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Dealing with Tax Documentation and Disclosure Requirements in a FIN 48 and *Textron* World

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Contents

- Introduction: Why Taxpayers Are Concerned
- Reasons Tax Documents May Need To Be Created and Potentially Dis closed
  - Compliance with Tax Obligations (Sections 6001, 6662, etc.)
  - Compliance with Financial Reporting Obligations (SOX 404, FIN 48 , etc.)
- Protecting Documents from Disclosure
  - Why Taxpayers May Want to Prevent Disclosure
  - General Rules
    - Attorney-Client Privilege
    - Accountant-Client Privilege
    - Attorney Work Product
- Specific Issues
  - Concerns Regarding Formal Tax Opinions
  - Concerns Regarding Tax Accrual Workpapers
    - IRS Policy of Restraint
    - Changes in IRS Policy
    - *Textron*
  - Potential Impact of Fin 48
- Recommendations
  - General Policies
  - Dealing with Auditor Requests for Information
  - Dealing with IRS Requests for Information

Introduction: Why Taxpayers Are Concerned

Why Taxpayers Are Concerned

- 10 Years Ago:
  - No “listed transactions”
  - No media exposés or Congressional hearings on tax shelters
  - No Enron scandal
  - No criminal prosecution threat for Arthur Andersen or KPMG
  - No Sarbanes Oxley, PCAOB, etc.
  - No tax accrual work papers sought by IRS
  - No FIN 48

Scandal After Scandal

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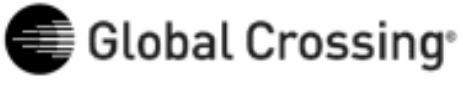

Corporate Scandals Led to Tougher Laws

- Republican Finance Committee Chair Grassley views Enron's tax planning as "nothing short of racketeering"

- Vowed to propose new legislation to shut down tax shelters

- Grassley/Baucus asked IRS to examine Enron deals

Selected Provisions of Sarbanes-Oxley Act

- Public accounting firm regulation by the PCAOB (Section 101)
- Faster and better public disclosure of material information
- Whistleblower protections
- Up-the-line reporting by attorneys of perceived illegality
- Audit committee of the Board of Directors
  - Member independence
  - Oversight of auditors

Selected Provisions of Sarbanes-Oxley Act

- Senior management accountability for internal controls insuring that
  - Transactions are recorded timely and properly
  - Transactions are properly authorized
    - Unauthorized use or disposition of assets is prevented or promptly detected
- Senior management quarterly certification that
  - The issuer's financial statements and SEC filings are accurate and complete
  - They have
    - Designed appropriate disclosure controls and internal controls
    - Evaluated the effectiveness of the disclosure controls
    - Disclosed any material change in the internal controls
    - Disclosed to the auditors and audit committee
      - All significant deficiencies and material weaknesses in the issuer's internal controls
      - Any fraud involving management of the issuer

Selected Provisions of Sarbanes-Oxley Act

- Auditor Independence: Auditor should not
  - Be an advocate for the client
  - Audit its own work
  - Be part of management
- Therefore:
  - Pre-approval of Audit Committee required for all services provided by outside auditor (Section 202)
  - Public accounting firms prohibited from providing certain non-audit services to issuers they audit (Section 201)
    - Bookkeeping or similar services
    - Financial information systems design and implementation
    - Appraisal or valuation services, fairness opinions, or contribution in kind reports
    - Actuarial services
    - Internal audit outsourcing services
    - Management functions or human resources
    - Broker or dealer, investment adviser, or investment banking services
    - Legal services and expert services unrelated to the audit and
    - Any other services that the PCAOB determines to be impermissible

