

## Does the Attorney-Client Privilege Apply to Tax Lawyers?: An Examination of the Return Preparation Exception to Define the Parameters of Privilege in the Tax Context

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### I. INTRODUCTION

A number of cases have held that confidential attorney-client communications associated with the giving of tax advice are protected by the attorney-client privilege. Courts, however, have also long expressed that the privilege does not protect certain documents and communications in the return preparation context—hereafter referred to as the “return preparation exception.” Unfortunately, the return preparation exception has not always been well-explained or consistently applied by the courts. This exception is also inherently confusing because taxpayers do not seek tax advice in a vacuum. With few exceptions, when a taxpayer/client follows an attorney’s advice with respect to tax issues, that advice will in some fashion ultimately be reflected on the taxpayer/client’s tax returns filed with the government. In this sense, almost all tax law advice is, in some regard, associated with return preparation activities.

As a result of this relationship to the tax return, some have asserted the return preparation exception is so broad in scope that the attorney-client privilege simply does not apply at all to the “practice of tax.”<sup>1</sup> That understanding, however, is not widely accepted by commentators or practitioners.<sup>2</sup> That view is also inconsistent with a significant

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1. See Lee A. Sheppard, *News Analysis: No Privilege for Tax Planning*, TAX NOTES TODAY, Jan. 14, 2003, LEXIS, 2003 TNT 9-9.

2. See Jay L. Carlson & David A. Roman, *The Tax Advice Privilege Is Alive and Well*, TAX NOTES TODAY, Apr. 21, 2003, LEXIS 2003 TNT 77-28; Peter A. Lowy & Juan F. Vasquez, Jr., *Attorney-Client Privilege: When Does Tax Advice Qualify As “Legal Advice”?*, TAX NOTES TODAY, Dec. 9, 2002, LEXIS, 2002 TNT 237-50.

amount of case law, which has explicitly stated that tax lawyers are practicing law and the attorney-client privilege can apply to at least some of their communications. Further, in light of Internal Revenue Code (I.R.C.) § 7525, it is clear that Congress also believes the privilege applies, in some fashion, to tax lawyers.<sup>3</sup> In 1998, the provision was enacted to statutorily extend the protections of the attorney-client privilege to certain non-lawyers when they provide “tax advice” to their clients.<sup>4</sup> As a result, most commentators do believe the attorney-client privilege can apply to the communications of tax lawyers, but considerable confusion continues to exist as to when and to what extent the privilege is applicable.<sup>5</sup>

This confusion detracts from the purpose of the attorney-client privilege, which has repeatedly been stated to encourage full and frank communications between a client and his or her attorney.<sup>6</sup> The United States Supreme Court has observed that for that purpose to be fulfilled, attorneys and clients must be able to predict with a fair degree of certainty when the privilege will apply, and which communications will be protected.<sup>7</sup> However, amongst the Tax Bar, tremendous uncertainty exists as to the scope of protection available.

The uncertainty seems to have been exacerbated in recent years due to several high-profile, poorly-reasoned judicial opinions.<sup>8</sup> For example, in 2002, the United States District Court of the District of Columbia held in *KPMG LLP v. United States*<sup>9</sup> that the § 7525 privilege did not apply to an accounting firm’s confidential opinion of tax advice to its client because the court determined there was no indication that the document was written “for a purpose other than preparation of a tax return.”<sup>10</sup> However, the court later determined an equivalent opinion from a law firm was protected by the attorney-client privilege.<sup>11</sup> These

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3. See I.R.C. § 7525 (1998).

4. *Id.*

5. See, e.g., BERNARD WOLFMAN ET AL., STANDARDS OF TAX PRACTICE 350-51 (6th ed. 2004) (noting that the status of tax advice related to tax return preparation is uncertain but the “better view” seems to be that communications related to tax return preparation are protected by attorney-client privilege as long as they relate to substantive legal issues and contain material beyond that which is to be disclosed on the return); Martin J. McMahon, Jr. & Ira B. Shepard, *Privilege and the Work Product Doctrine in Tax Cases*, 58 TAX LAW, 405 (2005) (observing the frequent disconnect between the actual scope of the attorney-client privilege and tax practitioners’ understanding of its scope; they also flag the uncertainty caused by the fact that the parameters and scope of privilege in the tax context are “still being developed”).

6. See, e.g., *Swidler & Berlin v. United States*, 524 U.S. 399, 403 (1998); *Jaffee v. Redmond*, 518 U.S. 1, 9 (1996).

7. *Upjohn Co. v. United States*, 449 U.S. 383, 393 (1981).

8. McMahon & Shepard, *supra* note 5, at 420-22 (citing *United States v. KPMG LLP*, 237 F. Supp. 2d 35 (D.D.C. 2002)); *Long-Term Capital Holdings v. United States*, 91 A.F.T.R.2d (RIA) 2003-1139 (D. Conn. Feb. 14, 2003) (observing that several recent high-profile cases have produced internally inconsistent holdings and have failed to explain their discrepancies).

9. 237 F. Supp. 2d 35 (D.D.C. 2002).

10. *Id.* at 42.

11. *Id.* at 44.

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distinct holdings were perplexing because § 7525 is supposed to be coextensive with the attorney-client privilege, except for a few statutory exceptions that were not at issue.<sup>12</sup>

*Long-Term Capital Holdings v. United States*,<sup>13</sup> decided in 2003, also contributed to the confused state of the law. The District Court of Connecticut held that the attorney-client privilege never attached to a tax law opinion from Shearman & Sterling, but the privilege did initially attach to a separate opinion from King & Spalding.<sup>14</sup> The court determined that the Shearman & Sterling opinion was unprivileged because it was sought as support for a return position as to the tax basis of contributed stock, but the King & Spalding opinion was privileged legal advice that a particular tax loss could be reported on the taxpayer's return.<sup>15</sup> The court's contrary holdings were difficult to reconcile because both opinions provided an attorney's legal opinion as to the appropriate return characterization of particular tax items.<sup>16</sup> Further, the client subsequently disclosed both opinions to third parties, and both disclosures appeared quite foreseeable.<sup>17</sup>

This article examines the return preparation exception in detail in order to provide some clarity in the muddled state of the law. Section II of this article provides a general overview of the rules of the attorney-client privilege. Section III then describes in some detail the case law applying the return preparation exception. Section IV analyzes the trends in the case law to suggest the types of attorney communications that fall within the exception, as well as those that are beyond the exception and should enjoy the protections of privilege. Section V summarizes the author's conclusions.

## II. ATTORNEY-CLIENT PRIVILEGE 101

Section II of this article provides the reader with some background on the attorney-client privilege, which will provide important context for the discussion of the return preparation exception in Section III. Section II-A describes the applicable legal authorities governing privilege law in most tax practices. Section II-B then summarizes the basic rules of the attorney-client privilege.

### A. *Origins of Privilege Law Applicable in the Tax Context*

To examine the return preparation exception, it is first necessary to

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12. I.R.C. § 7525 (2006) (detailing statutory exceptions).

13. 91 A.F.T.R.2d (RIA) 2003-1139 (D. Conn. Feb. 14, 2003).

14. *Id.* at 2003-1145.

15. *Id.* at 2003-1144 to 48.

16. *Id.* at 2003-1143.

17. *Id.*

understand the origins of the attorney-client privilege in the practice of tax. When litigation arises in the federal income tax context, federal evidence law is applicable.<sup>18</sup> By contrast, state evidence law governs state tax cases.<sup>19</sup> As most tax lawyers practice exclusively or primarily in the area of federal income tax, the bulk of tax attorney-client privilege cases involve federal evidence law.

Since 1975, federal evidence law has largely been codified in the Federal Rules of Evidence.<sup>20</sup> Draft Rule 503 originally proposed the attorney-client privilege be codified to protect “confidential communications made for the purpose of facilitating the rendition of professional legal services to the client.”<sup>21</sup> However, because the draft Rules were reviewed by Congress during the Watergate scandal when the issue of executive privilege bore significant scrutiny, the privilege rules initially proposed by the Advisory Committee received tremendous scrutiny and were deleted in the version ultimately enacted.<sup>22</sup> Instead, Congress substituted Federal Rule of Evidence 501, which states simply: “[T]he 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.”<sup>23</sup> Thus, the basic rules of the federal attorney-client privilege are not codified and are established entirely through case law.

### *B. Fundamental Principles of the Federal Attorney-Client Privilege*

As a result of the lack of codification, courts do not always apply the same elements. For example, many courts rely upon Professor Wigmore to state the elements of the federal attorney-client privilege:

(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.<sup>24</sup>

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18. See, e.g., *Fisher v. United States*, 425 U.S. 391, 402 (1976); *United States v. Blackman*, 72 F.3d 1418, 1423 (9th Cir. 1995); *Colton v. United States*, 306 F.2d 633, 636 (2d Cir. 1962); *Johnston v. Comm’r*, 119 T.C. 27, 33 (2002).

19. See, e.g., *Rhone-Poulenc Rorer, Inc. v. Home Indem. Co.*, 32 F.3d 851, 861-62 (3rd Cir. 1994); *Pacificorp v. Dep’t of Revenue of Montana* 838 P.2d 914, 917 (Mont. 1992).

20. CHRISTOPHER B. MUELLER & LAIRD C. KIRKPATRICK, *EVIDENCE UNDER THE RULES* 4 (5th ed. 2004).

21. GLEN WEISSENBERGER & JAMES J. DUANE, *WEISSENBERGER’S FEDERAL EVIDENCE* App. B (5th ed. 2006).

22. MUELLER & KIRKPATRICK, *supra* note 20, at 4.

23. FED. R. EVID. 501.

24. *Cavallaro v. United States*, 284 F.3d 236, 245 (1st Cir. 2002) (emphasis added) (quoting 8 J.H. Wigmore, *Evidence* § 2292, at 554 (McNaughton rev. 1961)); see, e.g., *Reed v. Baxter*, 134 F.3d 351, 355-56 (6th Cir. 1998); *Admiral Ins. Co. v. U.S. Dist. Court*, 881 F.2d 1486, 1492 (9th Cir. 1989); *United States v. Tedder*, 801 F.2d 1437, 1441 (4th Cir. 1986).

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Other courts use different—and arguably somewhat broader—formulations such as:

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.<sup>25</sup>

The requirement that a client seek “legal advice”—or a legal opinion, “legal services,” or assistance in a legal proceeding—has been understood widely to mean that the lawyer’s services involve the interpretation and application of legal principles to specific facts in order to guide future conduct.<sup>26</sup> The privilege is not necessarily inapplicable, however, if the task performed could have been accomplished easily by a nonlawyer.<sup>27</sup> Indeed, because the law does not provide bright-line rules in determining whether this requirement has been satisfied, many courts have employed a presumption that clients consult with lawyers for the sake of obtaining the requisite legal advice or assistance.<sup>28</sup>

In applying the federal attorney-client privilege, courts have emphasized that only communications—and not facts—are protected. In *Upjohn Co. v. United States*,<sup>29</sup> the United States Supreme Court instructed:

The privilege only protects disclosure of communications; it does not protect disclosure of the underlying facts by those who communicated with the attorney: . . . “A fact is one thing and a communication concerning that fact is an entirely different thing. The client cannot be compelled to answer the question, ‘What did you say or write to the attorney?’ but may not refuse to disclose any relevant fact within his knowledge merely because he incorporated a statement of such fact into his communication to his attorney.”<sup>30</sup>

*Upjohn* involved a corporate taxpayer’s refusal to comply with an Internal Revenue Service (IRS) summons demanding production of communications between the taxpayer’s lawyer and its employees.<sup>31</sup> The communications had been initiated by the lawyer to learn more about

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25. *In re Grand Jury Subpoena*, 415 F.3d 333, 339 n.3 (4th Cir. 2005) (emphasis added); see, e.g., *Maine v. U.S. Dep’t of Interior*, 298 F.3d 60, 71 (1st Cir. 2002); *Colton v. United States*, 306 F.2d 633, 637 (2d Cir. 1962) (citing *United States v. United Shoe Mach. Corp.*, 89 F. Supp. 357, 358-59 (D. Mass. 1950)); *First Fed. Sav. Bank of Hegewisch v. United States*, 55 Fed. Cl. 263, 266 (2003).

