THE FEDERAL TAX PRACTITIONER-CLIENT PRIVILEGE (I.R.C. SECTION 7525): A SHIELD TO CLOAK CONFIDENTIAL COMMUNICATION OR A DAGGER FOR BOTH THE PRACTITIONER AND THE CLIENT?

Phillip W. Gillet, Jr., M.S., J.D.[*]

In 1998, then President William Jefferson Clinton signed into law the Internal Revenue Service Restructuring and Reform Act of 1998 (Restructuring Act) (as codified in Title 26 of the United States Code). Initially, it appeared as though Section 7525 of the Restructuring Act extended the common law attorney-client privilege to federally authorized tax practitioners, such as CPAs and enrolled agents. However, after further examination, it appears as though the new privilege is far from a clear-cut extension of the attorney-client privilege. This uncertainty creates a privilege that is wrought with pitfalls for both the client and the federally authorized tax practitioner.

I. INTRODUCTION

Clients often choose to have a Certified Public Accountant (CPA) or an enrolled agent (EA) represent them in tax disputes. Should the client's communication with a tax practitioner be less protected than a communication between an attorney and the client concerning the same matter? On the surface, the recently enacted Internal Revenue Code (I.R.C.) Section 7525 apparently says, "No." Yet, after further analysis of this rather recent extension of the attorney-client privilege to federally authorized tax practitioners, the answer is "it depends."

On July 22, 1998, President Clinton signed into law the Internal Revenue Service Restructuring and Reform Act of 1998 (the "Restructuring Act").[1] One of the objectives of this legislation was to improve the IRS's efficiency and service to taxpayers.[2] The legislation laid out a "Taxpayer Bill of Rights" that attempted to arm the taxpayer with certain rights and protections.[3] One of the protections provided to taxpayers was to make "tax advice" between the taxpayer and a federally authorized tax practitioner,[4] such as a CPA or EA, privileged in federal forums.[5] The privilege specifically refers to the common law attorney-client privilege in its wording; however, this new federal "tax practitioner-client

---

[*] Adjunct Professor of business law and accounting, San Diego City College; tax associate for the Law Offices of James E. Schneider, LL.M., Inc., San Diego, California; Chief Operating Officer, American Community Renewal, Inc.; Chief Financial Officer, Gillet Trucking; President, MVP Sports Cards & Collectibles.

[1] Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-126, 112 Stat. 685 (as codified in Title 26 of the United States Code).

[2] H.R. REP. NO. 105-364, pt. 1, at 31(1997).

[3] *Id.*

[4] C.F.R. § 10.3 (1994) (commonly referred to as Circular No. 230) (allowing attorneys, certified public accountants, enrolled agents, and enrolled actuaries to practice before the Internal Revenue Service).

[5] I.R.C. § 7525 (2000).

privilege" appears limited when compared to the attorney-client privilege.

Courts in many jurisdictions have created a privilege for clients of accountants similar to that of the attorney-client privilege.[6] Unfortunately, these state-created accountant-client privileges govern in actions interpreting state law only, and are not applicable in federal criminal prosecutions,[7] usually those involving situations where federal jurisdiction is based on diversity of citizenship.[8] In addition, in an I.R.C. Section 7602 summons proceeding—a common way the IRS enforces a summons after a tax practitioner asserts that the information sought is privileged—the federal common law evidentiary privileges apply and state privileges are inapplicable.[9]

This paper seeks to analyze the federal tax practitioner-client privilege and rules of evidence relating to it. Although some parallel may exist between the state accountant-client privilege and the federal accountant-client privilege, the state-accountant privilege goes beyond the scope of this paper. Additionally, although many articles refer to I.R.C. Section 7525 as the "federal accountant-client privilege,"[10] this description is inaccurate because the privilege includes communication made to all federally authorized tax practitioners, including attorneys,[11] EAs, and enrolled actuaries. Furthermore, the description does not include all accountants, but only Certified Public Accountants. Any further references to the tax practitioner-client privilege in this paper are to the federal privilege as codified in I.R.C. Section 7525.

The Restructuring Act defines "tax advice" as "advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice . . ." and limits application of the tax practitioner-client privilege to situations where it can cloak communication that is "tax advice."[12] This vague and ambiguous definition will force the courts to decide where to draw the line between "tax advice" and "general accounting." Any advice outside of "tax ad-

---

[6] 33 A.L.R. 4TH 539, 545-46 (including Arizona, Colorado, Florida, Georgia, Illinois, Indiana, Louisiana, Maryland, New Mexico, and Pennsylvania).

[7] *See, e.g.,* United States v. Jaskiewicz, 278 F. Supp. 525, 530-31 (E.D. Pa. 1968); Hayes v. United States, 407 F.2d 189, 192 (5th Cir. 1969).

[8] 28 U.S.C.A. § 1332 (West 1993 & Supp. 2000) (WESTLAW).

[9] FED. R. EVID. 501 (West 2001); *see also* Couch v. United States, 409 U.S. 322, 335 (1973) (holding that no state-created privilege has been recognized in federal cases).

[10] Alicia K. Corcoran, Note, *The Accountant-Client Privilege: A Prescription for Confidentiality or Just a Placebo?,* 34 NEW ENG. L. REV. 697; *see also* Edward J. Schnee, *Accountant/Client Privilege*, 189 J. OF ACCT., Mar. 2000, at 78; Terry L. Lantry, *Be Careful What You Ask For, You May Get It: With the Client-Accountant Privilege You May Have Gotten Less Than You Thought*, 77 TAXES, June 1999, at 31 (1999); Therese LeBlanc, *Accountant-Client Privilege: The Effect of the IRS Restructuring and Reform Act of 1998,* 67 UMKC L. REV. 583 (1999); Alyson Petroni, *Unpacking the Accountant-Client Privilege Under I.R.C. Section 7525*, 18 VA. TAX REV. 843 (1999); Edward Brodsky, *The New Federal Accountant-Client Privilege*, 221 N.Y. L. J. 3 (1999).

