Cir. 1986); *see also* United States v. Liebman, 742 F.2d 807, 810 (3d Cir. 1984) (holding that a client's identity, "when combined with the substance of the communication as to deductibility that is already known, would provide all there is to know about a confidential communication between the taxpayer-client and the attorney" and this would violate the attorney-client privilege). The court in *United States v. Sindel* summarized the circumstances under which the identity of the client would be protected by the attorney-client privilege:

> The legal advice exception protects client identity and fee information when "there is a strong probability that disclosure would implicate the client in the very criminal activity for which legal advice was sought." The last link exception, as its name implies, prevents disclosure of client identity and fee information when it would incriminate the client by providing the last link in an existing chain of evidence. The confidential communications exception, which we have recognized on another occasion, protects client identity and fee information "if, by revealing the information, the attorney would necessarily disclose confidential communications."

53 F.3d 874, 876 (8th Cir. 1995) (citations omitted).

shelters" were protected by the attorney-client privilege.[173] The court noted that the unnamed clients failed to show that disclosing their identities would reveal confidential communications.[174] Importantly, the court based its holding on the presence of the tax shelter statutes.[175] With a clear Congressional mandate of the reporting and listing requirements of the tax shelter statutes, BDO Seidman's clients could not have reasonably expected their communications to be kept confidential.[176]

In a similar ruling in *Doe v. KPMG, L.L.P.*, a federal district court in Texas held that the identities of the taxpayers were not protected because the taxpayers could not reasonably believe that their identities or communications related to their participation in abusive tax shelters would not be disclosed because of the reporting and listing requirements of the tax shelter statutes.[177] Even if the taxpayers mistakenly believed that their identities were not subject to the tax shelter statutes, the court found that they could not reasonably believe the communications were confidential.[178] If the taxpayers were subsequently audited, they must have known that the loss they claimed on their tax return would have required the disclosure of their participation in the tax shelters.[179]

The court in *KPMG* ruled against the taxpayers' argument that disclosing their identities would reveal underlying confidential

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173. *BDO Seidman*, 337 F.3d at 812. Actually, the privilege at issue in *BDO Seidman* was the § 7525 tax practitioner privilege. *Id.* at 810. However, because the coverage of the § 7525 privilege is based solely on the common law definition of the attorney-client privilege, the court's holding is instructive as to the attorney-client privilege as well. *See id.* In *BDO Seidman*, the IRS had received information that BDO Seidman was not complying with the tax shelter statutes, and as a consequence summoned several documents from BDO Seidman seeking the identity of investors in certain transactions, "the date on which those investors acquired an interest, and all tax shelter registrations filed and investor lists prepared with respect to the transactions." *Id.* at 806. The clients then attempted to intervene to protect their identities from disclosure. *Id.* at 807. The court denied the clients' motion to intervene. *Id.* at 813.

174. *Id.* at 812.

175. *Id.*

176. *Id.*; *see also* Lavoie, *supra* note 2, at 183 n.197 ("[W]hile the attorney-client privilege is still potentially available despite the enactment of section 6112, the reality of the Service's implementation of that provision would normally negate a crucial element (i.e., the expectation of confidentiality) that a taxpayer would need to prove for the privilege to apply.").

177. Doe v. KPMG, L.L.P., 325 F. Supp. 2d 746, 753 (N.D. Tex. 2004), *rev'd on other grounds*, 398 F.3d 686 (5th Cir. 2005). In *KPMG*, the IRS summonsed KPMG seeking the identities of KPMG's clients who participated in some identified transactions. *Id.* at 748. The clients had hired KPMG to assist in tax return preparation and to give tax advice regarding certain investments. *Id.* In response to the IRS summons, the taxpayers claimed that by revealing their identities, they would also reveal the "underlying communications regarding the tax shelter described in Notice 2000-44, including their purpose and motivation for entering the transaction." *Id.* at 752.

178. *Id.* at 754.