26. PAUL R. RICE, ATTORNEY-CLIENT PRIVILEGE IN THE UNITED STATES § 7:9 (2d ed. 1999).

27. *Id.*

28. *Id.*

29. 449 U.S. 383 (1981).

30. *Id.* at 395-96 (quoting *Philadelphia v. Westinghouse Electric Corp.*, 205 F. Supp. 830, 831 (E.D. Pa. 1962)).

31. *Id.* at 386-88.

certain “possibly illegal” payments made by a subsidiary to the benefit of foreign government officials.<sup>32</sup> That information was necessary for the lawyer to formulate appropriate legal advice.<sup>33</sup> The Court held that the fact-gathering communications were protected by the attorney-client privilege, but clarified that this did not mean the IRS was barred from learning the underlying facts:

Here the Government was free to question the employees who communicated with [Upjohn’s attorneys]. Upjohn has provided the IRS with a list of such employees, and the IRS has already interviewed some 25 of them. While it would probably be more convenient for the Government to secure the results of [Upjohn’s] internal investigation by simply subpoenaing the questionnaires and notes taken by [Upjohn’s] attorneys, such considerations of convenience do not overcome the policies served by the attorney-client privilege.<sup>34</sup>

In light of the rule that facts themselves are not protected by the attorney-client privilege, it is not surprising that courts have regularly refused to find that privilege attaches to pre-existing documents given by the client to the attorney.<sup>35</sup> For example, pre-existing business books and records are considered “independent documents,” and not client communications to an attorney.<sup>36</sup> Consequently, such books and records do not become privileged simply by virtue of being passed from a client to an attorney—even if they are provided to enable the attorney to give the client legal advice.<sup>37</sup>

In order for privilege to attach, case law also requires that at the time the attorney and client communicate, the client must intend the communication to remain confidential. When a client communicates information with his or her attorney so that the attorney can share it with third parties, the privilege never attaches to such attorney-client communications.<sup>38</sup> As a result, items such as “corporate documents, real estate documents, contracts, leases, and other business documents” are themselves generally not considered privileged even when prepared by

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32. *Id.* at 387.

33. *Id.*

34. *Id.* at 396.

35. See JOHN WILLIAM GERGACZ, ATTORNEY-CORPORATE CLIENT PRIVILEGE 3-51, 3-87 to 3-91(3d ed. 2001); Paul R. Rice, *Attorney-Client Privilege: Continuing Confusion About the Attorney Communications, Drafts, Pre-Existing Documents, and the Source of the Facts Communicated*, 48 AM. U. L. REV. 967, 989-96 (1999); see also *In re Grand Jury Proceedings*, 655 F.2d 882, 886 (8th Cir. 1981) (“We agree that the remaining papers are ordinary business and financial records of corporations and partnerships which would not have been privileged in the hands of the client. Mere delivery of the documents to the attorney would not create the privilege where it previously did not exist.”) (citing *Fisher v. United States*, 425 U.S. 391, 403-04 (1976)); *Radiant Burners, Inc. v. Am. Gas Assoc.*, 320 F.2d 314, 324 (7th Cir. 1963) (“Certainly, the privilege would never be available to allow a corporation to funnel its papers and documents into the hands of its lawyers for custodial purposes and thereby avoid disclosure.”).

36. See, e.g., *Grant v. United States*, 227 U.S. 74, 79 (1913).

37. *Id.*

38. See RICE, *supra* note 26, § 7:12; see also *In re Grand Jury Subpoena Duces Tecum*, 731 F.2d 1032, 1037 (2d Cir. 1984) (stating “[i]f confidentiality were not intended, of course, the privilege would not attach”).

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an attorney at the request of his or her client.<sup>39</sup> Such documents are by their nature intended to be shared with third parties; they are prepared so that they will be filed with governmental authorities or given to private parties with whom the client is conducting business. Thus, the initial intent for confidentiality is considered to be lacking.

Difficult questions can still arise, however, in trying to determine initial client intent as to confidentiality. For example, when attorneys and clients communicate confidentially in the course of preparing such documents, not everything communicated between them will ultimately be shared with third parties.<sup>40</sup> Communications about some issues may not be intended to be published or otherwise revealed to third parties; such communications should remain privileged.<sup>41</sup> Further, because the attorney-client privilege protects communications, but not underlying facts, any intent to disclose to third parties purely factual information discussed with an attorney does not necessarily signify a lack of the requisite intent for confidentiality.<sup>42</sup>

In addition to the required intent for confidentiality when the attorney-client communication first takes place, confidentiality also must be maintained subsequently. To the extent the substance of those initially privileged communications are later disclosed to third parties, courts have found the privilege to have been waived.<sup>43</sup> However, this too can be a subtle issue. Because facts are never privileged, a waiver is

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39. See, e.g., *United States v. Willis*, 565 F. Supp. 1186, 1207 (S.D. Iowa 1983).

40. *In re Grand Jury Subpoena Duces Tecum*, 731 F.2d at 1037.

41. See, e.g., *Andritz Sprout-Bauer, Inc. v. Beazer E., Inc.*, 174 F.R.D. 609, 632-33 (M.D. Pa. 1997); see also Rice, *supra* note 35, at 989-96 ("To conclude that the disclosure of an attorney's final written product, after a series of exchanges with the client, results in the loss of all privilege claims for all prior exchanges would destroy the privilege protection in a large percentage of instances where legal assistance is rendered. All drafts of civil complaints, leases, and contracts, as well as prospectuses, patent applications, and government reports would have no privilege protection after the client decided to file a claim. This would strike at the very heart of the privilege because it would make clients wary of being open and candid when responding to the attorney's drafts. More fundamentally, however, if the conclusion about relinquishing reasonable expectations of confidentiality were applied logically, the resulting waiver could not be limited to *written drafts*. This conclusion would require the disclosure of *all oral exchanges* as well. After all, drafts are nothing more than written forms of what otherwise could have been oral communications and, at the very least, are often the product of those exchanges.").

42. *In re Grand Jury Subpoena Duces Tecum*, 731 F.2d at 1037 ("The possibility that some of the information contained in these documents may ultimately be given to AG employees does not vitiate the privilege. First, it is important to bear in mind that the attorney-client privilege protects communications rather than information; the privilege does not impede disclosure of information except to the extent that the disclosure would reveal confidential communications. Thus, the fact that certain information in the documents might ultimately be disclosed to AG employees did not mean that the communications to Proskauer were foreclosed from protection by the privilege as a matter of law. Nor did the fact that certain information might later be disclosed to others create the factual inference that the communications were not intended to be confidential at the time they were made. If confidentiality were not intended, of course, the privilege would not attach; but we see no indication that confidentiality was not intended." (citations omitted)).

43. See, e.g., *Nguyen v. Excel Corp.*, 197 F.3d 200, 204-07 (5th Cir. 1999) (stating that a waiver of privilege occurred when corporate executives testified as to the nature of legal advice given to the corporation, and the attorney-client privilege was only asserted when opposing counsel posed questions about the attorneys' conclusions).

not triggered simply by communicating with third parties facts that were also shared with an attorney.<sup>44</sup> The client can discuss with third parties any facts shared with an attorney as long as the client does not refer to communications of those facts with the attorney.<sup>45</sup>

It is also worth noting that the case law interpreting the federal attorney-client privilege in the tax law context has been confused partly due to the overlapping responsibilities of tax lawyers and tax accountants. The Supreme Court has long established that there is no federal accountant-client privilege.<sup>46</sup> Thus, communications with accountants on federal tax matters have historically not been privileged except in certain circumstances when the accountant is assisting the attorney as an “interpreter” of accounting concepts so that the attorney can provide legal advice to the client.<sup>47</sup> By contrast, to the extent an accountant provided his or her own advice on tax issues, the communications have not traditionally been privileged.<sup>48</sup>

However, this traditional approach to tax accountant communications changed dramatically in 1998 when Congress enacted I.R.C. § 7525, which extends to “federally authorized tax practitioners,” including certain accountants, “the same common law protections of confidentiality which apply . . . between a taxpayer and an attorney” with respect to “tax advice.”<sup>49</sup> Rather awkwardly, to determine the boundaries of § 7525, courts have had to superimpose on federally authorized tax practitioners the already muddled federal case law involving questions of privilege with respect to tax attorney-client communications.<sup>50</sup> Because the attorney-client privilege and the § 7525 privilege are intended to be coexistent in most respects, this process has unfortunately created even more confusion as to which tax attorney communications are within the scope of the attorney-client privilege.<sup>51</sup>

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44. See, e.g., *Upjohn Co. v. United States*, 449 U.S. 383, 395-96 (1981); see also *Carlson & Roman*, *supra* note 2 (noting that “the mere filing of a Tax Court petition[] does not place in issue all privileged materials relating to the transaction in question”).

45. See, e.g., *Upjohn*, 449 U.S. at 396; *Nguyen*, 197 F.3d at 207.

46. See, e.g., *United States v. Arthur Young & Co.*, 465 U.S. 805, 815-16 (1984); *Couch v. United States*, 409 U.S. 322, 335 (1973).

47. *United States v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961) (“By the same token, if the lawyer has directed the client, either in the specific case or generally, to tell his story in the first instance to an accountant engaged by the lawyer, who is then to interpret it so that the lawyer may better give legal advice, communications by the client reasonably related to that purpose ought fall within the privilege; there can be no more virtue in requiring the lawyer to sit by while the client pursues these possibly tedious preliminary conversations with the accountant than in insisting on the lawyer’s physical presence while the client dictates a statement to the lawyer’s secretary or is interviewed by a clerk not yet admitted to practice.”)

48. *Id.*; see also *United States v. Adlman*, 68 F.3d 1495, 1499-1500 (2d Cir. 1995).

49. I.R.C. § 7525 (1998).

50. See John Gergacz, *Using the Attorney-Client Privilege As a Guide for Interpreting I.R.C. § 7525*, 6 HOUS. BUS. & TAX L.J. 240, 243 (2006).

51. *Id.* at 244-45; see, e.g., *United States v. KPMG LLP*, 237 F. Supp. 2d 35, 39-40 (D.D.C. 2002).

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### III. THE DEVELOPMENT OF THE RETURN PREPARATION EXCEPTION

Section III describes the return preparation exception case law. Section III-A explains the main genres of communication that have fallen within the exception to the privilege. Section III-B discusses the two legal rationales courts have given when applying the return preparation exception.

#### A. *Communications Falling Within the Return Preparation Exception*

Three distinct types of communications tend to fall within the return preparation exception. First, some cases involve assertions of privilege to protect pre-existing documents. Typically, the pre-existing documents in question were the financial or accounting records of the client taxpayer, which were relevant to the preparation of the tax return.<sup>52</sup> In such cases, the courts have typically just applied the general rule that pre-existing documents are not privileged, and they gain no special protection when passed to an attorney.<sup>53</sup> Sometimes the courts have also observed that the documents in question were either not prepared by the client at all, or were prepared by the client with the initial intent of providing them to someone other than the attorney.<sup>54</sup> Privilege generally attaches only to attorney-client communications.<sup>55</sup>

“Workpapers” are the second type of communication commonly encountered in the return preparation exception case law. Typically, these cases involve workpapers created by an attorney preparing the client’s tax return.<sup>56</sup> However, sometimes the cases involve workpapers prepared by an accountant—who is not also an attorney.<sup>57</sup> Such workpapers are almost universally regarded as outside the scope of the attorney-client privilege.<sup>58</sup> Nonetheless, there have been a few exceptions

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52. See, e.g., *Colton v. United States*, 306 F.2d 633, 639 (2d Cir. 1962); *United States v. Schmidt*, 360 F. Supp. 339, 350 (M.D. Pa. 1973); *United States v. Schoeberlein*, 335 F. Supp. 1048, 1057-58 (D. Md. 1971).