[11] I.R.C. § 7525(a)(3)(A) (2000). The application to attorneys seems somewhat redundant and unnecessary. The statute merely extends the common law attorney-client privilege to federally authorized tax practitioners. Therefore, the only extension grated by this statute would be to attorney-accountants performing "accountant's work;" however, the courts have refused to make accountant's work privileged merely because it is performed by an attorney.

[12] *Id.* § (a)(3)(B).

vice" will not be privileged.

I.R.C. Section 7525(2) sets forth two limitations on the privilege. It may only be asserted in (1) non-criminal tax matters before the IRS; and (2) non-criminal proceedings in Federal Court brought by or against the United States. Therefore, in addition to the lack of corporate privilege, the vague construction and the broad exceptions of the statute leave several questions unanswered. For example, When and how is the privilege waived? How is "tax advice" defined? When does an IRS civil inquisition become criminal? Can the IRS circumvent the privilege by working around it? Does the privilege include the work product doctrine? Could a taxpayer suppress evidence obtained in violation of the privilege? The vaguely constructed statute begs the question whether the federal tax practitioner-client privilege will be interpreted narrowly, or as broadly as the common law attorney-client privilege.

The novelty of this newly recognized federal privilege, which only applies to communications occurring after the statute's enactment date of July 22, 1998, has yet not afforded the United States Supreme Court an opportunity for interpretation.[13] In addition, the inherent uncertainty in such a vaguely written and judicially uninterrupted statute leaves the tax practitioner-client privilege wrought with dangers for both the client and the practitioner. One thing that is clear is the scope of the privilege falls short of the protections afforded by the attorney-client privilege. This means that blanket protection is not provided. Therefore, this paper seeks to fully examine this privilege and its limitations, and in so doing, must analyze the history of the attorney-client privilege along with current law.

II. HISTORY OF THE ATTORNEY-CLIENT PRIVILEGE[14]

A comprehensive history of the federal courts' law of evidence has never been written; however, the structure of the new Federal Rules of Evidence makes a detailed knowledge of case law unnecessary.[15] The drafters of the new Federal Rules chose to build upon the states' rationalization and codification of the common law rules,[16] and therefore practitioners can disregard the federal precedents that do not have a constitutional basis.[17] A brief summary of the history of federal evidence might, however, allow practitioners to better understand the underlying framework that led to the current rules and may likely influence their interpretation.

The idea of privileged communications, and more specifically the attorney-

---

[13] Restructuring Act, s*upra* note 1, § 3411(c).

[14] Based largely on 21 CHARLES ALAN WRIGHT & KENNETH W. GRAHAM, JR., FED. PRAC. & PROC. EVID. § 5001 (1977).

[15] *Id.*

[16] *See generally id.* § 5006.

[17] Some examples of evidence with constitutionally-based exclusionary justifications are the Fifth Amendment prohibition against compulsory self-incrimination; the Fourth Amendment right against unreasonable searches and seizures; confessions and eye-witness identification violating the Sixth Amendment right to counsel; and confessions violating due process of the Fifth and Fourteenth Amendment.

client privilege, seems to have been firmly rooted and unquestioned as early as the reign of Elizabeth I in the early 1500s.[18] In fact, at least one U.S. court has called it the oldest of the privileges for confidential communications.[19] Given that witness testimony and testimonial compulsion, in the modern sense, were not common sources of proof in jury trials until the early 1500s, the privilege could not have come into practical use much sooner.[20] There would not have been much reason to assert its application before this period, and thus it appears that the attorney-client privilege has been a constant in modern Anglo-American jurisprudence.

The theory behind excluding privileged communication between the attorney and client was, however, much different in its formative days during the 1500s than it is today.[21] The original attorney-client privilege was the attorney's privilege to assert rather than the client's.[22] It was an objective privilege based upon the attorney's solemn pledge of secrecy, but by the end of the 18th century, this theory of privilege had fallen by the wayside.[23] Nevertheless, the judiciary and the bar saved the privilege by recognizing a new theory early in the 18th century.[24] This theory was based subjectively upon the "client's freedom from apprehension in consulting his legal adviser."[25] The two theories of privilege existed together for about half a century, and the original theory was totally eliminated by the last quarter of the 18th century.[26] Therefore, the newer policy of privilege based upon the client's subjective considerations has been plainly grounded since the latter part of the 1700s.[27]

The history of the United States' federal evidence law began in 1789 when Congress enacted a set of statutes characterized as "[a] lumpy mixture of theory and pragmatism, a set of vague and even conflicting general statutes together with a disparate group of specific regulations."[28] This set of statutes may have provided the basis for Congress's current trend to avoid the regulation of evidence because the statutes shifted evidentiary regulation to the courts. Another important development in the law of evidence occurred when Wigmore published his evidence treatise in 1904. This treatise still commands respect among scholars and the courts alike. His treatise did not merely reconcile the available legal precedents, he also embraced the sound common law rules that had been viewed less favorably among his contemporary American judiciary and bar. He used opinions from both great American and English judges to support the idea that the judiciary should control the admissibility of evidence. Wigmore urged that

---

[18] 8 WIGMORE, EVIDENCE § 2290 (McNaughton rev. 1961).
[19] Cox v. Adm'r U.S. Steel & Carnegie, 17 F.3d 1386, 1414 (11th Cir. 1994).
[20] WIGMORE, *supra* note 18.
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] WIGMORE, *supra* note 18 (emphasis omitted).
[26] *Id.*
[27] *Id.*
[28] WRIGHT & GRAHAM, *supra* note 14.