179. *Id.* ("Knowing that any information included on a tax return could be questioned during an audit, Plaintiffs could not have reasonably believed their participation in the tax shelter was confidential.").

communications because the taxpayers did not identify which communications would be revealed by disclosing their identities.[180] Only participation in the tax shelters, not communications regarding the tax shelters, would be disclosed by revealing their identities.[181] As to the claim of confidentiality for the taxpayers' motivations for seeking advice from KPMG, the court dismissed this by noting that "'virtually any taxpayer who seeks tax advice from an accounting firm is looking for ways to minimize his taxes' or for assurance that he is complying with the tax laws."[182] By disclosing the loss from the tax shelters on their tax returns, the taxpayers could not reasonably believe that the fact that they had communicated with an accounting firm would be privileged.[183]

The tax shelter cases have a special importance as illustrations of the IRS's attempts to assert the crime-fraud exception to the attorney-client privilege.[184] In *BDO Seidman*, the court reviewed over 250 documents in camera and held that the crime-fraud exception applied to only one of the documents.[185] On that document alone, the IRS successfully made a prima facie showing of fraud and it was now up to the accounting firm to show why the document should not be disclosed.[186] The court identified seven factors it used to guide its in camera review of the documents for a prima facie showing of fraud:

> (1) the marketing of pre-packaged transactions by BDO; (2) the communication by the Intervenors [the taxpayers] to BDO with the purpose of engaging in a pre-arranged transaction developed by BDO or third party with the sole purpose of reducing taxable income; (3) BDO and/or the Intervenors attempting to conceal the true nature of the transaction; (4) knowledge by BDO, or a situation where BDO should have known, that the Intervenors lacked a legitimate business purpose for entering into the transaction; (5) vaguely worded consulting agreements; (6) failure by BDO to provide services under

180. *Id.* at 752.

181. *Id.* at 752-53.

182. *Id.* at 753 (citation omitted).

183. *Id.* ("Therefore, Plaintiffs' participation in the Notice 2000-44 tax shelter is not a privileged communication because Plaintiffs could not have had a reasonable expectation that it was confidential, or that it would not be disclosed to others, *i.e.*, via their tax returns.").

184. *See* United States v. BDO Seidman, LLP, 95 A.F.T.R.2d (RIA) 2005-1725, 2005-1729 (N.D. Ill. 2005).

185. *Id.* at 2005-1737. The court held it would not find a blanket application of the crime-fraud exception. *Id.* at 2005-1734. The court found that the IRS had failed to make a showing that the crime-fraud exception was applicable to all but one of the BDO documents. *Id.* The IRS claim that the transactions were illegal was not sufficient evidence of a crime or fraud. *See id.*

186. *Id.* at 2005-1737.

> the consulting agreement yet receipt of payment; (7) mention of the COBRA transaction; and (8) use of boiler-plate documents.[187]

Importantly, the court was careful to state that these factors were not dispositive, and the court would continue to consider the "totality of circumstances" in determining whether the government made a prima facie showing of a crime or fraud.[188]

The difficulties of asserting an attorney-client privilege in a tax shelter case are laid out in some detail in *Doe v. Wachovia*.[189] There, the court first held that in marketing the same tax opinion to more than one client, a law firm acting as a promoter of a tax shelter could not expect that their communications were confidential.[190] By distributing information to multiple parties, even if there were privileged information present, it would be waived.[191] Further, if the marketed tax avoidance promotion contained hypothetical data and not that supplied by an individual client, then there is no legal advice given or client communication to protect.[192]

This summary of the uneven determination of the federal courts finding the presence of an attorney-client privilege in tax communications highlights an uncertainty that could well chill communications between tax attorneys and their clients.[193] Perhaps most onerous is the burden on the attorney to prove each document and communication was not intended to be divulged to the IRS and was, in fact, "legal" advice and not accounting or business advice.[194]

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187. *Id.*

188. *Id.* (citing United States v. BDO Seidman, No. 02 C 4822, 2002 WL 32080709 (7th Cir. Dec. 18, 2002).

189. Doe v. Wachovia Corp., 268 F. Supp. 2d 627, 635-36 (W.D.N.C. 2003).

190. *Id.* at 636. The court stated that "'[t]here may be no attorney-client relationship with the potential investor; nor may there be an expectation of confidentiality,'" and "'when the opinion is marketed, any privilege will be waived.'" *Id.* (citation omitted).

191. *Id.*

192. *Id.* ("'Where the tax advice is given based on a set of hypothetical facts not posed by the client (as is often the case in marketed tax avoidance transactions), divulging that advice would not disclose a privileged communication by the client.'" (citation omitted)).

193. *See* Dorth, *supra* note 120, at 62 (arguing that the BDO decisions weaken the candidness policy behind the attorney-client privilege).

