

# The Firm: Navigating Privilege and Ethics Obligations

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## Rules You Need to Know

- Circular 230
- Tax Returns

## Working with Advisors

- Privilege
- Kovel Doctrine
- Section 7525 Privilege
- Exceptions to Privilege

## Things to Keep in Mind

- Reporting Considerations
- Best Practices

## Circular 230

- Applies to those who practice before the Internal Revenue Service (“IRS”), including employees who represent their employers on tax matters
- Rigorous oversight responsibilities for those overseeing a firm’s practice in conforming with Circular 230
- IRS will apply a “reasonable practitioner standard,” considering all facts and circumstances, including ... “the scope of the engagement and the type and specificity of the advice sought by the client” in determining whether a practitioner giving written advice has complied with the applicable requirements
- Requirements for all written tax advice

## Circular 230 – Written Advice

- For written advice concerning federal tax matters, practitioner must:
  - Base written advice upon reasonable factual and legal assumptions
  - Reasonably consider all relevant facts that the practitioner knows or reasonably should know
  - Use reasonable efforts to identify and ascertain relevant facts
  - Not rely on representations, statements, findings, or agreements if reliance would be unreasonable
  - Relate applicable law and authority to the facts
- Consider ethical obligations of client

## Circular 230 – Best Practices

- Clearly set out the scope and form of advice to be provided
- Evaluate the reasonableness of any assumptions or representations made
- Advise clients on the potential effects of the conclusions

## Treatment of Tax Returns

- No confidentiality privilege for tax return preparers
- However, section 6103 provides that tax returns and return information shall be confidential and generally shall not be disclosed
  - Certain exceptions include disclosure to:
    - State tax officials and state and local law enforcement;
    - Persons with a material interest (you can get your own tax return);
    - Certain federal officers and employees;
    - The president; and
    - Committees of Congress...

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## Privileges and Protections

- **Attorney-Client Privilege:** “To encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice.” *Upjohn Co. v. United States*, 449 U.S. 383 (1981)
- **Work Product Doctrine:** To protect the diligent lawyer from a dilatory adversary. *See Hickman v. Taylor*, 329 U.S. 495 (1947)
- **Tax Practitioner Privilege:** Extends attorney-client privilege to tax practitioners and is interpreted according to the same common law principles. *See United States v. BDO Seidman*, 337 F.3d 802 (7<sup>th</sup> Cir. 2003)



## Attorney-Client Privilege

- Attorney-client privilege allows a party to withhold relevant information that they would otherwise be compelled by law to produce
- If there is no legal compulsion to disclose the information, there is no need for privilege

# Attorney-Client Privilege – When Is it Relevant?

- During an IRS audit or other administrative proceeding
- During Discovery
  - In response to a deposition subpoena
  - In response to a request for production of documents
- During trial
  - In response to a trial subpoena
  - In response to questioning during a cross examination

## Attorney-Client Privilege – What Does It Cover?

Clients have the privilege to withhold, and cause others to withhold:

1. A communication,
2. Between privileged persons,
3. Made in confidence, and
4. To obtain legal counseling or representation

## Attorney-Client Privilege - When Does Privilege Apply?

To be privileged, a confidential communication to an attorney must be for the purpose of obtaining legal advice. Privilege does not apply to documents created with the intention of public or third party disclosure

### TRAP:

*Not all communications with attorneys are privileged. Labeling a document as "privileged and confidential" does not conclusively make it privileged*

### TIP:

*Copying internal or external counsel is not sufficient to establish privilege for transmissions to outside persons*

## Attorney-Client Privilege – Belongs to the Client

- In *Upjohn Co. v. United States*, the US Supreme Court ruled that attorney-client privilege can apply to corporations
- Privilege belongs to the client; not to any of its employees
- Attorney-client privilege extends to the client in dealings with both in-house counsel and outside counsel
- Who is the client?

# Attorney-Client Privilege – Was There an Expectation of Confidentiality?

- Privilege only applies to extent there is a “reasonable expectation of confidentiality” that the information at issue will be publicly disclosed
- Privilege does not apply to:
  - Documents created with the intention of third party or public disclosure;
  - Tax return information;
  - FIN 48; and
  - SEC filings.