the notions of rationality and the rule of expertise, or "science" as he often called it, should control the procedure of courts rather than popular notions of justice.[29]

Two additional important events in federal evidentiary history took place in 1927. First, Frankfurter and Landis published *The Business of the Supreme Court*,[30] which was a collection of articles on the history of federal courts (all of which had previously appeared in the Harvard Law Review). Frankfurter and Landis's publication argued that the federal courts should control procedure because of its technical and non-partisan nature.[31] The second event to impact federal evidentiary history was the publication of a report by the Commonwealth Fund Committee to Propose Reforms in the Law of Evidence (Committee). [32] The Committee's judges and scholars, at work for seven years, made five broad proposals, although none were original and only the business records exception rule was widely adopted.[33] The report showed the Committee's use of Wigmore's rationality and "science," and several of their arguments relied on a crude application of modern day "cost-benefit analysis."[34]

Although the Committee's proposal was not widely adopted, its importance to the Federal Rules of Evidence should not be understated. The work was unique because its argument for reform was based on empirical research into the operation of trials. The long-range importance of this report was that it was the first step in this codification reform movement, which ultimately led to enacting the Federal Rules of Evidence.

III. APPLICATION OF THE ATTORNEY-CLIENT PRIVILEGE TO THE TAX PRACTITIONER-CLIENT PRIVILEGE

Federal Rule of Evidence 501 sets forth the general rules relating to privileged communications, including the federal attorney-client privilege. [35] When enacted, following Wigmore's and the Committee's recommendations, Rule 501 left the law of privileges in its present state and allowed the judiciary of the United States to develop the law further.[36] It states that privileges shall be "governed by the rules of the common law as they may be interpreted by the courts of the United States in the light of reason and experience [a standard derived from rule 26 of the Federal Rule of Criminal Procedure]."[37] The rule prevents the federal privileges from applying in "civil actions and proceedings, with respect to an element of a claim or defense as to which State law applies the rule of the deci-

---

[29] *See generally* WIGMORE, *supra* note 18.
[30] FELIX FRANKFURTER & JAMES M. LANDIS, THE BUSINESS OF THE SUPREME COURT: A STUDY IN THE FEDERAL JUDICIAL SYSTEM (1927).
[31] *Id.*
[32] MORGAN ET AL., THE LAW OF EVIDENCE: SOME PROPOSALS FOR ITS REFORM (Yale Univ. Press 1927).
[33] Business Records Act, 49 Stat. 1561.
[34] MORGAN, *supra* note 32, at 51-63.
[35] FED. R. EVID. 501.
[36] *Id.*
[37] *Id*.

sion . . . ."[38] Therefore, the federal privilege will apply in criminal and federal civil cases involving a federal question.[39]

The federal attorney-client privilege is summarized well in an often-quoted passage by Judge Wyzanski,[40]

> [T]he 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.[41]

For purposes of the attorney-client privilege, the communication must be between an attorney and his client.[42] The client need not actually pay fees or retain the attorney;[43] the communication will be considered privileged as long as the consultation was made in contemplation of hiring the attorney.[44] A "client" is a person, public officer,[45] corporation,[46] or other entity[47] that has consulted an attorney in a professional capacity.[48] The federal tax practitioner-client privilege specifically excludes advice regarding corporate tax shelters.[49] Therefore, given the broad definition of a tax shelter as "a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, arrangement, is the avoidance or evasion of Federal income tax,"[50] most if not all advice to a corporation would fall outside of this provision's protections.[51]

---

[38] *Id.*
[39] H.R. REP. NO. 93-1597; *see also* 28 U.S.C.A. § 1331 (2001).
[40] United States v. United States Shoe Mach. Corp., 89 F. Supp. 357, 358 (D.C. Mass. 1950).
[41] *Id.*
[42] *United States Shoe Mach.Corp*., *supra* note 40.
[43] United States v. Costanzo, 625 F.2d 465, 468 (3rd Cir. 1980); Westinghouse Elec. Corp. v. Kerr-McGee Corp., 580 F.2d 1311, 1317-18 (7th Cir. 1978); 8 WIGMORE, EVIDENCE § 2303 (McNaughton rev. 1961).
[44] 24 CHARLES ALAN WRIGHT & KENNETH W. GRAHAM, FEDERAL PRACTICE AND PROCEDURE § 5484 (1986).
[45] Hearn v. Rhay, 68 F.R.D. 574 (E.D. Wash. 1975); People By and Through Dept. of Public Works v. Glen Arms Estate, Inc., 230 Cal App. 2d 841 (Cal. Ct. App. 1964).
[46] *In re* Grand Jury 90-1, 758 F. Supp. 1411, 1412 (D. Colo. 1991).
[47] D.I. Chadbourne, Inc. v. Superior Court of City and County of San Francisco, 388 P.2d 700 (1964) (holding that artificial people have an equal opportunity to communicate with an attorney, without fear of disclosure).
[48] *In re* Grand Jury Matter No. 91-01386, 969 F. 2d 995 (11th Cir. 1992) (holding only confidential communications between attorney and client regarding the matter of representation are privileged).
[49] I.R.C. § 7525(b).
[50] I.R.C. § 6662(d)(2)(C)(iii).
[51] *See* Corcoran, *supra* note 10 (citing Douglas H. Frazer, *Don't Learn the Hard Way: How U.S. Limits Confidentiality of Tax Practitioners,* MILWAUKEE J. SENTINEL, Jan. 18, 1999, at 8.) *See also*

In addition, a representative of the client, such as an employee,[52] can communicate privileged information with an attorney. The definition of an attorney for privilege purposes includes persons reasonably believed to be so authorized.[53] Therefore, this would seem to include those believed to be a federally authorized tax practitioner. The privilege also attaches to communications between the attorney's representatives and the client.[54] The term "representative" is exceptionally broad. It can include secretaries, law students, paralegals, employees of the attorney's office, and professionals such as accountants or doctors whom the attorney uses in preparation of litigation.[55] Therefore, it would seem that federal authorized tax practitioner's representatives would be included within the tax practitioner-client privilege as well.

