Privileges for Accountants: Protecting Your Clients and Yourself
Agenda

- Federal Tax Practitioner Privilege: IRC 7525
- Attorney-Client Privilege & Kovel Engagements
- State Accountants’ Privileges
- Work Product Doctrine
- Responding to Subpoenas and Summons
Federal Tax Practitioner Privilege: IRC 7525
Federal Tax Practitioner Privilege

• Statutory privilege for federal tax practitioners
  ▪ Any “tax advice” communication between a taxpayer and a “federally authorized practitioner” is privileged to the same extent that it would be privileged if the communication were between a lawyer and client.
  ▪ I.R.C. § 7525

• Covers attorneys, CPAs, enrolled agents.
Federal Tax Practitioner Privilege

- Subject to limitations
  - Applies in federal tax contexts (before IRS and federal courts in actions by or against the United States).
  - Does not cover criminal 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.
Federal Tax Practitioner Privilege

• The definition of “tax advice” is unhelpful.
  ▪ Can be hard to distinguish between tax advice and accounting advice or tax return preparation services.

• “Legal advice” issues
  ▪ Tax advice is privileged to the extent it would be privileged if given by an attorney (i.e., if it is legal advice) but accountant cannot engage in “unauthorized practice of law.” So what protection does this provide?

• Advice must be confidential to be privileged.
Attorney-Client Privilege & Kovel Engagements
Attorney-Client Privilege

• Classic Definition of Attorney-Client Privilege
  1. where legal advice of any kind is sought
  2. from a professional legal advisor 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 advisor
  8. except the protection may be waived
Attorney-Client Privilege

• Key Elements of Attorney-Client Privilege:

  ▪ A party invoking the attorney-client privilege must demonstrate that there was (1) a communication between client and counsel that (2) was intended to be and was in fact kept confidential, and (3) was made for the purpose of obtaining or providing legal advice. *In re Cnty. of Erie*, 473 F.3d 413, 419 (2nd Cir.2007).

1. Lawyer/Client
2. Communication
3. Legal Advice
Elements: The “Communication” Requirement

• Protected communications
  - Communications from client
  - Communications from lawyer if they would reveal confidential communication from client or provide legal advice

• Underlying facts are not privileged.
  - A document does not become privileged merely because you send it to an attorney.
Elements: The “Legal Advice” and “Confidentiality” Requirements

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

- Tax return preparation documents prepared by lawyer/accountant not covered by attorney-client privilege.
  - IRS issued a summons to Frederick, who was a lawyer and accountant, for records of a client of Frederick. Frederick created most of the records for purposes of preparing the client’s tax returns and responding to audit requests.
  - “A taxpayer must not be allowed, by hiring a lawyer to do the work that an accountant . . . would do, to obtain greater protection from government investigators . . .”

- Documents prepared in connection with IRS audit also not covered by attorney-client privilege.
  - But issues of “statutory interpretation or case law . . . is lawyer’s work and the attorney-client privilege may attach”
Waiver of the Attorney-Client Privilege

• Waiver can occur if the confidential communication is disclosed to a third party.
  ▪ Waiver can occur even when the third party is under an obligation of confidentiality (e.g., auditors).
    ▪ Ann. 2010-76—If the taxpayer is eligible for the policy of restraint, IRS will not assert waiver for an otherwise privileged document disclosed to auditors.
  ▪ Waiver can occur even when the third party does not retain a copy.

• Compelled disclosure arguably does not waive the privilege if the compulsion is ordered by a court (administrative agency generally does not count).
Kovel Engagements

*United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961)

- A law firm specializing in tax hired an accountant to assist it in rendering legal advice to a client.

- Extended the attorney-client privilege to communications between a client and an accountant hired to assist the attorney in representing the client.
  - “What is vital to the privilege is that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer.”
Kovel Engagements

• The caveat to the Kovel rule is that the advice rendered must be that of the attorney, not the accountant.
  

  ▪ No privilege where in-house lawyer hired accountant to evaluate state income tax consequences of restructuring, but memo protected as work product. Comm'r of Rev. v. Comcast Corp., 901 N.E.2d 1185 (Mass. 2009).

• Draws “what may appear to some as an arbitrary line”
  
  ▪ Advice from accountant, who then obtains lawyer for legal service = Privilege does NOT apply
Kovel Engagements: Takeaways

• Consider having counsel engage the accountant where information gathering and analysis is for the purpose of assisting counsel in providing legal advice.

• Document how the accountant’s work will assist counsel in providing legal advice.

• Accountant should properly mark documents “prepared at the request of counsel” and segregate these files from other materials.