53. See, e.g., *In re Grand Jury Subpoena Duces Tecum*, 697 F.2d 277 (10th Cir. 1983); *United States v. Davis*, 636 F.2d 1028 (5th Cir. 1981); *Bouschor v. United States*, 316 F.2d 451 (8th Cir. 1963); *United States v. Schlegel*, 313 F. Supp. 177 (D. Neb. 1970); *United States v. Threlkeld*, 241 F. Supp. 324 (W.D. Tenn. 1965). *But see* *United States v. Bornstein*, 977 F.2d 112, 116 (4th Cir. 1992) (finding the IRS had waived its argument with regard to pre-existing documents, the court refused to disturb the district court’s ruling that the attorney-client privilege protected such documents); *United States v. Jeremiah*, 37 A.F.T.R.2d (RIA) 76-1285, 76-1288 (D. Or. Nov. 26, 1975) (refusing to enforce an IRS summons against an attorney-return preparer who had asserted privilege in refusing to provide a description of her client’s records from which information was obtained in preparing the client’s tax return).

54. *Colton*, 306 F.2d at 639; *Schmidt*, 360 F. Supp. at 350; *Schoeberlein*, 335 F. Supp. at 1055.

55. See, e.g., *In re Grand Jury Subpoena*, 415 F.3d 333, 338-39 n.3 (4th Cir. 2005); *Cavallaro v. United States*, 284 F.3d 236, 245 (1st Cir. 2002); *First Fed. Sav. Bank of Hegewisch v. United States*, 55 Fed. Cl. 263, 266 (2003).

56. See, e.g., *United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999); *In re Grand Jury Subpoena Duces Tecum*, 697 F.2d at 279-80; *In re Shapiro*, 381 F. Supp. 21, 22 (N.D. Ill. 1974).

57. *Bornstein*, 977 F.2d at 116-17; *United States v. Schwimmer*, 892 F.2d 237, 243-45 (2d Cir. 1989); *United States v. Cote*, 456 F.2d 142, 144-45 (8th Cir. 1972).

58. See, e.g., *Frederick*, 182 F.3d 496; *Schoeberlein*, 335 F. Supp. 1048; *Canaday v. United States*,

with contrary holdings.<sup>59</sup>

A third genre found in the case law is client communication of factual information to the attorney-return preparer. In such cases, the factual information provided is often at least potentially important to one preparing the tax return.<sup>60</sup> The courts' holdings, as well as their reasoning, have varied greatly. This genre of communication has produced the greatest amount of controversy, as well as the bulk of the courts' analyses on the scope of the return preparation exception. Through such cases, the courts have developed the two legal rationales offered for the return preparation exception.

### *B. The Rationales Underlying the Return Preparation Exception*

When applying the return preparation exception, the cases have tended to provide at least one of two legal rationales for denying the protections of privilege. Section III-B-1 describes cases that justify the exception on the theory the attorney was not serving the client in his or her legal role, or was not providing legal services to the client. Section III-B-2 discusses case law that imposes the exception based on defects in the requirement of confidentiality.

#### 1. Only Communications Associated with Attorney Work Can Be Privileged

Regardless of how the elements of the attorney-client privilege are worded by the courts, it is clear that the privilege only applies when communication is directed to an attorney when he or she is acting in the role of an attorney. Moreover, the elements of privilege also require that the client be seeking some type of legal services from the lawyer.

In applying these prerequisites, courts have consistently held that the attorney-client privilege does not apply when the attorney is acting in a non-legal role. For example, privilege claims have failed when they were asserted with respect to an attorney providing business advice,<sup>61</sup> communicating in a managerial role,<sup>62</sup> engaging in social conversa-

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354 F.2d 849 (8th Cir. 1966).

59. *Schwimmer*, 892 F.2d at 245 (finding that the district court erred in refusing to conduct an evidentiary hearing to determine if the workpapers were privileged; the court observed they were not the type ordinarily submitted with returns and contained information not ascertainable from bank records); *Colton*, 306 F.2d at 639 (holding that "memoranda and worksheets" prepared by a law firm were privileged "to the extent of any unpublished expression made by an attorney therein of confidences which had passed between him and his clients"); *United States v. Jeremiah*, 37 A.F.T.R.2d (RIA) 76-1285, 76-1288 (D. Or. Nov. 26, 1975) (holding all return workpapers as privileged); *United States v. Higgins*, 266 F. Supp. 593, 593 (S.D. W. Va. 1966) (finding some workpapers privileged and others not).

60. *See, e.g.*, *Olender v. United States*, 210 F.2d 795 (9th Cir. 1954); *In re Shapiro*, 381 F. Supp. 21.

61. *Diversified Indus. v. Meredith*, 572 F.2d 596, 603-04 (8th Cir. 1977).

62. *United States v. Lipshy*, 492 F. Supp. 35, 41-44 (N.D. Tex. 1979).

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tions,<sup>63</sup> or giving investment advice.<sup>64</sup> Communications with an attorney have also been held not privileged when the attorney is providing non-legal services such as maintaining a bank account,<sup>65</sup> making bank deposits,<sup>66</sup> collecting rent,<sup>67</sup> or relaying factual information to employees.<sup>68</sup>

One important commonality in the return preparation exception cases is that they typically involve lawyers who themselves have prepared tax returns for their clients.<sup>69</sup> Often those lawyers are also accountants by training.<sup>70</sup> Occasionally, the return preparation case law has involved an attorney who did not directly prepare his or her client's return but instead hired an accountant to do so.<sup>71</sup> In all of these cases, the courts grappled with two interrelated issues: (1) whether the attorneys were acting in their role as attorneys, and (2) whether the attorneys were providing legal services. Case law had already long established that there was no federal evidentiary privilege applicable to protect communications with accountants.<sup>72</sup> It was not initially clear, however, whether the preparation of tax returns was an accounting service, a legal service, or both.

Some early return preparation exception cases simply held that an attorney preparing a tax return was not serving in a legal capacity, but the courts did not provide much analysis or explanation for these holdings. For example, in 1954, the United States Court of Appeals for the Ninth Circuit in *Olender v. United States*<sup>73</sup> concluded there was no evidence the return preparer in question had "at any time functioned as a lawyer" and instead he was "employed as an accountant solely and simply."<sup>74</sup> Similarly, in 1966, the United States Court of Appeals for the Eighth Circuit in *Canaday v. United States*<sup>75</sup> simply stated its agreement with the district court's finding that the return preparer "had acted not as a lawyer, but merely as a scrivener for [the] defendant."<sup>76</sup>

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63. *Jeremiah*, 37 A.F.T.R.2d (RIA) at 76-1287.

64. *Colton*, 306 F.2d at 638.

65. *United States v. Chin Lim Mow*, 12 F.R.D. 433, 434 (N.D. Cal. 1952).

66. *Pollock v. United States*, 202 F.2d 281, 286 (5th Cir. 1953).

67. *Kelly v. Simon*, 9 A.F.T.R.2d (RIA) 888, 890 (S.D. Cal. 1962).

68. *Dawson v. New York Life Ins. Co.*, 901 F. Supp. 1362, 1366 (N.D. Ill. 1995).

69. *See, e.g., Olender v. United States*, 210 F.2d 795 (9th Cir. 1954).

70. *See, e.g., United States v. Davis*, 636 F.2d 1028, 1032 (5th Cir. 1981).

71. *See, e.g., United States v. Schmidt*, 360 F. Supp. 339, 342 (M.D. Pa. 1973) (noting the taxpayer's attorney was assisted by an accountant, who prepared the taxpayer's return).

72. *See United States v. Kovel*, 296 F.2d 918, 920-24 (2d Cir. 1961); *Falsone v. United States*, 205 F.2d 734, 739-40 (5th Cir. 1953); *Himmelfarb v. United States*, 175 F.2d 924, 938 (9th Cir. 1949); *In re Fisher*, 51 F.2d 424, 425 (S.D.N.Y. 1931).

73. 210 F.2d 795 (9th Cir. 1954).

74. *Id.* at 806.

75. 354 F.2d 849 (8th Cir. 1966).

76. *Id.* at 857. The opinion simply described the return preparer as a lawyer, and never indicated he also had training as an accountant. This may explain why the court described the return preparer in question as having acted as a "scrivener" and not an accountant. This wording seems to insinuate that the attorney prepared a fairly simple return that did not involve questions of judgment, and instead he simply copied onto the returns numbers in the documents provided by the taxpayer. However, this point is not explicit. *See id.*

Not all courts, however, took this approach. In 1962, the United States Court of Appeals for the Second Circuit in *Colton v. United States*<sup>77</sup> explained: “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.”<sup>78</sup> As a result, the court held that some return preparation communications were privileged to the extent they had not been divulged to third parties like the IRS.<sup>79</sup>

Many courts followed the lead of the Second Circuit in *Colton*. For example, in the 1965 case of *United States v. Threlkeld*,<sup>80</sup> the Western District of Tennessee was very influenced by the facts that the attorney-accountant in question only held himself out as a lawyer and was employed by the taxpayers as a lawyer.<sup>81</sup> Consequently, the court held the respondent was “entitled to claim the privilege to the extent that it be available.”<sup>82</sup> In *United States v. Baucus*,<sup>83</sup> the District of Montana in 1971 came to the same conclusion by placing emphasis on similar facts.<sup>84</sup>

Other courts have seemed to agree that attorneys preparing returns did so in their roles as attorneys, but have not examined the question in as much detail.<sup>85</sup> For example, the United States District Court for the District of Maryland in the 1971 case *United States v. Schoeberlein*<sup>86</sup> simply stated that the lawyer-accountant in question was not foreclosed from invoking the attorney-client privilege when preparing a tax return.<sup>87</sup> In the 1975 case, *United States v. Jeremiah*,<sup>88</sup> the United States District Court for the District of Oregon cited *Colton* to implicitly conclude the attorney was acting as an attorney when preparing her clients’ tax returns.<sup>89</sup> Such cases instead focused largely on other elements of privilege.

Beginning in the mid-1970s, the case law began to take a different turn. Courts that examined the issue began to show more hesitancy in

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77. 306 F.2d 633 (2d Cir. 1962).

78. *Id.* at 637.

79. *Id.*

80. 241 F. Supp. 324 (W.D. Tenn. 1965).

81. *Id.* at 326.

82. *Id.*

83. 34 A.F.T.R.2d (RIA) 74-5009 (D. Mont. 1971).

84. *Id.* at 74-5018.

85. However, one case providing little analysis seemed to produce confused conclusions. Without explaining its reasoning, in 1966 the Southern District of West Virginia in *United States v. Higgins* held a return preparer had acted in his role as attorney as to certain “workpapers and schedules” of the taxpayers. 266 F. Supp. 593, 594 (S.D. W. Va. 1966). Confusingly, the court indicated other attorney-created “papers and schedules incident to the returns” were “primarily of an accounting nature.” *Id.* at 595. The opinion offers no insight as to reason for the differentiation. *See id.*

86. 335 F. Supp. 1048 (D. Md. 1971).