Any communication that was not intended to be disclosed to third persons, other than those necessary to provide legal services or transmit that communication, is privileged.[56] Courts have held persons such as spouses, parent, confidants, or business associates as necessary for legal services.[57] An unintentional disclosure, such as by an eavesdropper, does not waive the privilege, however, the presence of disinterested third parties would waive the privilege.[58] This sort of waiver would seem to apply to the tax-practitioner privilege.

The client exclusively holds the privilege.[59] Therefore, the client has the right to prevent disclosure by anyone. The attorney is under a legal and ethical duty not to disclose privileged communications to anyone, and must claim the privilege unless the client waives it.[60] The privilege may be claimed by a guardian or conservator if the client is not competent to claim it; a personal representative may claim the privilege after the client's death.[61] The attorney's ethical duty to assert the privilege on behalf of clients does not end when the attorney's services are terminated.[62] By extension, the client would seem to hold the tax practitioner-client privilege and the practitioner would seem to have an ethical duty to assert the privilege whenever disclosure of privileged information is requested.

For privilege purposes, "communications" include words, spoken and written, intended to convey a message.[63] In addition, acts, such as exhibition of

---

Elizabeth MacDonald, *Congress Seeks Better Shield for Corporate Tax Advice*, WALL ST. J., July 16, 1998, at C15; Darryl Van Duch, *Tax Shelters Abound Even With New Law*, NAT'L L. J., Oct. 26, 1998, at B1.

[52] Upjohn Co. v. United States, 449 U.S. 383, 394-96 (1981).

[53] WRIGHT & GRAHAM, *supra* note 14, § 5478.

[54] *Id.*

[55] *Id.*

[56] *United States Shoe Mach. Corp.*, *supra* note 40.

[57] WRIGHT & GRAHAM, *supra* note 14, § 5478.

[58] FED. R. EVID. 503(a)(5) (Proposed Preliminary Draft), 46 F.R.D. 161, 249.

[59] JOHN W. STRONG, MCCORMICK ON EVIDENCE § 92 (4th ed. 1992); Fisher v. United States, 425 U.S. 391, 402 (1976).

[60] *See, e.g.*, Cal. Bus. & Prof. Code § 6068 (requiring an attorney "[t]o maintain . . . the confidence . . . at every peril to himself to preserve the secrets of his client.").

[61] FED. R. EVID. 503(c), *supra* note 58.

[62] *Id.* (Advisory Committee's Note).

[63] United States v. Liebman, 742 F.2d 807, 810 (3d Cir. 1984).

physical characteristics or a gesture, are considered communication.[64] This broad definition of communication does not include information from third parties or witnesses.[65] Written documents created specifically to or from the client are privileged, however, preexisting written documents are not privileged.[66] This broad definition of communications would seem to follow for the tax practitioner-client privilege.

In addition, communications must be for the purpose of obtaining legal services.[67] Consultation of a lawyer in the role of business adviser, friend, or confidant is not within the privilege.[68] Statements made to an attorney outside the scope of legal advice or services (such as fee arrangements) would not be privileged.[69] This same exception applies to tax practitioners. The courts have held that tax return information is not privileged regardless of the status of the preparer.[70] The most important aspect of this rule is that communications to parties other than the lawyer are not privileged unless they are made for the purpose of obtaining legal advice for the client.[71] Communications between or among any protected parties are privileged.[72] The attorney's statements are protected because in a conversation each party may assume the other's language. The same would seem to hold true for tax practitioners.

IV. EXCEPTIONS TO THE ATTORNEY-CLIENT PRIVILEGE

Given that the statute governing the federal tax practitioner-client privilege specifically cites to the common-law attorney-client privilege, any exception inherent in the attorney-client privilege would seem to be an exception to the tax practitioner-client privilege as well. For example, any communication made to plan or perpetrate a future crime or fraudulent act does not fall within the attorney-client privilege,[73] but discussions of past fraud or crimes for the purpose of defending the individual are covered.[74] Any party seeking to introduce the evidence relating to this exception must show a crime or fraud.[75] The exception could be broadened in the tax practitioner-client privilege context to include

---

[64] FED. R. EVID. 503(a)(5), *supra* note 58.
[65] *Id.*
[66] *Id.*
[67] *Id.*
[68] *Id.*
[69] *In re* Grand Jury Investigation No. 83-2-35, 723 F.2d 447, 452 (6th Cir. 1983), *cert. denied*, 467 U.S. 1246 (1984); Laflin v. Herrington, 66 U.S. 326, 339 (1861).
[70] United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999), *cert. denied*, 528 U.S. 1154 (2000).
[71] FED. R. EVID. 503(a)(5), *supra* note 58.
[72] Examples of such communications are discussions between the client and the attorney's representative, the attorney and his representative, and any conversations among them all.
[73] Examples of such communications are discussions where an attorney condones perjury, or where an attorney gives advice on how to cover up a crime. *See, e.g.*, United States v. Zolin, 491 U.S. 554, 565 (1989) (recognizing crime fraud exception); Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 354 (1985) (planning or commission of ongoing fraud); Clark v. United States, 289 U.S. 1, 13-14 (1933) (furtherance of fraud).
[74] FED. R. EVID. 503(d)(1), *supra* note 58.
[75] *Id.*

those discussions relating to taking aggressive or fraudulent positions. This application would seem to frustrate Congress's purpose in enacting the privilege; however, given strict construction of statutes relating to privileges, conversations concerning aggressive or fraudulent tax positions would seem to fall outside the privilege.