• Keep documents confidential.
State Accountant’s Privileges
State Accountant’s Privileges

• Federal Section 7525 privilege does not apply to state tax proceedings

• States take variety of approaches to adoption of accountant’s privilege:
  ▪ A majority of states recognize accountant’s privilege by statute
    ▪ California, Florida, Georgia, Idaho, Louisiana, Nevada, Oklahoma
    ▪ Some similar to federal Section 7525 privilege

• All states have ethical and professional obligation of confidentiality
State Accountant’s Privileges

• State approaches to accountant’s privilege (cont’d):
  
  ▪ Many states impose duty of confidentiality on accountants, but often unclear whether this creates evidentiary privilege.
    
    
  
  ▪ States with no statute at all generally do not recognize privilege.
    
    
    

• What state law applies?
Georgia’s Accountant-Client Privilege

• Accountant-Client Privilege Under O.C.G.A. § 43-3-29(b)
  - Protects as privileged “[a]ll communications between a certified public accountant or employee of such certified public accountant acting in the scope of such employment and the person for whom such certified public accountant or employee shall have made any audit or other investigation in a professional capacity and all information obtained by a certified public accountant or such an employee in his or her professional capacity concerning the business and affairs of clients”
  - “The purpose of the accountant-client privilege is to insure an atmosphere wherein the client will transmit all relevant information to his accountant without fear of any future disclosure in subsequent litigation. Without an atmosphere of confidentiality the client might withhold facts he considers unfavorable to this situation thus rending the accountant powerless to adequately perform the services he renders.” Gearhart v. Etheridge, 232 Ga. 638, 639-40 (1974).
Does the Accountant-Client Privilege Exist in Federal Court? Yes and No.

• The United States Supreme Court Says “No” Under Federal Law
  ▪ “[W]e note that no confidential accountant-client privilege exists under federal law, and no state created privilege has been recognized in federal cases.” Couch v. United States, 409 U.S. 322, 335 (1973); see also United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984); In re Int’l Horizons, Inc., 689 F.2d 996, 1004 (11th Cir. 1982).

• But if the Claim Arises Under State Law, Federal Courts Recognize the State’s Accountant-Client Privilege
  ▪ “But in a civil case, state law governs privilege regarding a claim or defense for which state law applies the rule of decision.” Fed. R. Evid. 501.

• And again, all states have ethical and professional obligation of confidentiality
Work Product Doctrine
Origin of the Work Product Doctrine

**Hickman v. Taylor, 329 U.S. 495 (1947)**

- Interrogatories requesting lawyer’s notes of interviews of tugboat accident survivors. No showing that witnesses were unavailable or other necessity.
- Supreme Court held that notes not discoverable absent necessity.
- “Discovery was hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary.”
Elements of Work Product Doctrine

- Set forth in Federal Rule of Civil Procedure 26(b)(3) but different than *Hickman* articulation.
- Protects documents which are “prepared in anticipation of litigation.”
  - Extends to documents created by non-lawyers (“by or for another party or by or for that other party’s representative”)
  - Opinions prepared by KPMG regarding tax consequences of transactions were protected as work product because taxpayer reasonably anticipated litigation with IRS. *U.S. v. Roxworthy*, 457 F.3d 590 (6th Cir. 2006)
Elements of Work Product Doctrine

• Qualified privilege
  ▪ Opinion Work Product
    ▪ Requests seeking opinion, strategies, etc.
    ▪ Virtually undiscoverable.
  ▪ Fact Work Product
    ▪ Requests for other documents, e.g., facts obtained from witnesses.
    ▪ Can be discovered if the requester establishes “substantial need” and cannot be obtained without “undue hardship.”
“In Anticipation of Litigation”

• “Because of” test (majority of circuits)
  ▪ Dual purpose documents (created for both business and litigation-related purposes) can still be work product. *United States v. Roxworthy*, 457 F.3d 690 (6th Cir. 2006).

• “Primary purpose” test (5th Circuit)
  ▪ “Primary motivating purpose” of creating document must be litigation.
State Work Product Doctrine

• Supplemental to the federal work product doctrine.
• State rules of civil procedure vary by state.
• Some state rules are more protective than federal work product doctrine (e.g., New York, California)
• Other state rules rely on the federal doctrine (e.g., District of Columbia)
Work Product Doctrine: Takeaways

• May apply to documents created by an accountant if prepared in anticipation of litigation.
  ▪ For documents prepared in anticipation of litigation, make this clear in the document.
  ▪ Mark documents from the beginning.
  ▪ Keep the document confidential.
Responding to Subpoenas & Summons
You’ve received a subpoena or summons to produce documents. Now what?