87. *Id.* at 1057.

88. 37 A.F.T.R.2d (RIA) 76-1285 (D. Or. Nov. 26, 1975).

89. *Id.* at 76-1286.

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finding attorneys were providing legal services in the return preparation context. Some courts showed reluctance when attorneys were involved in the preparation of simple tax returns, but were more willing to allow privilege claims when the returns gave rise to questions of law. For example, in the 1973 case *United States v. Schmidt*,<sup>90</sup> the United States District Court for the Middle District of Pennsylvania addressed an assertion of privilege when an accountant working at the direction of the taxpayers' lawyer prepared their tax returns.<sup>91</sup> The court indicated that to the extent the preparation of returns required the "exercise of legal judgment," the attorney-client privilege could be applicable.<sup>92</sup> Similarly, the 1990 Ninth Circuit case, *United States v. Abrahams*,<sup>93</sup> noted that although communications made "solely" for tax return preparation were not privileged, communications made "to acquire legal advice about what to claim on tax returns may be privileged."<sup>94</sup>

Other cases began to adopt the view that attorneys preparing tax returns were not doing so in their capacity as lawyers unless other legal services were also being performed for the same client. Illustrative of this trend is the 1974 case from the United States District Court for the Northern District of Illinois, *In re Shapiro*.<sup>95</sup> The court observed that the documents in question pertained "solely to the preparation of [the taxpayer's] income tax returns," but the attorney-client privilege did not apply to communications involving "services . . . typically rendered by an accountant."<sup>96</sup> The court announced the rule that "the preparation of tax returns is sufficiently within the professional competence of an attorney to be protected by the privilege but only if the preparation of the returns is part of a bona fide attorney-client relationship evidenced by significant other legal services rendered by the attorney for the taxpayer."<sup>97</sup> Because there was no evidence the lawyer had performed any "legal services for [the taxpayer] other than the preparation of the tax returns," the court stated it had to presume that the return preparer was acting in the capacity of an accountant and not as an attorney.<sup>98</sup>

In 1981, the United State Court of Appeals for the Fifth Circuit took a similar position in *United States v. Davis*.<sup>99</sup> "[A]lthough preparation of tax returns by itself may require some knowledge of the law, it is primarily an accounting service. Communications relating to that service should therefore not be privileged, even though performed by a

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90. 360 F. Supp. 339 (M.D. Pa. 1973).

91. *Id.* at 348.

92. *Id.* at 347.

93. 905 F.2d 1276 (9th Cir. 1990).

94. *Id.* at 1284.

95. 381 F. Supp. 21 (1974).

96. *Id.* at 22.

97. *Id.* at 22-23.

98. *Id.* at 23.

99. 636 F.2d 1028 (5th Cir. 1981).

lawyer.”<sup>100</sup> The Fifth Circuit acknowledged that other courts had taken a different approach, but cautioned that due to the lack of a federal accountant-client privilege it would “make little sense to permit a taxpayer to invoke a privilege merely because he hires an attorney” to prepare his tax return.<sup>101</sup> Nonetheless, the Fifth Circuit explained it was not imposing a bright-line prohibition against finding return preparation communications to be privileged; the court noted that accounting services performed “ancillary to legal advice” had long been viewed as within the scope of the attorney-client privilege.<sup>102</sup> The opinion gave an example of such ancillary services—a taxpayer’s attorney who amended tax returns after the IRS begins investigating the original returns.<sup>103</sup>

In the 1982 case, *United States v. Willis*,<sup>104</sup> the United State District Court for the Southern District of Iowa also held that return preparation by attorneys was generally not a legal service for purposes of the attorney-client privilege.<sup>105</sup> In reaching this conclusion, the court seemed particularly influenced by the facts that nonlawyers were also capable of performing return preparation services, and most return preparation issues could be answered by the “instructions and informational publications” provided by the IRS.<sup>106</sup> Nonetheless, *Willis* also refused to adopt a bright-line prohibition against finding return preparation communications were privileged.<sup>107</sup> The court explained that return preparation by a lawyer might satisfy the “legal services” element of privilege if a taxpayer under investigation for civil or criminal liability hired a lawyer to advise on ways to avoid or minimize liability; tax returns filed pursuant to that advice would satisfy the “legal advice” element of privilege.<sup>108</sup>

The approach taken in *Davis* and *Willis* may have been too bold for some courts. In the period right after the opinions were first issued, the United States Court of Appeals for the Tenth Circuit refused to address the question of whether return preparation was lawyer work and instead decided a privilege case on different grounds.<sup>109</sup> As time went on, however, other courts also decided that return preparation alone was not a legal service for purposes of the attorney-client privilege.<sup>110</sup> By 1987, the Eleventh Circuit even characterized that position as the

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100. *Id.* at 1043.

101. *Id.*

102. *Id.* at 1043 n.17.

103. *Id.*

104. 565 F. Supp. 1186 (S.D. Iowa 1983).

105. *Id.* at 1189.

106. *Id.*

107. *See id.*

108. *Id.* at 1191.

109. *See In re Grand Jury Subpoena Duces Tecum*, 697 F.2d 277, 280 (10th Cir. 1983) (holding on other grounds).

110. *United States v. Abrahams*, 905 F.2d 1276, 1284 (9th Cir. 1990); *In re Witness Before the Grand Jury*, 631 F. Supp. 32, 33 (E.D. Wis. 1985).

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“majority rule.”<sup>111</sup>

More recently, in 1999, the United States Court of Appeals for the Seventh Circuit in *United States v. Frederick*<sup>112</sup> repeatedly characterized return preparation as an accounting service, and distinguished it from legal services like the “preparation of a brief or an opinion letter.”<sup>113</sup> However, as *Frederick* had served as the taxpayers’ lawyer in addition to preparing their returns, the court was willing to consider privilege claims in connection with communications beyond the return preparation context.<sup>114</sup> The very next year, the Seventh Circuit in *In re Grand Jury Proceedings*<sup>115</sup> affirmed its holding that the preparation of tax returns was an accounting service, not a legal service for purposes of the attorney-client privilege.<sup>116</sup>

## 2. A Lack of Confidentiality

Despite the Eleventh Circuit’s pronouncement that the majority rule was that return preparation services were not legal services, not all return preparation cases even address the question of whether an attorney has served in an attorney role or provided legal services. Such cases, as well as those holding that return preparation is a legal service, tend to focus instead on issues of confidentiality. The elements of privilege require communications that were initially “made in confidence.”<sup>117</sup> Communications that were initially confidential, however, will cease to enjoy the protections of privilege if confidentiality is not maintained but is subsequently lost.<sup>118</sup>

The timing of a loss of confidentiality provides a subtle but important difference in result. If communications are not confidential initially, then they are never privileged and subsequent disclosures cannot trigger a waiver.<sup>119</sup> If communications are initially confidential and otherwise satisfy the elements of privilege, however, a subsequent loss of confidentiality will generally be deemed to have triggered a subject matter waiver.<sup>120</sup> Despite the significance of when confidentiality is lacking, the courts have sometimes been lax in the wording of their opinions, and have equated an initial lack of confidentiality with a waiver of privilege.<sup>121</sup>

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111. *In re Grand Jury Investigation*, 842 F.2d 1223, 1225 (11th Cir. 1987).

112. 182 F.3d 496 (7th Cir. 1999).

113. *Id.* at 500.

114. *Id.* at 499-500.

115. 220 F.3d 568 (7th Cir. 2000).

116. *Id.* at 571.

117. *See, e.g.*, *Cavallaro v. United States*, 284 F.3d 236, 245 (1st Cir. 2002).

118. *See, e.g.*, *GERGACZ*, *supra* note 35, § 5.02.

119. *Id.*

120. *Id.*

121. *See, e.g.*, *United States v. Frederick*, 182 F.3d 496, 500-01 (7th Cir. 1999) (noting that information communicated by the client to his attorney-return preparer “so that it might be used on the

In the ten-year period between 1962 through 1972, five key cases involving confidentiality in the return preparation context were decided. These cases were extremely influential on subsequent case law. In the 1962 opinion, *Colton v. United States*, the Second Circuit first addressed this issue.<sup>122</sup> The court stated that in the case of an attorney preparing a tax return, much of the information transmitted by the client is not privileged because it is not intended to be confidential but is given to the attorney for transmittal to others on the tax return.<sup>123</sup> Nonetheless, the court also explained:

[T]he privilege is still available . . . to withhold any particular confidential papers which were “specifically prepared by the client for the purpose of consultation with his attorney” and any of the [law] firm’s memoranda and worksheets “to the extent of any unpublished expression made by an attorney therein of confidences which had passed between him and his clients.”<sup>124</sup>

The court’s analysis did not seem to focus explicitly on the client’s intent, but instead seemed concerned with whether attorney-client communications were actually disclosed to third parties.

In 1965, the Western District of Tennessee took a somewhat different approach in *United States v. Threlkeld*.<sup>125</sup> The court indicated that client communications to an attorney were not privileged if made with the “understanding that the information would be inserted in the return.”<sup>126</sup> By contrast, the court explained that the privilege did attach if information was communicated by the client with direction to the attorney that the information not be inserted in the return.<sup>127</sup> Additionally, the court expressed the privilege could also attach if information was communicated by the client with the direction that the information be inserted or not be inserted in the return “in the discretion and judgment” of the attorney.<sup>128</sup> *Threlkeld* differed from *Colton* in the explicit scrutiny of the client’s intent at the time the client communicated with the attorney. *Threlkeld* was also the first time emphasis was placed on a client’s deference to the attorney’s judgment in determining what should be divulged.

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tax return” would demonstrate a lack of confidentiality, which would constitute a “waiver of the privilege”); *Bernardo v. Comm’r*, 104 T.C. 677, 682-87 (1995) (stating that materials provided by a taxpayer to his attorney for tax preparation purposes are intended to be disclosed to the IRS in the return). The court held that such intent for disclosure constitutes a waiver of privilege as to that information. *Id.* at 686-87. *See also* *United States v. El Paso Co.*, 682 F.2d 530, 541 (5th Cir. 1982) (finding that the taxpayer had “waived” privilege by disclosing the documents in question to a third party, i.e., their independent auditor, but subsequently stating that the taxpayer had failed to prove privilege attached to any of the documents in question).

122. *Colton v. United States*, 306 F.2d 633, 636-37 (2d Cir. 1962).

123. *Id.* at 638.

124. *Id.* at 639.

125. 241 F. Supp. 324 (W.D. Tenn. 1965).

126. *Id.* at 326.

127. *Id.*

128. *Id.*

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In 1969, United States District Court for the Northern District of New York in *United States v. Merrell*<sup>129</sup> held the return preparation documents in question were not privileged due to an initial lack of confidentiality.<sup>130</sup> Unlike *Colton* and *Threlkeld*, however, the court did not analyze the client's intent or the extent to which the information on the documents was divulged on the filed return.<sup>131</sup> Instead, the court seemed to simply apply a broad rule against the application of privilege in the return preparation context.<sup>132</sup> The specific documents addressed in *Merrell*, however, probably would not have fared much more favorably under the approach taken by *Colton* or that taken by *Threlkeld*.<sup>133</sup> These documents include: (1) retained copies of the taxpayers' returns, (2) income and expense summaries given to the attorney by the clients "for inclusion in the returns," and (3) the attorney's "workpapers" which the court declared "by definition, consisted of information that was intended to be transcribed onto the tax returns."<sup>134</sup>

The next year, the United States District Court for the District of Nebraska in *United States v. Schlegel*<sup>135</sup> took an approach more reminiscent of *Threlkeld*.<sup>136</sup> The court expressly rejected the black and white approach adopted by *Merrell*, and reasoned:

[A] more realistic rule would be that the client intends that only as much of the information will be conveyed to the government as the attorney concludes should be, and ultimately is, sent to the government. In short, whatever is finally sent to the government is what matches the client's intent. The fact that the client has relinquished to his attorney the making of the decision of what needs to be included within the tax return should not enlarge his intent or decrease the scope of the privilege. A different rule would not really support the purpose of the privilege, which is to encourage free disclosure of information by the client to the attorney. If the client, not knowing what the attorney would advise be sent or would choose to send to the government, were to think that all information given to his attorney would lose its confidential status by the act of delivery to his attorney, the tendency would be to withhold information which he, without advice of counsel, would suppose was detrimental to him, the client. Thus the attorney, the very one professionally capable of evaluating information, could be of no help in evaluating it, because he would not receive it.<sup>137</sup>

The court held that except for the information incorporated in the tax return that was actually filed with the government, other attorney-client communications remained privileged.<sup>138</sup> Specifically, oral conversations

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129. 303 F. Supp. 490 (N.D.N.Y. 1969).