V. THE NEW PRIVILEGE LEAVES SEVERAL QUESTIONS UNANSWERED

A. United States v. Frederick[76]

Given the novelty of I.R.C. Section 7525, the Seventh Circuit's opinion in *Frederick*, written by renowned legal scholar Chief Judge Richard Posner, provides one of only two published appellant decisions interpreting I.R.C. Section 7525.[77] Although both decisions mentioned I.R.C. Section 7525, the statute applied to neither because the communications in question occurred before the statute went into effect.[78] Frederick, an accountant-attorney, providing both tax return preparation and legal services to his client, contested an IRS summons ordering him to hand over hundreds of documents relating to an IRS tax return investigation.[79] Frederick asserted that these documents were both privileged and subject to the work-product privilege.[80] Posner, writing for the majority, held that documents created for both tax returns and litigation are not within the scope of the attorney-client or the new tax practitioner-client privilege.[81] In addition, the court held that unprivileged work normally performed by an accountant would not become privileged merely because an attorney performed it instead.[82]

B. When and how is the privilege waived?

The issue of when and how the tax practitioner-client privilege is waived is rather difficult to determine. The statute is silent as to this issue and therefore, it has been left largely to the judiciary to further define the law. At least one court has held that a state accountant-client privilege is waived when joint clients retain an accountant.[83] In contrast, the attorney-client privilege is less limited between joint clients; it is waived with respect to the secondary client, but not to anyone else. [84]

Partnerships also appear to be less protected under the accountant-client

---

[76] *Frederick*, *supra* note 70.
[77] *Id.*; United States v. Randall, 194 F.R.D. 369 (D. Mass 1999).
[78] *Id.*
[79] *Frederick*, *supra* note 70, at 499.
[80] *Id.*
[81] *Id.* at 502.
[82] *Id.*
[83] Harwood v. Randolph Harwood, Inc., 333 N.W.2d 609 (Mich. App. 1983). *See also* Transmark, U.S.A. v. Department of Ins., 631 So. 2d 1112, 1116 (Fla. App. 1994) (holding that privilege does not apply between joint clients, however, it still applies to all outside parties).
[84] *Id.*

privilege. At least one court has held that a partnership's financial documents possessed by an accounting firm are not protected by the accountant-client privilege.[85] Certified Public Accountants functioning as directors of companies have also been held outside the accountant-client privilege's protections.[86] In addition, another state privilege case reasoned that an assertion of reliance upon a CPA's audit and report as a defense serves as a waiver of the privilege.[87] Furthermore, one court held that the privilege is waived by a defendant taking the stand and stating that his accountant could testify.[88] Finally, one court found that an accountant, acting within his scope of employment and authority, giving an estimate of the taxpayer's cash reserves to a government agent, was acting as an authorized agent.[89] A taxpayer is prevented from claiming, under I.R.C. Section 6103, that their tax returns are confidential for the years in question once legal action is commenced that puts the taxpayer's earnings at issue.[90] Therefore, the accountant's disclosure of such information results in a waiver of the privilege by the taxpayer. Thus, the courts appear to allow waiver of the accountant-client privilege more liberally than the attorney-client privilege.

The development of this law should prove interesting. *Frederick* can be read as transferring the attorney-client privilege with the statute's express limitations to tax practitioners. If the statute is interpreted this way, then the tax practitioner-client privilege will be nearly as powerful as the attorney-client privilege. On the other hand, should the courts decide that this privilege is more like the state accountant privilege, then it appears that the tax practitioner-client privilege provides less protection than the attorney-client privilege. The IRS could also force a waiver of the privilege. The "subject matter doctrine" makes disclosure of any portion of non-privileged information to a third-party a waiver of the privilege for all the information.[91] Therefore, by extension, an accountant attempting to resolve a matter with the IRS by disclosing some information would be effectively waiving the privilege for all information the accountant possesses concerning that client.

Given the lack of direction in I.R.C. Section 7525, the waiver of the privilege could result from a number of actions, some still unidentified. Therefore, practitioners should be careful not to waive the privilege as this could result in malpractice suits. As this can be especially difficult to predict, practitioners may wish to seek legal assistance to effectively determine an appropriate course of action.

---

[85] *See* Nashville City Bank & Trust Co. v. Reliable Tractor, Inc., 90 F.R.D. 709, 711-12 (M.D. Ga. 1981) (extending Florida's and Georgia's exception to the accountant-client privilege for actions where members of a partnership are adverse parties).
[86] Pattie Lea, Inc. v. District Ct. of Denver, 423 P.2d 27, 30 (Colo. 1967).
[87] Savino v. Luciano, 92 So. 2d 817, 819 (Fla. 1957).
[88] Louisiana v. McKinnon, 317 So. 2d 184, 188 (La. 1975).
[89] Hayes v. United States, 407 F.2d 189, 192 (5th Cir. 1969).
[90] Tollefsen v. Phillips, 16 F.R.D. 348, 349 (Mass. Dist. Ct. 1953).
[91] *See generally* I.R.C. § 7525.

C. What is tax advice?

I.R.C. Section 7525(a)(3)(B) reads, "[t]he term 'tax advice' means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice [as] described [in section 330 of title 31, United States Code.]" Therefore, given the lack of clarity in defining what is privileged, Congress has left it up to the judiciary to define what constitutes "tax advice."