PCAOB Ethics and Independence Rules

- PCAOB rules
  - Increase the auditor's responsibilities in connection with seeki ng audit committee pre-approval of tax services
    - Auditor must supply the audit committee with certain information , discuss with the audit committee the potential effects of the services o n the firm's independence, and document the substance of that discussion.
  - The rules also identify three circumstances in which the provisi on of tax services impairs an auditor's independence:
    - If the firm enters into contingent fee arrangements with audit c lient
    - If the firm provided tax services to officers in a financial rep orting oversight role of an audit client.
    - If the firm provides services related to planning or opining on the tax consequences of a transaction
      - That is a listed or confidential transaction under Treasury regu lations or
      - That is based on an aggressive interpretation of applicable tax laws and regulations, with “aggressive” being defined as not meeting a “more likely than not” standard

Reasons Tax Documents May Need To Be Created and Potentially Disclosed

Compliance with Tax Obligations: Section 6001

- Section 6001 provides for certain recordkeeping requirements
  - "Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title …."

Section 6001

- The Treasury regulations under section 6001 provide such records required to be maintained must be made available to the Internal Revenue Service.
  - "All records required by the regulations in this part shall be kept, by the person required to keep them, at one or more convenient and safe locations accessible to internal revenue officers, and shall at all times be available for inspection by such officers." Treas. Reg. § 31.6001-1(e)(1)
  - "…every person required by the regulations in this part to keep records in respect of a tax (whether or not such person incurs liability for such tax) shall maintain such records for at least four years after the due date of such tax for the return period to which the records relate, or the date such tax is paid, whichever is the later…." Treas. Reg. § 31.6001-1(e)(2).

Compliance with Tax Obligations: Section 6662

- Section 6662 provides certain accuracy-related and fraud penalties that may be assessed against underpayments of tax.
- However, section 6664 provides that "No penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion."
- There are separate rules that apply specifically to reportable transactions.

Section 6662A—Accuracy Related Penalty for Reportable Transactions

- Two-tier accuracy related penalty for a reportable transaction (new section 6662A of the Code included in American Jobs Creation Act of 2004)
  - A new accuracy-related penalty
  - Applies to reportable and listed transactions
  - Penalty rates
    - A 20% accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed or reportable avo idance transaction
    - A 30% accuracy-related penalty is imposed on any understatement attributable to a listed or reportable avoidance transaction tha t is not adequately disclosed
      - The 30% penalty cannot be waived under the reasonable cause exce ption

Section 6662A—Accuracy Related Penalty for Reportable Transactions

- The 20% penalty can be waived for reasonable cause (the "strengthened reasonable cause exception"), which exists only if it is shown that there was reasonable ca use for the understatement and the taxpayer acted in good faith
- Such a showing requires:
  - Adequate disclosure (in accordance with the section 6011 regulat ions) of the transaction
  - That there is or was substantial authority for the taxpayer 's position and
  - That the taxpayer reasonably believed that its position was more likely than not the correct position
- A taxpayer will be treated as having a "reasonable belief" only if such belief:
  - Is based on the facts and law that exist at the time of the tax return and
  - Relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that
    - A return will not be audited
    - The treatment will not be raised on audit or
    - The treatment will be resolved through settlement if raised on a udit

Section 6662A—Accuracy Related Penalty for Reportable Transactions

- Section 6664(d)--A taxpayer may rely on an opinion of a tax advisor in establishi ng its belief, but a taxpayer may not rely on an opinion of a tax a dvisor if the opinion
  - Is provided by a "disqualified tax advisor" or
  - Is a "disqualified opinion"
- A "disqualified tax advisor" is any advisor who
  - Is a material advisor (as that term is defined under section 611 1)
  - Is compensated directly or indirectly by a material advisor with respect to the transaction
  - Has a fee arrangement with respect to the transaction that is co ntingent on all or part of the intended tax benefits from the transaction being sustained o r
  - Has a "disqualifying financial interest" with respect to the transaction, as determined by regulations
- A "disqualified opinion" is an opinion that
  - Is based on "unreasonable factual or legal assumptions"
  - "Unreasonably relies" upon representations, statements, findings or agreements of the taxpayer or any person,
  - Does not identify and consider all relevant facts, or
  - Fails to meet any other requirements prescribed by Treasury