194. *See* United States v. El Paso Co., 682 F.2d 530, 539 (5th Cir. 1982) ("The line between accounting work and legal work in the giving of tax advice is extremely difficult to draw."); *see also* United States v. Millman, 822 F.2d 305, 310 (2d Cir. 1987) (holding that documents were not protected by the attorney-client privilege because the attorney had "not sustained his burden of showing that the communications in question were related to his status as an attorney rather than as a business adviser or accountant").

C. Academics and Other Critics of the Privilege

A substantial majority of the academics and other legal commentators writing on the subject of the attorney-client privilege in the tax setting would seldom recognize it.[195] Many focus on what they see as the great importance and substantial difficulties in the federal government's efforts to collect needed revenues.[196] Some question the personal and professional integrity of tax attorneys.[197] Other critics do not believe that the attorney-client privilege promotes candidness between the parties.[198]

Many of the critics that do not see the privilege as fostering candidness argue that clients are predisposed to only communicate information that they think will help their case without regard for privilege and tend to withhold personally damaging information from their attorney, even after they are assured that it will remain confidential.[199] More fundamentally, these critics see a privilege as incompatible with a U.S. tax system based on self-disclosure, voluntary compliance, and self-assessment.[200]

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195. *See, e.g.*, Linda M. Beale, *Tax Advice Before the Return: The Case for Raising Standards and Denying Evidentiary Privileges*, 25 VA. TAX REV. 583, 593 (2006) (arguing for the "inapplicability of attorney-client and work-product privileges for pre-return tax planning advice"); Lavoie, *supra* note 2, at 201 (arguing that the attorney-client privilege should not apply to protect a tax client's identity in a tax shelter investigation by the IRS). Lavoie also argues that the privilege should be limited in the context of tax planning. *Id.* at 202.

196. *See, e.g.*, Caplin, *supra* note 87, at 975; Watson, *supra* note 111, at 1220.

197. *See* Caplin, *supra* note 87, at 976 (quoting Chairman Charles Grassley, R-Iowa: "At the heart of every abusive tax shelter is a tax lawyer or accountant."); Watson, *supra* note 111, at 1213 ("If there is a discrete duty to the tax system, the public's interest in ensuring that the federal tax system operates efficiently and fairly should be paramount, and questionable positions ideally should be resolved in favor of the government. Doubtless, there are some practitioners with very high standards who operate under this assumption. But this certainly is not true across the board.").

198. *See* Beale, *supra* note 195, at 663 (asserting that denial of privilege "should not be a deterrent" to candid attorney-client communications).

199. *See id.* at 663 (arguing that "[f]or taxpayers who enter into legitimate business transactions, the need for guidance in structuring to avoid unnecessary tax liability will lead them to seek help from qualified advisors" regardless of whether the privilege applies); Snyder, *supra* note 23, at 485 (stating that clients do not divulge or withhold information because of the protections afforded or not afforded by the attorney-client privilege). One legal commentator suggested that a client will decide not to divulge information to his attorney for reasons other than the belief that they the communications will not be held in confidence, including:

> ego threat (threat to the client's self-esteem), case threat (fear that information will be harmful to the case), role expectations (yielding to the direction the lawyer takes the discussion), etiquette barriers (avoiding embarrassment or discomfort), trauma (avoiding reliving bad experiences), and perceived irrelevancy. So long as clients are subject to the vicissitudes of human nature and the vagaries of human emotion, attorneys can expect less than complete and accurate information about their clients' legal problems.

Snyder, *supra* note 23, at 485.

200. *See* Lavoie, *supra* note 2, at 200-02.

The central argument of many of the articles is that because the U.S. tax system is based on self-disclosure, there should be as much transparency as possible in order for the IRS to determine whether the taxpayer and attorney acted within the bounds of the Code.[201] The call for transparent tax transactions often contends that the IRS is overburdened, cannot police the imposing volume of tax returns, and needs the assistance of the courts in identifying and punishing those that violate the Code.[202]

The critics of the privilege often argue that tax law is sufficiently different from other areas of law and therefore there should be a narrower attorney-client privilege, or no privilege at all.[203] They reason that taxpayers are required by the Code to divulge their transactions and should expect a pervasive and comprehensive duty to divulge, even if they seek professional assistance or advice.[204] Tax attorneys, they argue, owe a comparable duty to the tax system to ensure that it functions "honestly, fairly, and smoothly," and asserting a privilege that inhibits consistent and unshielded disclosure is directly at odds with the attorney's duty to that system.[205]

V. ANALYSIS

The criticism that the attorney-client privilege does not foster candidness between the client and attorney, especially between tax clients and attorneys, has not been accepted by the courts.[206] Instead, those courts not granting the protection of the privilege have generally

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201. *See* Beale, *supra* note 195, at 593 (arguing for increased transparency which would result from denial of the attorney-client privilege); Lavoie, *supra* note 2, at 201 (arguing against the attorney-client privilege's application to the Code's tax shelter listing requirements); Walsh, *supra* note 112, at 14.