## Attorney-Client Privilege – Best Practices

- Define and implement a protocol; there is no one-size-fits-all solution
- Label everything; make it obvious that the information is privileged
- Separate and limit access to privileged correspondence and documents
- Confer with in-house or external counsel before sharing information and documents
- Know your audience; confirm whether anyone outside of the attorney-client protection will be in the room/on the phone
- When in doubt, leave it out; it is easier to send follow-up correspondence than to claw back privilege after inadvertent disclosure

## Work Product Doctrine

- The work product doctrine is not a “privilege,” it is a tool of judicial administration that furthers the goals of fairness and convenience. *Hickman*, 329 U.S. 495
- In contrast to attorney-client privilege, this doctrine is a qualified protection intended to “preserve a zone of privacy in which a lawyer can prepare and develop legal theories and strategy ‘with an eye toward litigation’ free from unnecessary intrusion by his adversaries.” *United States v. Textron*, 577 F.3d 21 (1<sup>st</sup> Cir. 2009)(quoting *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998))



## Work Product Doctrine

- Does the work product doctrine apply to tax accrual workpapers?
  - The protection of tax accrual workpapers turns on whether they are prepared in “anticipation of litigation”
    - Two Courts of Appeal have addressed this issue:
      - Fifth Circuit – No protection because the primary purpose is not in anticipation of litigation
      - First Circuit – No protection because they are not prepared because of anticipation of litigation
    - The broader a court’s test for “anticipation of litigation” the more likely protection exists
- The safest approach is to assume that the workpapers are not protected

# *Kovel* Arrangements



**Extends attorney-client privilege to non-attorney consultants** – protects communications with an accountant retained by a client's attorneys to provide technical advice to help facilitate representation



**Between a client, an attorney, and the third party accountant** – generally, it must be clarified that the accountant's work will be performed under the direction of the attorney



**Establishing *Kovel* arrangements** - *Kovel* arrangements between attorneys and accountants should be properly documented and all formalities in implementing them must be respected

# Elements of *Kovel* Arrangement

## A non-legal professional hired by an attorney:

### To facilitate **legal services**

- For a particular client
- General, in-house work for firm or corporation not specific enough
- Need to show expert was an agent of the attorney

### by **translating, interpreting, or explaining**

- The rule applies to communications with a non-legal professional that has been engaged by the attorney
- The expert must be nearly indispensable—mere convenience not enough

## Establishing a *Kovel* Arrangement

Expert should have no prior contact with client

- For example, client's existing accountant or a corporation's in-house accounting firm may not be the best option
- Can be hard to prove the first element – that expert's sole role is facilitating legal services, rather than advising client
- If unavoidable, the expert must maintain separate files

*Kovel* engagement letter

- Establishing that the expert's relationship is solely with the attorney: paid by the lawyer, takes directions only from the lawyer
- The expert is necessary for effective representation
- Relationship exists for a specific named client

## Section 7525 Privilege

- Section 7525 provides a limited privilege to communications between a federally authorized tax practitioner and a taxpayer to the extent the communication would be considered privileged if it were between an attorney and a taxpayer
- No section 7525 privilege where there is no reasonable expectation of confidentiality
- Tax opinions are generally privileged *but* providing said opinion to a tax preparer may waive this privilege

# Application of Section 7525 Privilege



**Protects tax advice communications only** - advice given by a practitioner with respect to a matter which is within the scope of the tax practitioner's authority to practice



**Between a federally authorized tax practitioner and a client** - any individual authorized under federal law to practice before the IRS (lawyers, CPAs, in-house practitioners, etc.)



**Waiver** - Similar to the attorney-client privilege, if the communications are disclosed to others, the privilege can be waived.

## Limits to Section 7525 Privilege

- Applies in federal tax contexts (before IRS and federal courts in actions by or against the United States)
- Does not cover criminal tax matters
- Does not protect work product
- Does not apply to “written communications” in connection with the promotion of a “tax shelter”
- Privilege is waived if the communication is shared with any person outside the practitioner-client relationship

## Exceptions to Privilege - Waiver

- Privileges and protections can be waived in a number of ways
- Expressly or implicitly
- Intentionally or inadvertently
- Examples of waiver include:
  - Raising reasonable cause and good faith reliance as a penalty defense
  - Producing privileged information to an adversary
  - Cocktail party chatter: “What did your attorney recommend?”
  - Talking on your cell phone in public
  - Broadly sharing privileged information, *e.g.*, beyond those with a need to know