Section 6662A—Accuracy Related Penalty for Reportable Transactions

- Coordination with other penalties
  - Any understatement upon which this penalty is imposed is not subject to the accuracy related penalty under section 6662
  - Any understatement upon which this penalty is imposed is included for purposes of determining whether any understatement is a "substantial understatement" under section 6662
  - Any understatement upon which this penalty is imposed is not subject to the valuation misstatement penalties under sections 6662(e) or 6662(h)
  - This accuracy related penalty shall not apply to any portion of an understatement to which a fraud penalty under section 6663 applies
- A publicly traded entity may be required to disclose the imposition of this penalty in a filing with the SEC (regardless of whether the amount of the penalty is "material" for SEC purposes)
- Effective date: Taxable years ending after the date of enactment

Compliance with Financial Reporting Obligations: Sarbanes Oxley § 404

- SEC rules under Sarbanes Oxley § 404 require a company's annual report to include a discussion on the company's internal control over financial reporting.
- Management's report must:
  - state management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
  - contain an assessment, as of the end of the company's most recent fiscal year, of the effectiveness of the company's internal control structure and procedures for financial reporting.
- Section 404 also requires every registered public accounting firm that prepares or issues an audit report on a company's annual financial statements to attest to, and report on, the assessment made by management.
  - The attestation must be made in accordance with standards for attestation engagements issued or adopted by the PCAOB.

Compliance with Financial Reporting Obligations: Sarbanes Oxley § 404

- PCAOB Auditing Standard No. 2 defines *"internal control over financial reporting"* as follows:
  - A process designed by, or under the supervision of, the company' s principal executive and principal financial officers, or persons performin g similar functions, and effected by the company's board of directors, man agement, and other personnel, to provide reasonable assurance regarding the r eliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting princi ples and includes those policies and procedures that:
    - (1) Pertain to the maintenance of records that, in reasonable de tail, accurately and fairly reflect the transactions and dispositions of the assets o f the company;
    - (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with ge nerally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and di rectors of the company; and
    - (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's as sets that could have a material effect on the financial statements.

Compliance with Financial Reporting Obligations: FIN 48

- FASB Interpretation No. 48 ("FIN 48") is an interpretation of FASB Statement 109 regarding accounting for uncertainty in income taxes.
- FIN 48 applies to all "tax positions" and may increase the amount of tax documentation required to satisfy accounting standards for such positions to be reflected on financial statements.

Fin 48: What Changes?

- FAS 5 Accounting for Contingencies
  - Accrue liability when it is “probable” of occurring and the amount can be reasonably estimated
- FIN 48 – Benefit recognition model
  - Tax position must meet minimum recognition threshold before being recognized in financial statements

Fin 48: What Changes?

- Client's documentary support of material positions more robust (plus process and controls)
- AU 9326 continues to apply and auditor needs to reach independent conclusion and maintain workpapers that include material aspects of Company's position
- Questions remain with respect to how much documentation auditors will require to support FIN 48 positions. AU9326 requires auditors retain sufficient content to articulate the position and support for conclusions reached. Also requires auditors to have access to outside opinions received by Company.

Fin 48: What Changes?

- Less flexibility in making judgments with respect to tax reserves; May need to revisit earlier judgments
- Standards may require reserves to fluctuate based on developments that may not have caused a fluctuation in the past
- Standards may require more interaction between accounting, financial reporting, and tax personnel and more attention from senior management
- Additional transparency may cause more inquires from analysts and regulators

FIN 48 –Disclosure

- For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next 12 months of the reporting date:
  - The nature of the uncertainty
  - The nature of the event that could occur in the next 12 months that would cause the change
  - An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made
- A description of the years that remain subject to examination by a major tax jurisdiction.