202. *See* Beale, *supra* note 195, at 648-49 (stating that "[t]he government does not send out tax police to inventory each taxpayer," and that self-assessment system requires transparency unimpeded by evidentiary privileges); Kayle, *supra* note 1, at 552 ("The privilege essentially protects private communications about motives, mistakes and misfeasance in the face of a regime created to provide access to information."); Lavoie, *supra* note 2, at 201 (stating that the IRS receives millions of tax returns a year and has limited funding and personnel to review them, which "places too great a burden" on the IRS to police abusive transactions).

203. *See* Beale, *supra* note 195, at 646-47 (stating that tax law differs from other areas of law because tax law does not "set out strict requirements that regulated entities must follow to avoid sanction for committing a proscribed act"); Lavoie, *supra* note 2, at 201 (stating that while the attorney-client privilege may foster candidness in other areas of law, it actually deters compliance with the Code); Camilla E. Watson, *Tax Lawyers, Ethical Obligations, and the Duty to the System*, 47 U. KAN. L. REV. 847, 850 (1999) (stating that the self-disclosure tax system requires tax attorneys to balance their duties to the clients with their duties to the tax system).

204. Lavoie, *supra* note 2, at 199.

205. Watson, *supra* note 203, at 850.

206. *See supra* note 23 (listing court cases where judges emphasize candidness).

focused on the privilege having been waived by the information being transmitted to an independent third party or that the advice from the attorney to the client was not legal in nature but simply business or accounting advice.[207] Even the courts that have ultimately denied the assertion of the privilege often give positive resonance to the traditional public policy behind the privilege—"full and frank" communication.[208]

In 2007, Senator Arlen Specter proposed legislation in the Senate—The Attorney-Client Privilege Protection Act[209]—in response to what some viewed as coercive measures by the Department of Justice intended to induce corporate officers and counsel to waive the attorney-client privilege in exchange for more lenient treatment during securities fraud investigations.[210] While Senator Specter's proposed legislation does not specifically address the privilege in the tax context, it signals a congressional interest in bolstering the public policy commitment behind the attorney-client privilege.[211]

The powerful argument behind attorney-client privilege legislation is that candidness between the attorney and client is particularly important in tax practice precisely because the U.S. tax system is based on self-assessment.[212] A client must feel comfortable divulging all financial information, including transactions simply considered as remote possibilities, in order for the tax advisor to aid the client in fully complying with Code.[213] The Code is notoriously detailed, voluminous, complex, and prone to change. Taxpayers with any type of sophisticated business interests will necessarily need assistance navigating through it.[214]

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207. *See supra* Part IV.B (discussing tax court cases).

208. *See supra* note 23.

209. S. 186, 110th Cong. (2007).

210. *See* S. 186 § 2(a)(6); *U.S. House Approves Attorney-Client Privilege Protection*, DAILY REC. (Rochester, N.Y.), Nov. 16, 2007. The Specter legislation was in response to the Department of Justice's Thompson Memorandum, which gave special consideration to parties who waived the attorney-client privilege during Department of Justice investigations. Senator Specter introduced similar legislation in 2008 and 2009. *See* S. 445, 111th Cong. (2009); S. 3217, 110th Cong. (2008).

211. S. 186.

212. *See supra* notes 83-84 and accompanying text.

213. *See supra* note 87 and accompanying text.

