ATTORNEY-CLIENT PRIVILEGE EXTENDS TO ACCOUNTANTS RETAINED BY LEGAL COUNSEL

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INTRODUCTION

The attorney-client privilege is a common law concept that dates back several centuries. The privilege protects information disclosed by the client to the attorney for the purpose of obtaining legal advice. Over time this concept has been extended to include communications to third parties retained by legal counsel to assist the attorney in providing legal advice.

SCOPE OF THE ATTORNEY-CLIENT PRIVILEGE

The seminal case is *U.S. v. Kovel*,[1] where the court extended the attorney-client privilege to cover client communications to an accountant engaged by legal counsel to assist on the case. Information was provided on a confidential basis by the client directly to the accountant. The U.S. government unsuccessfully sought access to the communication, contending that legal privilege did not extend to communications with an accountant. The court held that attorney-client privilege applied because the disclosures were made in confidence for the purpose of obtaining legal advice from legal counsel.

The attorney-client privilege belongs to the client, not the attorney. Consequently, when the privilege is attacked by an opposing party, such as the I.R.S. criminal investigation division, the privilege must be asserted by the client. Moreover, it is not always easy to identify the client, especially in a corporate setting.

Before the decision in *Upjohn v. U.S.*,[2] courts held that the privilege applied only to communications between counsel and those employees within the corporation's "control group."[3] In *Upjohn v. U.S.*, the Supreme Court determined that the privilege protects information given to counsel by employees to enable counsel to give the corporate client sound and informed advice. Consequently, certain communications by middle-level and lower-level employees are also protected by the privilege, because these employees may have information necessary for legal counsel to adequately advise the client regarding actual or potential legal difficulties.

For a client to assert the attorney-client privilege, the parties to the communication in question must bear the relationship of attorney and client, and the attorney must have been engaged or consulted by the client for the purpose of rendering legal

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1 *U.S. v. Kovel*, 296 F.2d 918, 921–22 (2nd Cir. 1961).

2 *Upjohn Co. v. U.S.*, 449 US 383 (1981).

3 *Philadelphia v. Westinghouse Elec. Corp.*, 210 F. Supp. 483 (ED Pa.1962).

services or advice.[4] Therefore, if an attorney is hired for any other purposes, the attorney-client privilege will not apply. [5]

"The attorney-client privilege belongs to the client, not the attorney."

The privilege can be waived. Generally, if the privileged information is communicated to someone outside the scope of attorney-client privilege then the privilege is waived. Both the client and the attorney should be careful when disclosing the privileged information, so as to not waive the privilege.

TAX PREPARER PRIVILEGE

Initially, in tax matters, advice received by a taxpayer from a non-attorney did not benefit from privilege. As a result, communications from a taxpayer's accountants, whether in the form of a planning memorandum, discussions of various options, or audit work papers relating to a tax provision, were subject to disclosure to the I.R.S. This was changed by the I.R.S. Restructuring and Reform Act of 1998 (the "Act"), which extended a form of client privilege to any communications between a taxpayer and a Federally authorized nonlawyer representative. The Act provides that with respect to any tax advice, the same common law protections of confidentiality that apply to a communication between a taxpayer and an attorney would also apply to a communication between a taxpayer and any Federally authorized tax practitioner, to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.[6] In addition to licensed attorneys, Federally authorized tax practitioners include C.P.A.'s, enrolled agents, and enrolled actuaries authorized to practice before the I.R.S. This extension of privilege may only be asserted in noncriminal tax proceedings before the I.R.S. and in Federal courts, such as the Tax Court, the Claims Court, and Federal district courts.[7]

I.R.S. ATTACKS ON CLAIMS OF PRIVILEGE

The availability of the common-law privilege to a third party has been heavily litigated. The basic concept of privilege is to safeguard the communications between an attorney and a client to encourage disclosures that will facilitate the client's compliance with law and better enable the attorney to present legitimate arguments when litigation arises.[8] In *Kovel*,[9] the court analogized an accountant retained by legal counsel to assist in providing competent legal advice to an interpreter retained by legal counsel for purposes of assisting in communication with a client not fluent in English:

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4 *Diversified Indus., Inc. v. Meredith*, 572 F2d 602 (where a law firm conducting an investigation was held to be acting in legal capacity).