- Things to consider:
  - Who sent the subpoena? A private litigant? The IRS? A state department of revenue? The SEC?
  - What is the scope of the subpoena?
  - Is there an accountant/client privilege to assert?
  - Are there statutory confidentiality obligations to assert?
  - Are there ethical obligations of confidentiality to assert?
  - Whom should you contact?
Ethical Obligation to Maintain Confidentiality – Georgia Standard

• Georgia State Board of Accountancy Rules
  ▪ “A licensee shall not without the consent of his client disclose any confidential information pertaining to his client obtained in the course of performing professional services.” Ga. Comp. R. & Regs. rule 20-12-.11.

• Notable Restrictions on the Obligation to Maintain Confidentiality
  ▪ The rule does not affect an accountant’s obligation to comply with a validly issued subpoena or summons enforceable by order of a court (still best practice is to object and allow client opportunity to raise privilege).
  ▪ The rule does not preclude an accountant from responding to any inquiry by the Georgia Board of Accountancy or any investigative or disciplinary board established by law or formally recognized by the Georgia Board of Accountancy.
  ▪ Can use confidential information to defend against lawsuit by client.
Ethical Obligation to Maintain Confidentiality – AICPA Standard

- **AICPA Professional Standards, ET § 301.01**
  - “A member in public practice shall not disclose any confidential information without the specific consent of the client.”

- **Notable Restrictions on the Obligation to Maintain Confidentiality**
  - The rule does not affect an accountant’s obligation to comply with a validly issued subpoena or summons, or prohibit an accountant’s compliance with applicable laws and government regulations (still best practice is to object and allow client opportunity to raise privilege).
  - The rule does not preclude an accountant from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.
Responding to a Subpoena or Summons

- **Contact your client**
  - Even in the face of a subpoena or summons, you should seek your client’s consent before divulging any confidential materials.
  - Give your client the opportunity to object to the subpoena or summons and to assert any privilege claims they have.

- **Possible Objections**
  - Calls for the production of privileged or confidential material
  - Calls for the production of personal financial information
  - Calls for the production of the accountant’s proprietary (trade secret) materials
  - The subpoena or summons is overbroad, unduly burdensome, or oppressive

- **Objecting to subpoena or summons can have ancillary benefits**
  - Provides an opportunity to narrow the scope of the documents and material requested; and
  - Provides an opportunity to educate the judge on privilege and confidentiality issues.
Failing to Obtain Client Consent Before Disclosing Tax Return Information

- **I.R.C. § 7216**
  - Tax preparers who knowingly or recklessly disclose tax return information, or use tax return information for an impermissible purpose, are guilty of a misdemeanor and subject to a $1,000 fine or one year imprisonment, or both.
  - Treasury Regulations provide a list of permissible disclosures without the taxpayer’s consent. Treas. Reg. § 301.7216-2.
  - Tax preparers can disclose tax return information in the following circumstances
    - Order of any court of record
    - Subpoena issued by federal or state grand jury
    - Administrative order, demand, summons or subpoena issued by a federal agency, including the courts of the United States
    - Written request from a professional association ethics committee
    - Written request from the PCAOB in connection with an inspection under section 104 of the Sarbanes-Oxley Act of 2002
Failing to Obtain Client Consent Before Disclosing **Tax Return Information** (cont’d)

- Client’s consent under I.R.C. § 7216 must include the following pursuant to Treas. Reg. § 301.7216-3(a)(3)
  - Name of the tax return preparer and the name of the taxpayer
  - The intended purpose of the disclosure
  - The identity of the recipients of the tax return information
  - The particular use of the tax return information authorized
  - Specification of the tax return information to be disclosed or used by the return preparer
  - Dated signature of the taxpayer

- IRS mandates language that taxpayers’ consent must include in Rev. Proc. 2013-14.
Failing to Obtain Client Consent Before Disclosing Confidential Information

• Georgia State Board of Accountancy Rules, Ga. Comp. R. & Regs. r. 20-12-.11
  - “A licensee shall not without the consent of his client disclose any confidential information pertaining to his client obtained in the course of performing professional services.”

• AICPA Professional Standards, ET § 301.01
  - “A member in public practice shall not disclose any confidential information without the specific consent of the client.”

• Subject to disciplinary actions by either State Boards of Accountancy or the AICPA
Failing to Obtain Client Consent Before Disclosing Confidential Information (cont.)

• Client may sue you
Conclusion: Practical Tips

• Proactively consider privilege issues when dealing with client communications and documents
  ▪ Especially when future litigation is possible
• Mark privileged documents
• Before sharing documents, consider waiver issues
• Consider Kovel engagements where appropriate
• Contact your client (any perhaps a lawyer) if you receive a subpoena or summons
Questions?
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