214. *See supra* note 88 and accompanying text; *but see* United States v. Willis, 565 F. Supp. 1186, 1189 (S.D. Iowa 1983) (reasoning that that taxpayers do not need to seek legal help in interpreting tax laws because "[u]nlike most other areas in which statutes impose legal obligations on the citizenry, in the income tax return preparation context the government has researched and interpreted the tax laws for the taxpayer in advance"). In *Willis*, the court believed that the government provided enough support to taxpayers through the "variety of income tax return preparation instructions and informational publications issued by the government." *Id.* The court went further to state that the "instructions and publications are supposedly written in everyday language, to permit a taxpayer to prepare his or her own return," and if "the taxpayer cannot understand the instructions or simply does not wish to be subjected to this universally-frustrating

The complexity of the tax system makes the premise that the attorney-client privilege promotes compliance with the law seem especially true in the tax context.[215] Tax attorneys can help. The candidness stimulated by confidentiality should result in more legal compliance, not less. Attorneys can help the client fully comply with the law and fully give their client the benefit of their expertise only if they are apprised of the client's entire situation.[216] Candidness between the attorney and client should lead to more accurate information being reported to the IRS and better comportment with the Code.[217] Full disclosure allows a sophisticated tax attorney to plan the tax implications of business decisions more thoroughly, to recommend more thoughtful business strategies, and to prepare more truthful returns.[218] Candid discussions with a trustworthy tax attorney lead to sound business decisions that take full advantage of tax incentives, but acknowledge full exposure for tax liability.[219] Congress uses the Code both to foster economic growth for American society as well as to generate operating revenue for the American government.[220] Underlying the broad range of economic and social policy fostered by the complicated provisions of the Code is almost certainly a conscious decision by Congress to foster honesty by compelling taxpayers to enlist the aid of professional tax advisors.

Not only does the privilege not impede a tax system based on self-assessment, the system requires the privilege to function properly. If we accept that the IRS will often not have the resources to police every taxable transaction, open communication enhances the tax attorney's role as a gatekeeper for the tax system.[221] Only by fostering candidness and openness, the hallmark of the attorney-client privilege, can the gatekeeper effectively play this role.[222] The attorney-client privilege is a necessity for a tax system that is based upon self-assessment and voluntary compliance. The greater the disclosure between the client and attorney, the more truth will ultimately be divulged to the IRS.[223] Greater disclosure to the tax advisor is the key to a fairer, more efficient, and

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task, the taxpayer is free to engage the services of lawyer or nonlawyer tax return preparers, who can also find guidance in the government-issued instructions and pamphlets." *Id.* at 1189-90.

215. *See supra* Part III.A.
216. *See supra* notes 26-27 and accompanying text.
217. *See supra* note 27.
218. *See supra* notes 26-27 and accompanying text.
219. *See supra* notes 26-27 and accompanying text.
220. *See supra* note 85 and accompanying text.
221. *See supra* note 90 and accompanying text.
222. *See supra* notes 88-90 and accompanying text.
223. *See supra* notes 26-27 and accompanying text.

valid tax system. Allowing the IRS to have unchecked access to communications that have for hundreds of years been protected in our legal system will harm the public's faith in our tax system.[224] Removal of this time-honored evidentiary privilege could well cause the taxpayer to view the system as unfairly skewed, not in favor of tax avoiders and evaders, but in favor of the IRS and a revenue-collection bias.[225] The perception of a confiscatory tax system could do substantial harm to a system based on voluntary compliance.[226]

There is no evidence to support a claim that clients seek attorneys to defraud the tax system. Attempts to defraud the IRS and abuse the system of self-assessment through egregious tax schemes can be addressed by the existing crime-fraud exception to the attorney-client privilege that allows the IRS to access these communications.[227] If Congress believes that certain types of transactions and plans have a higher than acceptable potential to defraud the tax system, they can create Code language specifically excepting those transactions from the attorney-client privilege. When tax shelters roused suspicions, Congress enacted extensive reporting requirements and made eminently clear in the § 7525 tax practitioner privilege that tax shelter planning was specifically excluded from the new privilege.[228]

A legislated attorney-client privilege should not leave exceptions to be addressed piecemeal by the courts.[229] The court decisions discussed above have highlighted to Congress the ongoing tensions in the attorney-

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224. *See* Lavoie, *supra* note 5, at 12 (arguing that "if taxpayers read Service guidance as being slanted in the government's favor, they lose respect for the law and are less likely to obey it"). Lavoie states that taxpayers' perception of a "just and equitable" tax system is necessary for it to function properly. *Id.* ("Even a few notable instances of Service overreaching are likely to taint the perceptions of taxpayers and tax practitioners and cause them to overlook the majority of instances where the Service's interpretations are fully in line with a balanced view of the law.").

225. *See id.* at 13.

226. *See id.* at 12-13.

227. *See supra* Part II.C.1 (discussing the crime-fraud exception to the attorney-client privilege).