130. *Id.* at 492-93.

131. *See id.*

132. *See id.*

133. *Id.* at 493.

134. *Id.*

135. 313 F. Supp. 177 (D. Neb. 1970).

136. *See generally id.*

137. *Id.* at 179.

138. *Id.* at 179-80.

and any written materials prepared by the taxpayer “solely for the purpose of delivery to his attorney for the preparation of his return” were found to be privileged.<sup>139</sup> The court specified that the taxpayer’s pre-existing books and financial records were not privileged, but summaries of them prepared for the attorney could be.<sup>140</sup>

In 1972, the Eighth Circuit issued its opinion in *United States v. Cote*,<sup>141</sup> in which privilege was found to have initially attached to the return workpapers of an accountant whose work facilitated the legal advice of the taxpayer’s attorney to file amended returns.<sup>142</sup> The court, however, also held that the privilege as to the workpapers was waived by filing the amended returns in question.<sup>143</sup> The court stated that in filing the amended returns “the taxpayers communicated, at least in part, the substance of that information [in the undisclosed privileged workpapers] to the government, and they must now disclose the detail underlying the reported data.”<sup>144</sup> Nonetheless, the court cited both *Colton* and *Schlegel* approvingly to conclude that to the extent any particular workpapers contained information not published in the return, they should be submitted to the district court for an in-camera ruling.<sup>145</sup> The court did not elaborate on this point, but presumably the intent was that privilege would apply only to workpapers not supporting numbers actually reported on the return.

After the period between 1962 and 1972 when these five leading cases were issued, some of the subsequent case law seemed to follow a bright-line approach like that taken in *Merrell* finding initial confidentiality was generally lacking in the return preparation context. The District of Maryland’s opinion in *United States v. Schoeberlein*, the Northern District of Illinois’s opinion in *In re Shapiro*, and the Northern District of New York’s opinion in *United States v. Schenectady Savings Bank*<sup>146</sup> appeared to apply such bright lines in 1971, 1974, and 1981, respectively.<sup>147</sup>

*Merrell*, however, has also been criticized, and many cases have expressed that *Threlkeld* and *Schlegel* provided a better-reasoned approach. For example, in 1971, in *United States v. Baucus*, the District of

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139. *Id.* at 180.

140. *Id.*

141. 456 F.2d 142 (8th Cir. 1972).

142. *Id.* at 143.

143. *Id.* at 145.

144. *Id.* at 144. The accountant testified that “the information on his workpapers was later transcribed onto the amended returns which were filed by the taxpayers with the government.” *Id.* at 145. Thus, there appeared to be no difference in content between the workpapers in question and the tax return that was filed.

145. *Id.* at 145 nn.3-4.

146. 525 F. Supp. 647 (N.D.N.Y. 1981).

147. *Id.* at 653 (noting only documents, which were not associated with return preparation, were privileged); *In re Shapiro*, 381 F. Supp. 21, 22-23 (D. Ill. 1974); *United States v. Schoeberlein*, 335 F. Supp. 1048, 1057-58 (D. Md. 1971).

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Montana rejected as “too broad” the government’s contention that the attorney’s return workpapers were unprivileged because they contained information intended to be included in the taxpayer’s returns.<sup>148</sup> The court reasoned that the workpapers contained only the “raw data” that the attorney used to prepare the returns, and were thus “analogous to a client interview.”<sup>149</sup> Also in 1971, the Tax Court in *Brittingham v. Commissioner*<sup>150</sup> cited *Threlkeld* to find within the privilege a letter to the attorney, in which the taxpayer “was relying on [the lawyer’s] professional expertise to determine what should be passed on” in the return.<sup>151</sup> The court stated that the purpose of the attorney-client privilege was to “foster this kind of disclosure.”<sup>152</sup> In 1973 and 1975, respectively, the Middle District of Pennsylvania in *United States v. Schmidt* and the District of Oregon in *United States v. Jeremiah* also applied the rule of *Schlegel* to hold certain return preparation communications were privileged.<sup>153</sup> Other cases appeared open to following *Threlkeld* and *Schlegel*, but concluded that the taxpayers before them had not provided sufficient evidence to establish they had actually left to the attorney’s discretion what would be included in the return.<sup>154</sup> It is also interesting to note that *Schlegel* in particular has been very influential even beyond the tax return preparation context. Several courts have explicitly followed *Schlegel’s* reasoning in non-tax cases.<sup>155</sup>

Further, a somewhat similar but even broader approach has emerged in the context of attorney-client communications with respect to patent applications. Initially, courts held that the client had no reasonable expectation of confidentiality and the filing patent attorney was a mere “conduit” of information to the United States Patent and Trademark Office due to statutory requirements that the attorney turn over all relevant factual information.<sup>156</sup> This view has fallen into disfavor, however, as subsequent cases differentiate between divulging information and divulging communication.<sup>157</sup> In *Knogo Corporation v. United States*,<sup>158</sup> the court explained:

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148. *United States v. Baucus*, 34 A.F.T.R.2d (RIA) 74-5009, 74-5017 (D. Mont. July 26, 1971).

149. *Id.* Although this holding seemed to follow the approach of *Schlegel*, a footnote of the opinion of *Baucus* noted that *Merrell* had recently been criticized by *Schlegel*, but the court believed the *Merrell* opinion was “proper.” *Id.* at 74-5018 n.17.

150. 57 T.C. 91 (1971).

151. *Id.* at 99 n.5.

152. *Id.*

153. *United States v. Jeremiah*, 37 A.F.T.R.2d (RIA) 76-1285, 76-1286 (D. Or. Nov. 26, 1975); *United States v. Schmidt*, 360 F. Supp. 339, 350 n.35 (M.D. Pa. 1973).

154. *See, e.g., In re Grand Jury Subpoena Duces Tecum*, 697 F.2d 277, 279-80 (10th Cir. 1983).

155. *See, e.g., Apex Mun. Fund v. N-Group Sec.*, 841 F. Supp. 1423, 1427-28 (S.D. Tex. 1993); *Schenet v. Anderson*, 678 F. Supp. 1280, 1283-84 (E.D. Mich. 1988); *SEC v. Texas Int’l Airlines, Inc.*, 1979 WL 184774, at \*1 (D.D.C. Aug. 3, 1979).

156. RICE, *supra* note 26, §§ 6:11, 7:12; *see, e.g., Jack Winter, Inc. v. Koratron Co.*, 50 F.R.D. 225, 229 (N.D. Cal. 1970).

157. RICE, *supra* note 26, §§ 6:11, 7:12.

158. *Knogo Corp. v. United States*, 213 U.S.P.Q. (BNA) 936 (Ct. Cl. Trial Div. 1980).

The attorney is not a mere conduit for either the client's communications containing the technical information or the technical information itself. He does not file his client's communications with the Patent Office. . . . The technical discussions between attorney and client enable the attorney to extract from this information one or more patentable inventions. The attorney then drafts one or more patent applications in accordance with the requirements of the federal statutes and regulations. The attorney "has no duty to transmit information which is not material to the examination of the application." The application for patent is reviewed by the client, and once approved, it is signed by the client and then filed in the Patent Office by the attorney on behalf of the client. The signed, sworn, and filed application might be considered a communication for relay and not for the attorney's ears alone, but the same cannot be said about the technical communications which precede the signed, sworn, and filed patent application.<sup>159</sup>

In *Advanced Cardiovascular Systems, Inc. v. C. R. Bard, Inc.*,<sup>160</sup> the court echoed similar points:

Again we emphasize that what we are focusing on is expectations about [attorney-client] communications, not expectations about substantive technical data itself. . . . It is extremely unlikely that an inventor would expect such conversations to be divulged to anyone. Thus we think an inventor is likely to expect to engage in much more communication with counsel than would ever be exposed to the PTO in the application process. In this respect, the inventor's expectations would seem to parallel the expectations of a prospective litigant who confers at length with counsel prior to the drafting of a complaint to launch civil litigation. The law presumes that such a litigant expects his or her communications with his or her lawyer to remain private, even though that same litigant understands that some of the factual material he or she shares with counsel will end up in the complaint. . . . There is simply no equation between disclosing material information and disclosing conversations.<sup>161</sup>

Thus, in the patent application context, the courts have gone even further than *Schlegel*.<sup>162</sup> Applying the same framework in the tax return preparation context would mean that the privilege would protect even attorney-client communication as to information that appears on the filed tax return. This approach is supported by the Supreme Court's warning in *Upjohn* that facts and communications were distinct concepts, and the privilege could extend to communications of facts even if those facts were shared with third parties.<sup>163</sup>

Nonetheless, despite the wide respect for *Schlegel* and the much more permissive approach taken in the patent application setting, it

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159. *Id.* at 940-41 (citation omitted).

160. 144 F.R.D. 372 (N.D. Cal. 1992).

161. *Id.* at 377-78 (emphasis omitted).

162. *But see* RICE, *supra* note 26, § 6:12 (noting that privilege questions factually analogous to patent applications arise when attorneys assist in the preparation of public filings required under securities laws, the preparation of amnesty applications, or in the preparation of bankruptcy petitions and supporting schedules, but courts have generally found clients to lack a reasonable anticipation of confidentiality in these settings). Professor Rice has criticized such holdings as "illogical, unfair and, therefore, unacceptable" and advocated following the approach of the patent application cases. *Id.*

163. *Upjohn Co. v. United States*, 449 U.S. 383, 395-96 (1981).

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would not be fair to say that *Merrell* has been completely abandoned. In 1999, the Seventh Circuit in *United States v. Frederick* seemed to apply a bright-line rule reminiscent of *Merrell* when it stated conclusively that confidentiality was lacking in the return preparation context.<sup>164</sup> Because *Frederick* was written by an extremely influential jurist, Judge Richard Posner,<sup>165</sup> the case has received a lot of attention.<sup>166</sup> Nevertheless, when looking at the body of case law as a whole, it appears that the *Schlegel* approach has emerged as the majority rule, and is more consistent with the patent application cases.