The federal courts have construed privileges in tax cases rather narrowly. In *Couch v. United States,*[92] the United States Supreme Court wrote in dicta that whether or not federal courts recognize an accountant-client privilege, a taxpayer has no reasonable expectation of privacy in information transmitted to an accountant for disclosure on tax returns.[93] The Seventh Circuit Court of Appeals wrote in dicta that a federally authorized tax practitioner's work was not protected when doing non-lawyer's work.[94] Therefore, it seems that documents obtained while doing work traditionally within the domain of accountants is not privileged.[95]

D. When does an IRS civil inquisition become criminal?

Some practitioners using I.R.C. Section 7525 have argued that communications between tax practitioners and their clients during, or with respect to, civil inquisitions are protected communications, even when later criminal tax matters or proceedings are brought forth.[96] Although there have been no published judicial opinions as of this date, the IRS has taken the position that all communications, even those occurring before the matter becomes criminal, are not privileged once the case turns criminal.[97]

Additionally, no case defines at what point the IRS crosses the criminal line for the federal tax practitioner-client privilege purposes. However, a number of cases interpreting state statutes recognize that the accountant-client privilege may provide some guidance. Virtually all cases interpreting state statutes hold that these statutes do not modify the criminal law, and most cases have admitted all communication made by the client to the accountant.[98] Exactly when and how a matter becomes criminal is difficult to determine because of the tax enforcement

---

[92] 409 U.S. 322 (1973).
[93] *Id.* at 335-36.
[94] *Frederick*, *supra* note 70.
[95] *See In Re* Fisher, 51 F.2d 424, 425 (N.D.N.Y. 1931) (holding that information gained for making financial statements and other accounting work are not privileged); *see also* United States v. Chin Lim Mow, 12 F.R.D 433, 434 (N.D. Cal. 1952) (finding that information obtained by an accountant-attorney acting in accounting capacity is not privileged); United States v. Pizzo, 260 F. Supp. 216, 221 (S.D.N.Y. 1966) (concluding papers incident to returns are primarily of an accounting nature and are not privileged); United States v. Schoeberlin, 335 F. Supp. 1048, 1057-58 (D. Md. 1971) (requiring disclosure of documents created in an accounting capacity).
[96] Internal Revenue Service (I.R.S.) Litigation Bulletin 200017,039, 2000 WL 1874048 (IRS LB).
[97] *Id.*
[98] United States v. Culver, 224 F. Supp. 419, 434 (D. Md. 1963); State v. O'Brien, 601 P.2d 341 (Ariz. Ct. App. 1979); *In Re* Hall Country Grand Jury Proceedings, 333 S.E.2d 389 (Ga. Ct. App. 1985), *cert. vacated* 338 S.E.2d 864 (Ga. 1985); *In Re* Special Investigation # 202, 452 A.2d 458, 462 (Md. Ct. Spec. App. 1982).

system that inherently intertwines civil and criminal investigations. Therefore, it seems that the courts have broadly construed the point at which a tax matter becomes criminal. Further, it appears that all information concerning this matter, even communications occurring before the matter became criminal, would lose the privilege. This conclusion is consistent with the IRS's opinion as expressed in a memorandum by the Los Angeles District Counsel.[99]

E. Can the IRS circumvent the privilege?

The IRS could attempt to circumvent the privilege created by I.R.C. Section 7525 because it would not protect communication in disputes in state courts, or with other regulatory bodies like the SEC, state boards of accountancy, or state taxing authorities.[100] Given that state taxing authorities (e.g., California Rev. & Tax Code §§ 19542-64) often share information with the IRS,[101] this privilege could be circumvented by obtaining the privileged information from those state authorities or other federal regulatory agencies.[102] Thus, arguably, it has been left to the judiciary to decide when, if at all, the IRS may circumvent the privilege.

The IRS is an administrative agency because it is "[a]n authority of the Government of the United States" and not of Congress, the courts, or a military authority.[103] Although the IRS is not subject to control by Congress, the President, and/or the courts, it is subject to general administrative law, both statutory and decisional. Administrative law can generally be viewed as law defining what administrative agencies cannot do.[104] In addition, all administrative power is derived from statutory authority, either expressly or implicitly.[105] The judiciary and Congress combine to keep the IRS within their scope of statutory authority, by use of the doctrine of *ultra vires.*[106] Under this doctrine, courts will hold actions of an administrative agency that are outside of Congress's express intent as outside the power delegated.[107]

Therefore, although not crystal clear, it appears as though given the lack of Congress's express intent to allow the IRS to circumvent the privilege, the courts could certainly find that these type of actions would be outside the scope of authority granted by Congress. To find otherwise would make the privilege susceptible to many more exemptions than Congress contemplated, thus frustrating

---

[99] I.R.S. Litigation Bulletin, *supra* note 96.
[100] For disclosure requirements and exceptions, *see generally* I.R.C. § 6103; *see also* Corcoran, *supra* note 10.
[101] I.R.C. § 6103(d) (2000).
[102] I.R.C. § 6103(h) & (i) (2000); McQueen v. United States, 5 F. Supp. 2d 473, 487 (S.D. Tex. 1998) (allowing disclosure of federal return information to the Department of Justice to help IRS obtain search warrant.)
[103] 5 U.S.C. § 551(1) (1994).
[104] MICHAEL I. SALTZMAN, IRS PRAC. & PROC. ¶ 1.03 (Student 2nd ed. 1991).
[105] *Id.*
[106] *Ultra vires* is defined as any action "[u]nauthorized; beyond the scope of power allowed or granted by a corporate charter or by law." BLACK'S LAW DICTIONARY 1525 (7th ed. 1999).
[107] SALTZMAN, *supra* note 104.

Congress's purpose in enacting I.R.C. Section 7525 and making it a weak privilege indeed.