228. *See supra* Part II.D (discussing the § 7525 privilege and its exceptions).

229. See Dorth, *supra* note 120, at 62 (arguing that the "case-by-case approach" will confuse tax attorneys and clients). Under the current state of attorney-client privilege law, IRS summons challenges can span years. For example, the *BDO Seidman* cases were repealed and remanded over and over again for nearly seven years. *See* United States v. BDO Seidman, LLP, 492 F.3d 806, 808 (7th Cir. 2007); United States v. BDO Seidman, 337 F.3d 802, 805 (7th Cir. 2003); United States v. BDO Seidman, LLP, 95 A.F.T.R.2d (RIA) 2005-1725, 2005-1728 to -1729 (N.D. Ill. 2005); United States v. BDO Seidman, LLP, 94 A.F.T.R.2d (RIA) 2004-5066, 2004-5066 to -5067 (N.D. Ill. 2004). In addition, a case against KPMG for summons enforcement also spanned several years. *See* United States v. KPMG LLP, 316 F. Supp. 2d 30, 31-32 (D.D.C. 2004). The court in the KPMG case had previously referred the case twice to two different magistrates in order to determine first, whether KPMG needed to produce a document-by-document privilege log, and second, whether each document was privileged. *See id.* at 33.

client privilege in tax matters.[230] But these same decisions have left substantial confusion and uncertainty.[231] The communications between clients and their tax attorneys can be significantly enhanced by a federal statute bringing uniformity in the definition of the privilege.[232]

Whittling away at the scope of the privilege will not stop tax abuse,[233] and a narrower privilege impacts all taxpayers, not simply those that the IRS views as abusive.[234] Nor should a narrower privilege be the vehicle used to address budget issues that may be facing enforcement efforts in the IRS.[235] The IRS's needs for policing abusive transactions should not be addressed by collapsing this important substantive right.[236]

VI. A SOLUTION TO THE PRIVILEGE PROBLEM

Congress has the clear constitutional authority to codify the attorney-client privilege through legislation.[237] Congress is best

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230. *See supra* Part III.B.

231. *See* Alexander F. Peter, *U.S. Cross-Border Discovery in International Tax Proceedings: An Overview From a European Comparative Law Perspective*, 58 TAX LAW. 881, 891 (2005) (stating that the scope of the privilege is "contentious"); Smith, *supra* note 4, at 240-41 (stating that case law is not clear on what constitutes tax advice and what constitutes tax return preparation).

232. *See* United States v. Threlkeld, 241 F. Supp. 324, 326 (W.D. Tenn. 1965) (stating that "uniformity is desirable in the application of the attorney-client privilege in tax investigations").

233. Smith, *supra* note 4, at 234-35 ("[W]hile large taxpayers may expect little sympathy in the current environment, permanently weakening the attorney-client privilege is a misguided reaction to the current crisis.").

234. Lavoie, *supra* note 5, at 2 (arguing that even honest taxpayers should fear the IRS's "overzealousness" in its investigations). Lavoie states that "perceptions matter. If taxpayers feel they are being dealt with unfairly, then their discontent is likely to spread to others and ultimately impair faith in the self-assessment system throughout society." *Id.* at 13. Lavoie also says that IRS tactics can become "counterproductive if they leave the taxpaying public with the impression that the Service is a Goliath trying to bully them into submission." *Id.*; *see also* Smith, *supra* note 4, at 252 ("The IRS's frustration with unmerited claims of privilege is understandable. Frustration with a few, however, does not justify threats for all.").

235. *See* Smith, *supra* note 4, at 253 ("Narrowing the privilege to enhance the IRS's ability to combat abusive tax shelters may produce a short-term benefit, but it seems likely that the long-term costs would far outweigh those limited short-term benefits.").

236. *See id.* (arguing that while "[a]ccepting the IRS's narrow interpretation of the attorney-client privilege would certainly make it easier for the IRS to uncover and punish the promoters of abusive tax shelters," it is not the true purpose of the privilege). Smith states that "[t]here are many areas of law in which the attorney-client privilege complicates and even hinders the government's ability to detect and punish misbehavior." *Id.* Although it may hinder the government, "our courts have consistently upheld the privilege against governmental attempts to narrow its application." *Id.*