After the period between 1962 and 1972 when the five leading cases were decided, some courts initially took a broad approach to waiver like that taken in *Cote*. In 1981, 1983, and 1995, respectively, the Fifth Circuit in *United States v. Davis*, the Seventh Circuit in *United States v. Lawless*,<sup>167</sup> and the Tax Court in *Bernardo v. Commissioner*<sup>168</sup> held privilege did not protect underlying communications detailing data reported in the filed return.<sup>169</sup> However, like *Merrell's* bright-line rule on initial confidentiality, the *Cote* approach to waiver has also not been uniformly embraced. In 1983, the United States District Court for the Southern District of New York in *In re Grand Jury Subpoena Duces Tecum*<sup>170</sup> examined a corporate taxpayer's assertion of attorney-client privilege and work product doctrine to protect various documents generated by an accountant who was retained by the taxpayer's attorney.<sup>171</sup> The court rejected the government's claim that the taxpayer had waived privilege when it filed an amended return:

[In filing the return, the taxpayer did not] disclose the disputed documents themselves; rather, [the taxpayer] simply made public certain conclusions which it based on the work incorporated in the disputed documents. No authority has been cited for the proposition that a document loses its privileged nature simply because the owner of the privilege relies on the material contained in the document in making a statement in *another* document. By the mere filing of a tax return, the taxpayer does not agree to disclose to all comers the documentation underlying the deductions claimed. Had the IRS challenged the deduction, [the taxpayer] would then have had the choice of waiving the privilege and supporting the deduction, or asserting the privilege and losing the deduction (and perhaps

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164. *United States v. Frederick*, 182 F.3d 496, 500-01 (7th Cir. 1999).

165. *Id.* at 499.

166. See, e.g., John Gergacz, *Using the Attorney-Client Privilege As a Guide for Interpreting I.R.C. § 7525*, 6 HOUS. BUS. & TAX L.J. 241 (2006); Michael W. Loudenslager, *Cover Me: The Effects of Attorney-Accountant Multidisciplinary Practice on the Protections of the Attorney-Client Privilege*, 53 BAYLOR L. REV. 33 (2001); John S. Dzienkowski & Robert J. Peroni, *Multidisciplinary Practice and the American Legal Profession: A Market Approach to Regulating the Delivery of Legal Services in the Twenty-First Century*, 69 FORDHAM L. REV. 83 (2000).

167. 709 F.2d 485 (7th Cir. 1983).

168. 104 T.C. 677 (1995).

169. *Lawless*, 709 F.2d at 487-88; *United States v. Davis*, 636 F.2d 1028, 1044 (5th Cir. 1981); *Bernardo*, 104 T.C. at 687.

170. 566 F. Supp. 883 (S.D.N.Y. 1983).

171. *Id.* at 884.

incurring a penalty). . . . [The taxpayer] retained the choice to disclose or not to disclose; having not disclosed the documents themselves, there is no basis for finding that the privilege was waived in these instances.<sup>172</sup>

In the 1989 case of *In re Sealed Case*,<sup>173</sup> the United States Court of Appeals for the District of Columbia Circuit also cautioned against an overly broad application of *Cote*'s holding that a waiver as to underlying details is triggered when a taxpayer files a return:

[T]he government much too facetly claims that the six documents are merely "details" underlying past or future returns. To be sure, virtually all the material in the documents reflects adjusting entries in Company's books, which have been or will be reported to the IRS. But the crucial significance of the documents—and the apparent reason the government wishes to present them to the grand jury—is that they suggest Company made the adjusting entries *on the advice of counsel*. . . .<sup>174</sup>

The court noted: "If the information has not yet been disclosed, it is hard to think of [the] Company's action as a waiver. Rather, data that [the] Company intends to report is never privileged in the first place."<sup>175</sup> The court concluded there had been no waiver of the documents in question due to the filing of the taxpayer's return, and such documents needed to be protected because they "reveal directly the attorney's confidential advice."<sup>176</sup>

In the 1989 case, *United States v. Schwimmer*,<sup>177</sup> the Second Circuit also took an approach inimical to *Cote*.<sup>178</sup> The court rejected the government's assertion that the documents in question were unprivileged because they simply supported information transmitted on the return.<sup>179</sup> The court noted that certain documents were "not of the type ordinarily submitted with corporate tax returns."<sup>180</sup> One such document was a return workpaper that included the underlying computation for a figure included in the return.<sup>181</sup>

Moreover, tax cases beyond the return preparation context also cast doubt on the viability of the broad approach to waiver taken in *Cote*. For example, in 2001, the United States Court of Appeals for the Federal Circuit addressed confidentiality in the tax planning context in *In re Pioneer Hi-Bred International, Inc.*<sup>182</sup> Declining to follow *Cote*,

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172. *Id.* The court's holding was technically directed at the work product doctrine theory because a finding of waiver in that context was dispositive of the issue in the attorney-client privilege context. *Id.* at 884-85. The rules of waiver in the work product doctrine and the attorney-client privilege are similar in some ways but not completely co-existent. Thus, one could argue whether the quoted language is pertinent to an analysis of waiver in the attorney-client privilege context.

173. 877 F.2d 976 (D.C. Cir. 1989).

174. *Id.* at 979.

175. *Id.* at 979 n.4.

176. *Id.* at 979.

177. 892 F.2d 237 (2d Cir. 1989).

178. *See generally id.*

179. *Id.* at 245.

180. *Id.*

181. *Id.*

182. *In re Pioneer Hi-Bred Int'l, Inc.*, 238 F.3d 1370, 1374-75 (Fed. Cir. 2001).

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the court rejected assertions that there had been a waiver of privilege as to legal advice concerning a possible merger because the client had disclosed the merger plans to third parties.<sup>183</sup> The court explained:

A party does not forego the attorney-client privilege with respect to merger negotiations by disclosing the existence of the merger, the negotiations between the parties concerning the merger, or the property rights of the respective parties, and a waiver occurs only when a party relies on or discloses advice of counsel or other privileged information in connection with the merger.<sup>184</sup>

It is also interesting that several non-tax cases have also rejected and criticized the *Cote* approach to waiver.<sup>185</sup> In light of the foregoing, the *Cote* approach to waiver is currently disfavored and cannot be viewed as the majority rule today.

#### IV. PUTTING IT ALL TOGETHER

After reviewing the general rules of attorney-client privilege and the cases applying the return preparation exception, it is evident that the law is not settled and significant ambiguities certainly remain. Nonetheless, it is possible to make some generalizations as to the types of tax lawyer communications that are—and are not—protected by the attorney-client privilege. To that end, section IV-A of this article synthesizes the return preparation exception case law to describe items that fall within the exception, as well as items that should not. Section IV-B assesses the status of attorney-client communications in the tax controversy context. Section IV-C analyzes whether pre- or post-transaction tax advice may be privileged. Section IV-D examines the policy implications of applying the attorney-client privilege in various tax lawyering settings.

##### A. *What Do We Know for Sure About the Exception?*

From studying the cases that apply the return preparation exception, it is obvious that the law is still evolving. Due to the variance in the courts' approaches to the issue, as well as the doctrine of stare decisis, the result in any given case may ultimately depend on the specific body of case law in the circuit where the case is actually litigated. None-

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183. *Id.* at 1374.

184. *Id.* The court noted that there had only been a third-party disclosure of legal advice with respect to the tax consequences of the merger. *Id.* at 1374-75. As a result, the court held there was a waiver only as to the documents forming the basis for that tax advice, the documents considered by counsel in rendering that tax advice, and the reasonably contemporaneous documents reflecting discussions by counsel or others concerning that tax advice. *Id.* at 1375-76.

185. See *Muncy v. City of Dallas*, No. 3:99-CV-2960-P, 2001 U.S. Dist. LEXIS 18675, at \*8 (N.D. Tex. Nov. 13, 2001); *Calvin Klein Trademark Trust v. Wachner*, 124 F. Supp. 2d 207, 210 (S.D.N.Y. 2000); *Apex Mun. Fund v. N-Group Sec.*, 841 F. Supp. 1423, 1428 (S.D. Tex. 1993); see also *Natta v. Hogan*, 392 F.2d 686, 691-92 (10th Cir. 1968) (failing to reference *Cote*, but declining to adopt an equivalent approach).

theless, there are certain trends across the circuits that one can use to make broad generalities about the state of the law.

Whenever an attorney is preparing returns for a client—or is directing a non-attorney to prepare returns on behalf of the attorney's client—there is a heightened risk that the privilege will not apply to communications associated with that return preparation service. In particular, pre-existing documents are unlikely to be protected by the attorney-client privilege. This is especially true if the pre-existing documents were either prepared by someone other than the client, or were prepared by the client for initial disclosure to someone other than the attorney. Workpapers created by a return preparer are also likely to be held beyond the protections of privilege.<sup>186</sup> A different result is possible, however, especially if the workpapers contain information not communicated on the return.

To the extent a client communicates factual information to an attorney in the return preparation context, there is a risk that privilege may not apply, but the result is much more uncertain than in the case of pre-existing documents and return workpapers. Communications of factual information are likely to be scrutinized much more closely in light of the two legal justifications underpinning the return preparation exception. For example, some courts simply view return preparation as nonlegal work such that the elements of privilege cannot be satisfied. This is particularly likely in the Fifth, Seventh, Eighth, Ninth, and Eleventh Circuits.<sup>187</sup> In such circuits, communication associated solely with return preparation is unlikely to be protected by privilege.<sup>188</sup> Nonetheless, communications with the same attorney-return preparer may be privileged to the extent they are associated with legal advice or legal services beyond the provision of strictly return preparation services.

By contrast, in the Second Circuit, return preparation can be viewed as *prima facie* legal work.<sup>189</sup> In other circuits, the issue is still an open question altogether. In these circuits, it is likely that communications of factual information will be scrutinized to determine if they satisfy the requirements of confidentiality. The view expressed in *Schlegel* has been widely praised; it has been adopted by other courts in both the return preparation context and non-tax cases. As a result, there is a good chance that the return preparation exception will only apply to communications of factual information when the factual information is ultimately disclosed directly on the filed return.

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186. See cases cited *supra* notes 53-56.

187. See, e.g., *United States v. Frederick*, 182 F.3d 496 (7th Cir. 1999); *In re Grand Jury Investigation*, 842 F.2d 1223 (11th Cir. 1987); *United States v. Davis*, 636 F.2d 1028 (5th Cir. 1981); *Canaday v. United States*, 354 F.2d 849 (8th Cir. 1966); *Olender v. United States*, 210 F.2d 795 (9th Cir. 1954).

188. See, e.g., *Frederick*, 182 F.3d 496; *In re Grand Jury Investigation*, 842 F.2d 1223; *Davis*, 636 F.2d 1028; *Canaday*, 354 F.2d 849; *Olender*, 210 F.2d 795.

189. See generally *Colton v. United States*, 306 F.2d 633 (2d Cir. 1962).

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This view is consistent with the non-binding but often influential Advisory Committee Notes to draft Rule 503—the proposed codification of the federal attorney-client privilege—which explained: “The requisite confidentiality of communication is defined in terms of intent. . . . Unless intent to disclose is apparent, the attorney-client communication is confidential.”<sup>190</sup> Thus, like *Schlegel*, the Advisory Committee Notes support the understanding that the intent for confidentiality should be presumed unless there is evidence to the contrary. Inclusion of factual information in a filed return would tend to disprove any intent for confidentiality as to the communications, through which the client conveyed the factual information.

However, particularly in the Eighth Circuit, where *Cote* was decided, there is a risk that a court will find any communications providing factual or computational “detail underlying the reported data” to be unprotected under a theory of waiver by filing the return.<sup>191</sup> Nonetheless, this result is not guaranteed even in the Eighth Circuit. *Cote* was decided in 1972, so it may be viewed as outdated. Further, the opinion has been criticized in other more recent, well-reasoned cases. The better view is that no waiver is triggered when a client includes on a filed return, factual information previously communicated to an attorney to facilitate the rendition of legal services.

#### *B. Attorney Communication in the Tax Controversy Context*

As noted in section IV-A, the return preparation exception is most likely to apply when an attorney is preparing a client’s return or is directing a non-attorney to prepare such a return. By contrast, it seems clear that the attorney-client privilege will generally apply when an attorney is advising or representing a client with respect to returns that have already been filed. Unless an issue is raised as to amended returns, it is self-evident that after a return has been filed, the attorney’s tax services do not involve return preparation and by definition cannot fall within the scope of the return preparation exception to the attorney-client privilege. Thus, the privilege is likely to apply to the extent communications facilitate an attorney’s representation of a taxpayer in the context of a post-filing tax controversy with the IRS.