F. Does the privilege include the work-product privilege?

Materials prepared by attorneys that do not incorporate communications from the client cannot be protected under the attorney-client privilege.[108] The Supreme Court has stated that "[a]t its core, the work-product privilege shelters the mental processes of the attorney, providing a privileged area within which he can analyze and prepare his client's case."[109] Posner asserts that the work-product privilege is best understood as the use of secrecy to protect the attorney's investment in research.[110] In *Frederick*, Posner wrote that "[t]he work-product privilege is intended to prevent a litigant from taking a free ride on the research and thinking of his opponent's lawyer and to avoid the resulting deterrent to a lawyer's committing his thoughts to paper."[111] Therefore, the same economic justification could extend the work product privilege to the tax practitioner-client privilege, however, the courts have not followed such reasoning.[112]

At least one compelling argument for not extending the work-product doctrine to the tax practitioner-client privilege is that I.R.C. Section 7525 does not mention it. There is an overriding concern to interpret statutes in derogation of common law strictly,[113] and evidence of this intent must be clearly expressed in the statute.[114] Generally, in order to justify privileges, the cost of evidence suppression must be outweighed by a countervailing policy.[115] Given the unfavorable treatment the state accountant-client privilege has received and the lack of mention in I.R.C. Section 7525, the extension of the work-product doctrine to tax practitioners would not seem likely.

In addition to I.R.C. Section 7525's silence regarding the work-product doctrine, a number of federal courts have denied extension of the work-product doctrine to accountants.[116] Notably, in *United States v. Arthur Young & Co.* the Su-

---

[108] FED. R. EVID. 503, *supra* note 58.

[109] Hickman v. Taylor, 329 U.S. 495, 510-11 (1947); United States v. Nobles, 422 U.S. 225, 238 (1975).

[110] RICHARD A. POSNER, THE ECONOMICS OF JUSTICE 244 (Harvard Univ. Press 1983).

[111] *Frederick*, *supra* note 70, at 500.

[112] *See id.* at 502 (refusing to extend the work-product privilege for dual-purpose documents (work papers) created in preparation for tax audits, returns, and litigation).

[113] American Cas. Co. v. M.S.L. Indus., Inc., Howard Indus. Div., 406 F.2d 1219, 1221 (7th Cir. 1969); Charney v. Thomas, 372 F.2d 97, 99 (6th Cir. 1967).

[114] United States v. Tilleraas, 709 F.2d 1088, 1092 (6th Cir. 1983); United States v. Mead, 426 F.2d 118, 123 (9th Cir. 1970).

[115] POSNER, *supra* note 110, at 283.

[116] *Frederick*, *supra* note 70, at 500; *see also* United States v. El Paso Co., 682 F.2d 530, 540 (5th Cir. 1982) (rejecting the application of the work-product doctrine to a tax pool analysis prepared by in-house counsel to support tax contingency on the corporation's balance sheet); *In re* International Horizons Inc., 689 F.2d 996, 1005 (11th Cir. 1982) (requiring disclosure of accountant-client communications to federal agencies based on significant federal policies); William T. Thompson Co. v. General Nutrition Corp., 671 F.2d 100, 103-04 (3rd Cir. 1982) (deciding that state accountant-client privilege does not trump the federal law not recognizing accountant privilege when a case involves both federal and state law claims); FTC v. St. Regis Paper Co., 304 F.2d 731,

preme Court recognized a limited accountant work-product privilege, but noted that the work-product would not be privileged in situations where the corporate records were otherwise unavailable.[117] Much discussion among commentators followed this decision.[118] While many commentators criticized the *Arthur Young* decision for not adopting an accountant-client privilege, several federal courts and at least one commentator found these arguments less than compelling.[119] In addition, several federal courts have since distanced or criticized the *Arthur Young* decision.[120] Thus, following this judicial trend, it is unlikely that a court will create a work product doctrine in the tax practitioner-client privilege.

G. Could a taxpayer suppress evidence obtained in violation of the privilege?

The Federal Rules of Evidence, except for privileges, do not apply to administrative hearings.[121] Therefore, absent some other law or doctrine, the IRS could theoretically introduce evidence that would otherwise be protected by a privilege. Administrative agencies are, however, required to comply with their own rules entitling a party to some procedural safeguard or substantial benefit.[122] Specifically, the *Accardi* doctrine,[123] a rule of administrative law, has been applied in tax cases.[124] In *Accardi*, the Supreme Court held that as long as regulations of the attorney general remained in force, the attorney general did not have the authority to exercise the discretion delegated to the board, even though he had original authority and could reassert if by amending the regulations.[125] Although the *Accardi* doctrine is an administrative rule, it also rests on "due process principles where the rights of individuals are affected by an agency's failure to observe rules promulgated for their protection."[126] This doctrine would support the idea that evidence obtained in violation of I.R.C. Section 7525 would be suppressed.

---

734 (7th Cir. 1962) (valuing the federal investigatory function significantly more than the state accountant-client privilege); SEC v. Coopers & Lybrand, 98 F.R.D. 414, 415 (S.D. Fla. 1982).

[117] 465 U.S. 805 (1984).

[118] *See* Frank J. Magill, Jr., *The Accountant-Client Work Product Privilege: United States v. Arthur Young & Co.*, TAX LAW. 457, 465 (1985) (criticizing the Court for merely adopting the IRS's position and failing to appreciate auditors' concerns); *see also* James A. Doering, Note, *Taxation-Creation of an Accountant Work-Product Privilege for Tax Accrual Workpapers: United States v. Arthur Young & Co., 104 S. Ct. 1495 (1984).*, 68 MARQ. L. REV. 155, 172 (1984) (requesting enactment of a statutory work-product privilege).

[119] Lester B. Herzog, *Protection of the Independent Audit Process: The Second Circuit Adopts a Limited Accountant's Work-Product Privilege*, 49 BROOK. L. REV. 1061, 1082-84 (1983).

[120] *Id.*

[121] *See generally* FED. R. EVID. 501.