237. Kenneth S. Broun, *Giving Codification a Second Chance—Testimonial Privileges and the Federal Rules of Evidence*, 53 HASTINGS L.J. 769, 814 (2002) ("Congress has the ultimate drafting responsibility with regard to any rule governing privilege."); Glynn, *supra* note 34, at 62 (arguing that Congress has the authority under the Commerce Clause and the Supremacy Clause to legislate on attorney-client privilege); *see also* Timothy P. Glynn, *One Privilege to Rule Them All? Some Post-Sarbanes-Oxley and Other Reflections on a Federally Codified Attorney-Client Privilege*, 38 LOY. L.A. L. REV. 597, 650-53 (2004) (arguing for the need of a federally codified attorney-client

equipped to deal with the current attorney-client privilege issue because it can make a national privilege and the case-by-case method of having the federal courts define the common law has failed.[238]

In 2007, Senator Arlen Specter's bill generated significant interest in legislative protection for the attorney-client privilege and it passed in the House.[239] Congress has the constitutional power and should have the political motivation to pass legislation stabilizing the attorney-client privilege in tax matters.

A codified privilege would send a clear message to the federal courts of the limits to the broad summons power of the IRS,[240] provide the framework for a uniform standard for the courts, and assure taxpayers that their communications will be effectively protected. What follows is language for the proposed federal statute codifying the attorney-client privilege for any matters brought under the Code:[241]

Attorney-client privilege relating to taxpayer communications

(a) Uniform application to taxpayer communications with licensed attorneys.

(1) General rule. Where tax advice of any kind is sought from an attorney in his capacity as such, the communications relating to the tax advice made in confidence by the client, are permanently protected from disclosure by the client or the attorney, unless the communications meet any of the common law exceptions to the attorney-client privilege or are specifically excepted by this or any other section of this chapter.

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privilege). Congress should have the authority to draft federal tax attorney-client privilege legislation under the Commerce Clause. Glynn, *supra* note 34, at 156-57. The Commerce Clause states that Congress shall have the power to regulate commerce among the states. U.S. CONST. art. I, § 8, cl. 3. The Supreme Court has held that Congress has the authority to regulate activities that substantially affect interstate commerce. *See, e.g.*, United States v. Morrison, 529 U.S. 598, 609 (2000). The commerce at issue in the attorney-client privilege context is the "economic and commercial activity" between the attorneys and their clients and the sheer volume of interstate legal business. Glynn, *supra* note 34, at 158-59. This is especially the case for a federal tax privilege because the imposition of federal taxes and the procedures of the IRS have a major impact on both individual and corporate taxpayers' economic decision-making.

238. *See* Glynn, *supra* note 34, at 62.

239. *See* Attorney Client Privilege Act of 2007, H.R. 3013, 110th Cong. (2007).

240. See United States v. BDO Seidman, 337 F.3d 802, 810 (7th Cir. 2003) ("Because the IRS' investigatory powers are essential to the proper functioning of the tax system, courts are reluctant to restrict the IRS' summons power, absent unambiguous direction from Congress.").

241. The statute is based upon the language of the § 7525 tax practitioner privilege, I.R.C. § 7525 (2006), the Wigmore description of the attorney-client privilege, 8 WIGMORE, *supra* note 18, § 2292, at 554-55 & n.2; § 2300, at 580-81; § 2306, at 591, and Florida's attorney-client privilege statute, FLA. STAT. ANN. § 90.502 (West Supp. 2009).

(2) Definitions. For purposes of this subsection—

(A) Attorney. The term "attorney" includes anyone licensed to practice law before a state court or federal courts.

(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). Tax advice includes but is not limited to advice included in opinions, legal advice related to the preparation of a tax return that is not ultimately included in the tax return, any legal advice in regards to tax accrual workpapers, and all legal communications related to an audit of the taxpayer.

(b) Exceptions. This section shall not to apply to the following communications—

(1) Communications regarding tax shelters. The privilege under subsection (a) shall not apply to any communication which is—

(A) between an attorney and—

(i) any person,

(ii) any director, officer, employee, agent, or representative of the person, or

(iii) any other person holding a capital or profits interest in the person, and

(B) 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)).

(2) Communications regarding underlying facts, calculations, and structure of transactions.

VII. CONCLUSION

The attorney-client privilege is an important component of legal tax representation. In order to safeguard the privilege, Congress should enact legislation to clearly define the boundaries of the privilege in tax representation. The codification of the attorney-client privilege will

remove the present uncertainty and bolster the centuries-old expectation of confidentiality so critical to the effective operation of our system of taxation.