There does not appear to be any dispute that an attorney representing a client in tax litigation is serving in an attorney role, and the elements of privilege are generally satisfied.<sup>192</sup> Indeed, court rules generally prohibit non-attorneys from representing non-family members in court. There appears to be no principled reason why attorneys in tax

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190. WEISSENBERGER & DUANE, *supra* note 21, at App. B.

191. *United States v. Cote*, 456 F.2d 142, 144 (8th Cir. 1972).

192. *See generally* McMahon & Shepard, *supra* note 5; Lowy & Vasquez, *supra* note 2.

litigation should be viewed differently for purposes of the attorney-client privilege than those litigating non-tax cases.

It is also likely that the attorney-client privilege applies when an attorney is advising a client in the course of a tax controversy in an administrative setting. Indeed, several cases have concluded that the attorney-client privilege does apply when an attorney is representing a taxpayer before the IRS in an audit.<sup>193</sup> Privilege seems especially likely to apply in the audit context to the extent the attorney is advising the taxpayer with respect to legal issues involving statutory interpretation or case law, and not merely assisting the IRS to verify the accuracy of the information in the return.<sup>194</sup>

It seems even more likely that the attorney-client privilege applies when an attorney is representing a taxpayer before the IRS Office of Appeals (Appeals). Representation before Appeals is similar in many respects to litigation. It is considered an adversarial setting analogous to non-binding arbitration.<sup>195</sup> Appeals is also understood to satisfy the "litigation" requirement of the work product doctrine.<sup>196</sup> Further, if courts have already extended the protections of attorney-client privilege to the audit context, it would be difficult to imagine courts would not also do so in the context of Appeals.

### C. Attorney Tax Advice: Pre-Transaction v. Post-Transaction

Although it appears clear that the privilege applies to protect attorney-client communications involving tax issues arising subsequent to the filing of the return, there has been more confusion in the pre-filing context. When provided before the return is filed, to some degree, all attorney tax advice is associated with and facilitates the preparation of a client's return. This is true even when an attorney does not actually fill out the return or even communicate directly with the client's return

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193. See, e.g., *United States v. Hankins*, 631 F.2d 360 (5th Cir. 1980); *Cote*, 456 F.2d 142; *United States v. Judson*, 322 F.2d 460 (9th Cir. 1963); *United States v. Nelson*, 65 F.R.D. 563 (M.D.N.C. 1974). But see *Boca Investorings P'ship v. United States*, 31 F. Supp. 2d 9, 11 (D.D.C. 1998) (stating that like return preparation, handling a tax audit is a function that may or may not be performed by a lawyer; communication in the course of an audit generally should not be considered privileged).

194. See *United States v. Frederick*, 182 F.3d 496 (7th Cir. 1999), noting:

An audit is both a stage in the determination of tax liability, often leading to the submission of revised tax returns, and a possible antechamber to litigation. When a revenue agent is merely verifying the accuracy of a return, often with the assistance of the taxpayer's accountant, this is accountants' work and it remains such even if the person rendering the assistance is a lawyer rather than an accountant. Throwing the cloak of privilege over this type of audit-related work of the taxpayer's representative would create an accountant's privilege usable only by lawyers. If, however, 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.

*Frederick*, 182 F.3d at 502.

195. See Peter A. Lowy & Juan F. Vasquez, Jr., *When is the Work of a Tax Professional Done in Anticipation of Litigation and Thus 'Work Product'?*, 98 J. TAX'N 155, 157 (2003).

196. *Id.*

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preparer. Whether the advice is provided to the client before or after a transaction is consummated, the advice will shape the way the client, or the return preparer, ultimately characterizes and reports the transaction on the tax return. Depending on the scope of the return preparation exception, one might argue such attorney tax advice is not privileged even if the attorney has no direct involvement in the provision of return preparation services.

Nonetheless, it seems uncontroversial that tax planning advice is protected by privilege; there does not appear to be any serious argument that it is within the scope of the return preparation exception. It simply appears to be too remote temporally and conceptually from return preparation activities. Indeed, numerous cases have explicitly held that communications to facilitate an attorney's tax planning advice are within the scope of the attorney-client privilege.<sup>197</sup>

Tax planning advice has been defined as "before-the-fact" advice to a client who is contemplating a potential course of action.<sup>198</sup> Such a client may want such pre-transaction advice to determine the best way to pursue the potential course of action while minimizing any tax consequences. That advice then enables the client to structure the transaction in a manner that provides a result with the lowest tax liability to the client. Alternately, tax planning may be aimed at helping the client to understand the resulting tax consequences from a contemplated course of action. Understanding and quantifying the tax costs of a proposed transaction can help the client make a final decision as to whether to pursue and consummate the contemplated transaction. Attorney-client communications associated with both types of pre-transaction tax planning advice are clearly privileged according to the existing case law.<sup>199</sup>

While many cases have clearly endorsed application of privilege in the tax planning context, some have attempted to distinguish pre-transaction from post-transaction advice. A leading case identifying this delineation is the Southern District of Iowa's 1983 opinion in *Willis*.<sup>200</sup> In the course of analyzing whether return preparation by attorneys was a legal service for purposes of the attorney-client privilege, the court expressed skepticism at the need or benefit of consulting with attorneys as to the tax repercussions of closed transactions.<sup>201</sup> In so doing, the court incorrectly blurred the line between return preparation services and

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197. See, e.g., *In re Grand Jury Subpoena Duces Tecum*, 731 F.2d 1032 (2d Cir. 1984); *United States v. BDO Seidman, LLP*, No. 02-C-4822, 2005 U.S. Dist. LEXIS 5555 (N.D. Ill. Mar. 30, 2005); *United States v. ChevronTexaco Corp.*, 241 F. Supp. 2d 1065 (N.D. Cal. 2002); *In re Federated Dep't Stores*, 170 B.R. 331 (Bankr. S.D. Ohio 1994).

198. *United States v. Willis*, 565 F. Supp. 1186, 1190 (S.D. Iowa 1983).

199. See, e.g., *BDO Seidman, LLP*, 2005 U.S. Dist. LEXIS 5555; *In re Federated Dep't Stores*, 170 B.R. 331.

200. See generally *Willis*, 565 F. Supp. 1186.

201. See *id.* at 1189-91.

post-transaction tax return characterization advice. The court noted the availability of extensive governmental “instructions and informational publications” that provided the answer to most issues return preparers encountered.<sup>202</sup> The court conceded that “questions occasionally arise in the [return] preparation context which require research and interpretation of the tax statutes and regulations beyond that manifested in the government-prepared instructions and pamphlets.”<sup>203</sup> The court, however, observed a “marked distinction” between tax planning advice and income tax preparation:

Taxplanning 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. . . .

Income tax return preparation, on the other hand, involves closed tax periods and entails evaluating the tax consequences of previously-consummated transactions and occurrences; compiling the information pertinent to those transactions and events; categorizing, classifying, and otherwise organizing that information in a way which corresponds with the classifications and categories appearing on tax return forms; selecting among the various available tax forms; electing the most advantageous tax filing status; computing the final figures to be included on the taxpayer’s return on the basis of the raw information available; completing the tax return; and other after-the-fact services ultimately aimed at satisfying the disclosure requirements for the tax period in question.<sup>204</sup>

The court concluded that although return preparation services did not satisfy the “legal advice” element of privilege, that element was satisfied in the context of pre-transaction tax planning advice from a lawyer.<sup>205</sup> This distinction appears to have been dicta because pre-transaction tax planning was not actually at issue in *Willis*. Moreover, *Willis* specifically rejected the application of privilege when an attorney is preparing his client’s tax return, but did not address the distinct situation when the attorney is not preparing the return but is consulted by the taxpayer for advice as to how a particular closed transaction should be characterized and reported on the return.<sup>206</sup>

Other courts have not necessarily placed an emphasis on the delineation between pre- and post-transaction tax advice. Despite the delineation described in *Willis*, other cases have in fact determined that privilege does attach on a post-transaction basis when an attorney is advising a client how to characterize and report an item on the tax re-

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202. *Id.* at 1189.

203. *Id.* at 1190.

204. *Id.* at 1190-91.

205. *Id.*

206. *See generally id.*

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turn.<sup>207</sup> Such holdings appear correct and in accord with other well-established privilege law principles. As a result of the complexity of our federal tax laws, there are many tax compliance issues that are not easy to resolve without legal assistance.<sup>208</sup> Particularly in the case of taxpayers with sophisticated financial affairs, a non-attorney return preparer may be unable to prepare a return without tax advice from an attorney. Indeed, *Willis* involved an attorney's preparation of returns for an individual taxpayer, and there was no indication in the court's opinion that the taxpayer's affairs gave rise to any particularly difficult tax compliance issues. One might argue that the *Willis* court's broad observations about post-transaction tax advice are potentially apropos only in the context of fairly simple returns for individuals, and would not be correct in the context of the more complicated returns of individuals or businesses with sophisticated financial structures and transactions.

Interestingly, in the same year *Willis* was decided, the Fifth Circuit in *United States v. El Paso Co.*<sup>209</sup> provided a very different commentary on compliance issues when it analyzed privilege claims asserted to protect a public corporation's tax accrual workpapers.<sup>210</sup> The court described the extreme complexity of determining proper return characterizations:

The income tax laws, as every citizen knows, are far from a model of clarity. Written to accommodate a multitude of competing policies and differing situations, the Internal Revenue Code is a sprawling tapestry of almost infinite complexity. Its details and intricate provisions have fostered a wealth of interpretations. To thread one's waythrough this maze, the business or wealthy taxpayer needs the mind of a Talmudist and the patience of Job.

Even endowed with these qualities, however, no taxpayer completes a return with the certainty that the IRS will agree with the bottom line, or the many steps taken to get there. There is no tax oracle one may consult to learn how a return will fare under the scrutiny of the revenue agents and the courts. The Code, after all, is a finite system of rules designed to apply flexibility to an infinite variety of situations. There are many "gray areas" in the tax world, twilight zones in which one may only dimly perceive how properly to treat a given accretion to wealth or given expenditure of funds.

When a large corporation like El Paso completes its return, the number of decisions in the gray areas is enormous. To characterize a sale as ordinary income or capital gain, to depreciate equipment over ten years or twenty, to attribute a transaction to this year or to the next: these decisions recur over and over in a course of preparing a return and guarantee

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207. See, e.g., *In re Sealed Case*, 877 F.2d 976 (D.C. Cir. 1989); *United States v. Liebman*, 742 F.2d 807 (3rd Cir. 1984); *United States v. BDO Seidman, LLP*, 94 A.F.T.R.2d (RIA) 2004-5066 (N.D. Ill. June 29, 2004); *United States v. Lake*, 257 F. Supp. 35 (E.D.N.C. 1966).

208. See, e.g., *United States v. Arthur Young & Co.*, 465 U.S. 805, 812 n.9 (1984); *United States v. ChevronTexaco Corp.*, 241 F. Supp. 2d 1065 (N.D. Cal. 2002).

209. 682 F.2d 530 (5th Cir. 1982).