[122] *See* United States v. Nixon, 418 U.S. 683, 696 (1974) (allowing Special Prosecutor the power to contest claim of executive privilege having force of law based upon Justice Department regulation); *see also* United States *ex rel.* Accardi v. Shaughnessy, 347 U.S. 260, 267 (1954); Vitarelli v. Seaton, 359 U.S. 535, 539-40 (1959).

[123] United States ex rel. Accardi v. Shaughnessy, 347 U.S. 260 (1954).

[124] For a more detailed discussion of this topic, see Saltzman, *supra* note 104, ¶ 1.06[3].

[125] *Id.* at 1-51.

[126] *Id.*at 1-52.

H. What is the proper procedure for asserting the tax practitioner-client privilege?

The practitioner asserting the newly created privilege has an uphill battle, as attorneys asserting the attorney-client privilege in tax cases have found. It appears as though the proper procedure for asserting the privilege would be the same as that of the attorney-client privilege. Thus, the proper procedure for asserting the privilege will depend upon the circumstances of the case, namely, the nature of the proceeding and whether or not the IRS has obtained the information requested.

If the client has already disclosed the information, the practitioner must assert the privilege as well as any other objections. This seems to be an especially daunting task for non-attorneys. In a case where the taxpayer has already been indicted, then a motion to suppress is the proper course of action (presumably, an attorney would have been retained).[127] Finally, a proactive course could be taken when waiting for an indictment. Counsel for the taxpayer and/or practitioner could bring independent civil proceedings in federal district court, joining the United States Attorney and the United States and seek injunctive relief restraining the use of the privileged evidence in any criminal prosecution against the taxpayer.[128]

A common procedure in federal tax investigations is to summon the tax preparer to appear before an IRS agent. An attorney is able to assert the attorney-client privilege at that point.[129] Therefore, a federally authorized practitioner should be able to do the same with Section 7525's privilege. In addition, the proper procedure for raising the attorney-client privilege under the provisions of the summons power of I.R.C. Section 7602 is to appear and refuse to testify regarding the privileged matters.[130] The IRS must then go to the federal district court requesting a summons compelling the attorney to appear and testify.[131] Obviously, counsel should appear at that hearing and again assert the privilege.[132] The same procedures should be proper for tax practitioners in I.R.C. Section 7602 summons proceedings as well. The obvious difference is that a non-attorney tax practitioner and/or the client should be represented by counsel.

III. CONCLUSION

Under federal law, the courts have held that they do not recognize an accountant-client privilege,[133] however, the Advisory Committee Notes to Federal Rule of Evidence 501 state "that the recognition of a privilege based on a confi-

---

[127] FED. R. CRIM. P. 12(b)(3) (West 2001).
[128] United States v. Schlegel, 313 F. Supp. 177, 178 (D.C. Neb. 1970).
[129] Tillotson v. Boughner, 350 F.2d 663 (7th Cir. 1965).
[130] Annotation, *What Matters Are Protected by Attorney-Client Privilege or are Proper Subject of Inquiry by Internal Revenue Service Where Attorney Summoned in Connection with Taxpayer-Client Under Federal Tax Examination*, 15 A.L.R. FED. 771 (1973).
[131] I.R.C. § 7602(a)(2) (West 2001).
[132] 15 A.L.R. FED. 771, *supra* note 130, at n.11.
[133] United States v. El Paso Co., 682 F.2d 530 (5th Cir. 1982), *cert. denied*, 104 S. Ct. 1927 (1984).

dential relationship and other privileges should be determined on a case by case basis."[134] Congress's enactment of the tax practitioner-client privilege trumps the rather outdated court cases disallowing a federal accountant-client privilege. In the state accountant-client privilege cases, the judiciary has read those statutes very narrowly. This should come as no surprise. It seems as though the foxes are guarding the hen house, and will likely keep as much of the bounty for themselves as possible. In an era when accountants are increasingly pursuing multidisciplinary practice, which upsets most members of the bar and judiciary, the courts are likely to interpret I.R.C. Section 7525 narrowly. Statutes creating privileges are strongly discouraged in federal practice.[135] In addition, statutes concerning privileges are to be strictly construed to avoid a construction suppressing otherwise competent evidence.[136]

Frederick has provided some guidance of how courts may interpret I.R.C. Section 7525. Following *Frederick*, it seems as though the newly created tax practitioner-client privilege protects federally authorized practitioners' work that would be privileged when done by an attorney. This proposition should be taken with a grain of salt. First, while *Frederick* is persuasive because it is a well-written opinion by renowned legal scholar Richard Posner, it is only binding on the federal courts in the Seventh Circuit. In addition, the Supreme Court could overrule *Frederick* in a subsequent case.

In conclusion, the inherently vague and gapping exceptions of the federal tax practitioner-client privilege along with the federal courts' long-standing policy of construing statutes relating to privileges rather narrowly and the seemingly dim view of accountant-client privileges, make the tax practitioner-client privilege very unpredictable and wrought with potential liability on the part of the tax practitioner for waiving it. Federally authorized tax practitioners would be well advised to inform their clients of these limitations and the lack of communication cloaking that the tax practitioner-privilege provides when compared to the attorney-client privilege. It behooves tax practitioners to advise their clients that despite this privilege and its purpose, they cannot speak as freely with their federally authorized tax adviser as they would with their attorney.

---

[134] FED. R. EVID. 501; *see also* Trammel v. U.S., 445 U.S. 40, 47-48 (1980) (recognizing that in rejecting the proposed rules and enacting Rule 501, Congress manifested its intention to provide the courts the opportunity to develop the rules of privilege).

[135] ACLU of Mississippi v. Finch, 638 F.2d 1336, 1344 (5th Cir. 1981).

[136] Baldrige v. Shapiro, 455 U.S. 345, 360 (1982).