5 *Coulton*, 201 F. Supp. 13, 16 (SDNY 1961), aff'd, 306 F2d 633 (2d Cir. 1962), cert. denied, 371 US 951 (1963) (where the attorney was hired to act solely as an accountant); *JP Foley Co. v. Vanderbilt*, 65 FRD 523, 526 (SDNY 1974) (where the attorney was hired to act only as a negotiator or business agent).

6 Code §7525(a)(1).

7 Code §7525(a)(2). The provision does not, however, limit the present attorney-client privilege of confidentiality.

8 *U.S. v. Mass. Inst. of Tech.*, 129 F.3d 681, 684 (1st Cir. 1997); Upjohn v. U.S., 449 U.S. 383, 389, 101 S. Ct. 677, 66 L. Ed. 2d 584 (1981).

9 *Supra* note 1.

> Accounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases. Hence the presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated tax story to the lawyer, ought not destroy the privilege, any more than would that of the linguist in the second or third variations of the foreign language theme discussed above; the presence of the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit. 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 in interviewed by a clerk not yet admitted to practice. What is vital to the privilege is that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer.

However, if the service sought by the client is not legal advice from competent legal counsel but accounting services or tax advice from the accountant's rather than the lawyer's, no attorney-client privilege exits.

U.S. V. ADAMS: ATTORNEY-CLIENT PRIVILEGE PREVAILS OVER CHALLENGE

It is one thing for a taxpayer to raise the attorney-client privilege under *Kovel* for communications with a non-lawyer retained by counsel, but it is another thing for the I.R.S. to respect the claim. Over the years, cases asserting the attorney-client privilege to a third-party agent of legal counsel have involved a public relations firm,[10] an independent contractor,[11] and of course a C.P.A. A recent example is *U.S. v. Adams*,[12] in which the U.S. government raised multiple challenges to the privilege.

In *Adams*, an accounting firm was retained by tax counsel under a Kovel arrangement. The taxpayer communicated often with the accountant. The I.R.S. issued a subpoena to obtain access to the written communications and issued a summons to the accountant seeking testimony. The taxpayer asserted the attorney-client privilege in an attempt to quash the summons and the subpoena, in legal proceedings brought in district court.

The government raised three challenges to the assertion of the attorney-client privilege:

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10 *Calvin Klein Trademark Trust v. Wachner*, 198 F.R.D. 53 (S.D.N.Y. 2000).

11 *Twentieth Century Fox Film Corp. v. Marvel Enterprises, Inc.*, 2002 WL 31556383 (S.D.N.Y Nov. 2002).

12 *U.S. v. Adams*, (DC MN 10/27/2018) 122 AFTR 2d ¶2018-5380.

- The communications do not qualify for the protections of the privilege.
- If the communications qualify for the privilege, all protection was waived by the taxpayer's subsequent filing of amended tax returns prepared by the accountant. Because a tax return is intended to provide information to the I.R.S. and the I.R.S. is responsible for examining the accuracy of tax returns, it is entitled to obtain information relevant to the preparation of the return. When the accountant prepared the return that was submitted to the I.R.S., any claim to privilege disappeared.
- The crime-fraud exception invalidated any claim of privilege. Generally, under the crime-fraud exception, the attorney-client privilege does not apply to a communication made for the purpose of getting advice for the commission of a fraud or a crime.[13]

In analyzing the case, the court relied on legal counsel's declaration that the taxpayer's communications to the accountants assisted him in his provision of legal advice to his client regarding the tax-related matters. The court found that legal counsel's declaration was sufficient to invoke the attorney-client privilege.