## Exceptions to Privilege - When can Privilege Be Punctured

- John Doe Summons
  - *Lohmeyer v. United States*
  
- Crime–fraud exception
  - Applies if a taxpayer attempts to obtain advice to further the commission of a crime or fraud

Privilege when  
working with  
attorneys

- What to know as a tax practitioner
- Circular 230 Rules

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## Reporting Considerations – Reportable Transactions

- Taxpayers that “participate” in a reportable transaction are generally required to file IRS Form 8886, *Reportable Transaction Disclosure Statement* with their return
  - Reportable transactions include:
    - Listed transactions;
    - Confidential transactions;
    - Transactions with contractual protection; and
    - Loss transactions.
  
- “Material advisors” with respect to a reportable transaction are required to file IRS Form 8918, *Material Advisor Disclosure Statement* (which is filed on a quarterly basis), disclosing:
  - The transaction;
  - Any potential tax benefits expected to result; and
  - Such other information required by the IRS.

## Reporting Considerations – DAC6

- DAC6 is a European Union (EU) information reporting regime applicable to certain cross-border transactions or arrangements that concern at least one EU member state
  - Transactions are reportable when certain hallmarks that point toward potential tax-avoidance are present – similar to the US reportable transactions regime
  - Reporting is required by intermediaries involved in such transactions (e.g., bankers, accountants and lawyers) and, in some cases, the taxpayer
  - Reportable transactions occurring between June 25, 2018 and June 30, 2020 must be reported by August 31, 2020 (i.e., retroactively) and thereafter on a current basis

# Reportable Transactions v DAC6: What gets Reported

Reportable Transactions		DAC6	
<b>1. Listed Transactions</b>	Transactions that the IRS has identified as having a tax-avoidance purpose	<b>Category A</b>	Generic hallmarks + main benefit test: arrangements that give rise to performance fees or involve mass-marketed schemes.
<b>2. Transactions of Interest</b>	Specific transactions that have the potential to be abusive	<b>Category B</b>	Specific hallmarks + main benefit test: Includes certain tax planning features, such as buying a loss-making company to exploit its losses or arrangements aimed at converting income into capital
<b>3. Confidential Transactions</b>	Transactions where the taxpayer pays \$250,000+ (or \$50,000 if an individual) and is offered under conditions of confidentiality	<b>Category C</b>	Specific hallmarks related to cross-border transactions: includes deductible cross-border payments between associated enterprises where the recipient is subject to no tax and double-claims for deductions for the same depreciation on an asset
<b>4. Contractually Protected Transactions</b>	Transactions where the taxpayer receives a refund if a certain tax benefit is not realized	<b>Category D</b>	Specific hallmarks concerning the automatic exchange of information and beneficial ownership
<b>5. Loss Transactions</b>	Transactions where a taxpayer claims a +\$10 mill loss under section 165 in a single taxable year (or \$20 million over multiple years)	<b>Category E</b>	Specific hallmarks concerning transfer pricing: includes use of unilateral safe harbors; the transfer of hard-to-value intangible assets

# Reportable Transactions v DAC6: Who Reports and When

US	DAC6
<p>Any taxpayer that participates in a reportable transaction and is required to file a federal tax return</p> <p>Material advisors with respect to a reportable transaction</p>	<p>All intermediaries (unless an intermediary has proof that the information has already been filed by another intermediary)</p> <p>Exceptions to reporting by intermediaries:            Non-EU Intermediary;            No Intermediary involved; or            Intermediary has the right to a waiver due to legal professional privilege</p> <p>If an exception applies, the relevant taxpayer must report</p>
<p>Taxpayer attaches Form 8886 to the tax return for year in which the taxpayer participated in a reportable transaction</p> <p>Material advisor files Form 8918 by the last day of the month following the end of the calendar quarter in which they became a material advisor with respect to the reportable transaction</p>	<p>Following date of implementation reporting is required within 30 days of the earliest of:</p> <ol style="list-style-type: none"> <li>1. The day after the reportable cross-border arrangement is made available for implementation;</li> <li>2. The day after the reportable cross-border arrangement is ready for implementation; or</li> <li>3. When the first step in the implementation of the reportable cross-border arrangement has been made.</li> </ol>

## Best Practices

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