210. *Id.* at 533-34.

that a large corporation has many opportunities to choose in good faith an interpretation of the tax code that leans toward lessening its taxes. The return is filed with the understanding, however, that the IRS may challenge some of these questionable positions and, through settlement or litigation, the corporation may end up owing more taxes than it initially acknowledged.<sup>211</sup>

Other courts have similarly noted the great difficulty in determining the ramifications of tax law on a given transaction.<sup>212</sup> Indeed, the kind of uncertainty as to proper return characterizations that is described in *EI Paso* and other cases supports the view that at the very least some post-transaction tax advice should come within the scope of the attorney-client privilege. To the extent that the proper characterization of closed transactions is clear under the law—expressly provided in “government-prepared instructions and pamphlets”—one might be able to argue persuasively that the attorney-client privilege ought not apply.<sup>213</sup> But to the extent a taxpayer is seeking a lawyer’s advice as to a tax characterization that is ambiguous under the law, the attorney-client privilege should be applicable.

Several points support the view that the attorney-client privilege should apply to at least some post-transaction tax advice. First, even in return preparation exception cases, the privilege has been held to protect some confidential attorney-client communications when the client is seeking the attorney’s advice.<sup>214</sup> Further, as noted already, some cases, not involving attorneys with direct involvement in return preparation, have held the privilege applies when an attorney provides advice as to how an item should be characterized or reported on the return.<sup>215</sup> However, it is also insightful to note that many other cases applying the at-

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211. *Id.* at 534.

212. *See, e.g.*, *United States v. Judson*, 322 F.2d 460, 468 (9th Cir. 1963) (“Few areas of the law draw so many individuals in contact with governmental powers as does federal taxation. Yet this branch is one of the thickest of the law’s ‘bramble bush.’ The ramifications of tax law are often a stubborn challenge to the most expert legal practitioner. The 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.”); *BDO Seidman, LLP*, 2005 U.S. Dist. LEXIS 5555, at \*30 (“As this court noted [previously], the tax code and underlying regulations is full of complexities and uncertainties. The question of whether the Intervenors and BDO engaged in unlawful activity, or alternative properly complied with the tax code, is one of the ultimate questions for this litigation.”).

213. However, it seems unrealistic to think that taxpayers would consult with a lawyer on such clear matters when there are numerous other ways to get an equivalent answer in a less expensive manner—by consulting with a tax accountant or a tax return preparation business like H & R Block or Jackson Hewitt, by using commercial tax return preparation software like Quicken or TurboTax, or by the taxpayer researching the issue with the assistance of the IRS’s website and publications. In the real world, it is more likely that taxpayers would consult with a lawyer on tax compliance issues when more difficult questions arise, and the less expensive alternatives either cannot provide an answer at all or cannot give an answer authoritatively.

214. *See, e.g.*, *United States v. Abrahams*, 905 F.2d 1276, 1284 (9th Cir. 1990); *In re Shapiro*, 381 F. Supp. 21 (N.D. Ill. 1974); *United States v. Schmidt*, 360 F. Supp. 339 (M.D. Pa. 1973); *United States v. Baucus*, 34 A.F.T.R.2d (RIA) 74-5009 (D. Mont. July 26, 1971).

215. *See, e.g.*, *In re Sealed Case*, 877 F.2d 976 (D.C. Cir. 1989); *United States v. Liebman*, 742 F.2d 807 (3rd Cir. 1984); *United States v. BDO Seidman, LLP*, 94 A.F.T.R.2d (RIA) 2004-5066 (N.D. Ill. June 29, 2004); *United States v. Lake*, 257 F. Supp. 35 (E.D.N.C. 1966).

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torney-client privilege simply fail to state whether the privileged tax advice was provided on a pre- or post-transaction basis.<sup>216</sup> The delineation was apparently just not considered significant by those courts.

Further, in enacting I.R.C. § 7525, Congress extended to federally authorized tax practitioners the same common law protections afforded by the attorney-client privilege, but did not observe a common law delineation between pre- and post-transaction tax advice.<sup>217</sup> Instead, the statutory privilege simply applies generally to the giving of “tax advice” as long as it does not fall into one of the specified limitations—criminal tax matters or tax shelters.<sup>218</sup>

Finally, in light of the application of privilege in other tax contexts, it would seem illogical to find that privilege does not protect confidential client communications to facilitate an attorney’s advice as to the proper characterization or reporting of tax items, especially when there are legal ambiguities involved. For example, there is a growing understanding that privilege initially attaches to an attorney’s assessment as to the relative weakness of positions already reported on a corporate taxpayer’s filed return.<sup>219</sup> Several cases examining the question have concluded that such advice is privileged when provided to assist the corporate taxpayer prepare a tax reserve for financial accounting purposes.<sup>220</sup> In light of that trend, it would be illogical to then assert privilege did not attach to an attorney’s underlying advice that such positions were legally appropriate to take on the return.

Moreover, tax advice spans a chronological spectrum from pre-transaction tax planning advice at the earliest stage to tax litigation at the latest stage. Post-transaction tax return characterization advice occurs at a mid-point in the spectrum per existing case law. Tax advice at each extreme of the spectrum is clearly privileged. Tax advice at other points in the middle—in the context of preparing tax reserves, representation in audits, and at Appeals—are likely privileged as well. Consequently, it would be illogical to make an exception for post-transaction tax return characterization advice. Unlike in the context of an attorney’s direct involvement in return preparation services, there is no prin-

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216. *See, e.g.*, *Long-Term Capital Holdings v. United States*, 91 A.F.T.R.2d (RIA) 2003-1139 (D. Conn. Feb. 14, 2003); *United States v. KPMG LLP*, 237 F. Supp. 2d 35 (D.D.C. 2002); *United States v. Mobil Corp.*, 149 F.R.D. 533 (N.D. Tex. 1993); *United States v. Jeremiah*, 37 A.F.T.R.2d (RIA) 76-1285 (D. Or. Nov. 26, 1975).

217. I.R.C. § 7525 (1998).

218. *Id.*

219. *See, e.g.*, *United States v. El Paso Co.*, 682 F.2d 530, 541 (5th Cir. 1982) (rejecting the taxpayer’s assertion of privilege as to its internal tax accrual workpapers because the taxpayer “waived” privilege by disclosing the workpapers to its independent auditor; there can be no waiver unless privilege first attaches); *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 152-53 (D.R.I. 2007) (finding that tax accrual workpapers prepared by the taxpayer’s attorneys were privileged, but the privilege was subsequently waived because the workpapers were disclosed to the taxpayer’s independent auditor).

220. *See* cases cited *supra* note 219.

cipld reason to prohibit application of the privilege.

*D. What About the Policy Implications?*

Because the attorney-client privilege is generally viewed as an impediment to the courts' truth-seeking function, some may query whether it is desirable from a policy perspective to have the attorney-client privilege apply to communications with tax lawyers. The strength of the policy arguments supporting an application of privilege may depend on the context where the communication takes place.

In the tax controversy setting, it is highly desirable for taxpayers to seek advice of and representation by lawyers. Pro se taxpayers typically are not savvy about administrative or judicial procedure, gathering and presenting evidence, or even substantive tax concepts. As a result, representation by an experienced lawyer generally expedites resolution of a taxpayer's case, which saves the IRS and the courts time. Moreover, consultation with a lawyer can provide a valuable reality check for taxpayers who may not have a strong case due to legal or evidentiary defects. Without such a reality check, pro se taxpayers often continue to prosecute a case they are destined to lose, which wastes the finite resources of both the IRS and the courts. For these reasons, in the tax controversy setting, taxpayer representation by attorneys promotes efficiency in the administration of the tax laws. Such representation is encouraged by the protection of privilege in this setting.

In the post-transaction tax return characterization advice setting, similar types of policy arguments support the application of privilege. Particularly in the case of corporate or individual taxpayers with sophisticated financial affairs, the tax laws are complex and not intuitive. As a result, the risk of inadvertent noncompliance by such unadvised taxpayers is high. Rampant noncompliance with our tax laws would degrade the integrity of the system as a whole. Further, inadvertent noncompliance can consume significant time during audit as the IRS tries to unravel the facts to determine proper return characterizations. Unfortunately, such time spent unraveling the facts is not always fruitful. Often, little or no adjustment is ultimately warranted, but the IRS may have lost valuable time to identify other areas for adjustment with greater impact to the federal fisc. Especially with respect to taxpayers with sophisticated financial affairs, it is beneficial to the administration of the tax laws that they seek post-transaction tax return characterization advice in order to properly comply with legal requirements. Such consultation is encouraged to the extent the attorney-client privilege is available to protect communications associated with that consultation.

Although it is well-established in case law that the attorney-client privilege applies in the pre-transaction tax planning advice context, it is

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interesting to note the policy rationales in that setting are arguably weaker. First, few taxpayers can afford legal advice in the pre-transaction tax planning advice stage. Because most taxpayers do without legal advice in that context, one might argue that such advice is unnecessary and there is no need to encourage it by permitting the attorney-client privilege to be applied. Indeed, the minority of taxpayers who do seek pre-transaction tax planning advice tend to be more affluent, and seek such advice to minimize their tax liabilities. Consequently, the impact of such advice is that the progressivism of our tax system is eroded. Moreover, as evident in many of the recent high-profile tax shelter cases, there appears to be a greater risk of abusive tax advice in the pre-transaction tax planning advice context. Lawyers advising taxpayers in both the post-transaction tax return characterization advice and tax controversy settings are confined to advising on closed transactions, and must do their best with previously-established facts. By contrast, in the pre-transaction tax planning advice context, lawyers have great latitude to suggest transactions and structures designed to manipulate provisions in the tax code to produce favorable tax results for the client. For these reasons, it may not be clear that it is necessarily desirable to have communications shielded by privilege in the pre-transaction tax planning advice setting.

Nonetheless, there are strong counter arguments that caution against an attempt to deny application of privilege to communications associated with pre-transaction tax planning advice. For example, it is long and well-established in the case law that privilege does apply to pre-transaction tax planning advice. Reliance interests support a continuance of the current approach. Further, in practice, the delineation between pre-transaction tax planning advice and post-transaction tax return characterization advice is often quite blurred and is arguably not meaningful. Permitting the latter to be privileged, but creating an exception for the former could waste a lot of IRS and court time in trying to split hairs to identify when pre-transaction tax planning advice ended and post-transaction tax return characterization advice began. Finally, beyond the tax law realm, there are numerous other situations when a client's consultation with a lawyer may lead to client conduct that is lawful but not necessarily desirable. Nonetheless, it is clear that privilege still applies in those situations. There would not be a principled reason to make an exception just in the tax setting.

## V. CONCLUSION

The application of the attorney-client privilege to the communications of tax lawyers continues to be an area of uncertainty in the law. Sometimes the result will depend on the case law of the particular cir-

cuit where the case is litigated. Other times, there are reoccurring trends that make it possible to make certain generalizations about when privilege is applicable. For example, the return preparation exception is most likely to apply to the extent an attorney is preparing a client's tax return or is directing a non-attorney to do so. In such situations, it is unlikely that privilege will protect pre-existing documents—for example, business records of the client. The same result is probable for return workpapers to the extent their contents were disclosed via the filed return. However, a different result is possible if the workpapers contain information not included in the return.

When a client communicates factual information to a lawyer providing return preparation services, it is harder to predict whether privilege will apply. In circuits where return preparation is viewed as nonlegal work, it is doubtful the protections of privilege will apply. In other circuits, however, the result may depend on the extent the information communicated was disclosed to the government via the return.

It seems doubtful that the return preparation exception bars application of privilege in other tax settings when the attorney is not directly involved with preparing the client's return. It is well-established that confidential attorney-client communications in the tax controversy and pre-transaction tax planning settings are generally privileged. Although there has been some question about whether the attorney-client privilege can apply when a lawyer is providing post-transaction tax return characterization advice, the more persuasive view is that privilege is applicable in that setting as well. Indeed, strong policy arguments support application of privilege in all three settings.