To determine if Mr. Adams waived the privilege by filing amended tax returns that were prepared by the same accountant that was retained by legal counsel, the court cited *Cote*,[14] where the court concluded that the privilege could apply to communications between a client and an accountant who is retained to assist an attorney in providing legal advice on tax matters. The court reasoned as follows:

> Notwithstanding our recognition that the attorney-client privilege attached to the information contained in the accountant's workpapers under the circumstances existing here, we find that by filing the amended returns the taxpayers communicated, at least in part, the substance of that information to the government, and they must now disclose the detail underlying the reported data.

However, the court cautioned on broad application of the waiver, as it may destroy the purpose of privilege that invites confidentiality between the attorney and the client. The *Cote* court distinguished between "workpapers [that] contain detail of unpublished expressions which are not part of the data revealed on the tax returns" and other workpapers to which the rule of waiver would apply.

The court in *Adams* distinguished between documents that related to the information that was later transcribed onto tax returns filed with the I.R.S. and communications between the taxpayer and the accountant that comprised unpublished expressions never revealed on the amended tax returns. The attorney-client privilege was waived in connection with the former documents. However, it remained available as a defense against the subpoena and the summons.

Regarding the crime-fraud exception to the attorney-client privilege, the government suggested that the taxpayer communicated with the accountants and legal counsel to further the submission of fraudulent tax returns, and therefore, the crime-fraud

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13 *In re Green Grand Jury Proceedings*, 492 F.3d 976, 979 (8th Cir. 2007) (quoting *U.S. v. Zolin*, 491 U.S. 554, 563 (1989)).

14 *U.S. v. Cote*, 456 F.2d 142 (8TH Cir. 1972).

exception applied. For the crime-fraud exception to apply, the government need only demonstrate that the legal advice was obtained to further an illegal or fraudulent scheme. The burden of proof is relatively low. All that must be demonstrated is a factual basis adequate to support a good faith belief by a reasonable person that an *in camera* review of the materials may reveal evidence to establish the claim that the crime-fraud exception applies.[15] To determine whether a *prima facie* showing has been made, the court may review any relevant evidence that has not been adjudicated to be privileged.

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The court concluded that a reasonable person could form a good faith belief that the communications may reveal that the taxpayer sought legal advice in furtherance of filing fraudulent tax returns. But, to make ultimate showing that the crime-fraud exception applies, a higher quantum of proof is required.[16] The Court in *Zolin* declined to specify the level of proof required to establish the crime-fraud exception. Therefore, the court in *Adams* looked for guidance in *Triple Five of Minnesota, Inc. v. Simon*,[17] which identified a two-part test for determining whether a sufficient showing was made. First, there must be a *prima facie* showing that the client was engaged in criminal or fraudulent conduct when he sought the advice of counsel, that he was planning such conduct when he sought the advice of counsel, or that he committed a crime or fraud subsequent to receiving the benefit of counsel's advice. Second, there must be a showing that the attorney's assistance was obtained in furtherance of the criminal or fraudulent activity or was closely related to it.[18]

Although the government met the threshold for reasonable cause, it failed to make the ultimate showing that the crime-fraud exception applied. The mere fact that a privileged communication may help the prosecution prove its case against the defendant is not enough to trigger application of the exception. Moreover, the mere fact that the attorney-client communication may help prove that a crime or fraud occurred does not mean that it was used in perpetrating the crime or fraud. Rather, the communication must be made in furtherance of the alleged crime.

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15 *Zolin*, 491 U.S. at 572; *In re Green Grand Jury Proceedings*, 492 F.2d at 982.

16 *In re Gen. Motors Corp.*, 153 F.3d 714, 716 (8th Cir. 1998) (noting the Supreme Court in *Zolin*, 491 U.S. at 563).

17 *Triple Five of Minnesota, Inc. v. Simon*, 213 F.R.D. 324, 326–27 (D. Minn. 2002).

18 *Id.*