Issues Arising in IRS Audits in FIN 48 World

- FIN 48 makes some changes in ways contingent taxes are reported on financial statements.
  - But, the presentation in financial statements is not totally "transparent."
  - Reserves ("tax cushion") for individual tax issues are not separately disclosed on financial statements.
  - If it looks at FIN 48 financial statements, IRS will have knowle dge concerning the total reserve for contingent taxes, but not the individual issue reserves.

General Background on Rules Protecting Documents from Disclosure

Why Does Protecting Documents Matter?

- Encourage employees to be forthcoming and candid with their attorneys so that the attorney is sufficiently well-informed to provide sound legal advice.
- *See Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

Why Does Protecting Documents Matter?

- Avoid disclosure of comprehensive internal and external legal analyses of transactions/issues subject to audit that will creat e a road map for the Service.

- Avoid disclosure of sensitive tax reserve analyses to the Service to prevent these from being the starting point of negotiations during an audit.

- Avoid disclosure of strategic communications with your outside advisors.

- Allow full and frank communications on a going forward basis with your tax advisors during the course of the audit and any future litigation, without fear of undermining the position.

Attorney-Client Privilege

- What is it?
  (1) Where legal advice of any kind is sought
  (2) from a professional legal adviser in his capacity as such,
  (3) the communications relating to that purpose,
  (4) made with an expectation of confidentiality
  (5) by the client, or by the legal advisor containing such communications by the client,
  (6) are at his instance permanently protected
  (7) from compelled disclosure by himself or by the legal adviser,
  (8) unless the protection is waived

Attorney-Client Privilege

- What decides whether a document is privileged?
  - The document must contain a privileged communication.
  - Giving a document to your lawyer does not make the document privileged.

Attorney-Client Privilege

- Communications with external legal advisors:
  - Direct communications with lawyer
  - Communications with law firm employees who assist attorneys in providing legal advice
  - Attorneys employed by accounting firms are generally not considered to be functioning as attorneys for purposes of the attorney-client privilege.

Attorney-Client Privilege

- *Kovel* Arrangements
  - The attorney-client privilege may be extended to communications with an accountant retained by an attorney for the purpose of assisting the attorney in understanding a client's financial information. *See United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961).
  - This extension is limited. The attorney-client privilege ordinarily does not attach to tax work prepared by accountants unless the accountant is translating complex tax terms into a form intelligible to a lawyer at the lawyer's behest and the accountant's efforts are otherwise necessary to allow the attorney to render the requested services. *See United States v. Bornstein*, 977 F.2d 112 (4th Cir. 1992).
  - The appropriate inquiry is whether the accounting services are performed primarily to allow the lawyer to give legal advice.
  - These arrangements may be made with individuals with specific expertise other than accountants.

Attorney-Client Privilege

- Communications involving in-house counsel
  - Communications with employees for purposes of providing legal advice are privileged.
  - Tax advice provided by in-house counsel with respect to the legal consequences of transactions is privileged.
  - The mere funneling of tax work done by non-attorneys through in-house counsel does not attach attorney-client privilege to documents.
  - Practically speaking, courts will examine assertions of privilege with respect to in-house counsel more closely because of the dual business/legal roles common to company lawyers.

Attorney-Client Privilege

- How is the privilege waived?
  - Actual Waiver
    - The privilege is waived when a privileged communication is volun tarily disclosed to a party not covered by the privilege.
    - The privilege may be waived when a privileged communication is involuntarily disclosed to a party not covered by the privilege.
    - The courts are also split as to whether an inadvertent disclosur e is treated as an actual waiver or not a waiver of the privilege.
      - Alternative 1--An inadvertent disclosure is treated the same as a voluntary disclosure, without exception.
      - Alternative 2--To determine if an inadvertent disclosure should be treated as a waiver, a balancing test is applied, weighing the following fact ors: (1) whether the disclosing party took reasonable precautions to prevent disc losure; (2) the speed at which the party acted to correct its mistake; (3) the o verall volume of documents provided; (4) the number of inadvertent disclosures; a nd (5) fairness.

Attorney-Client Privilege

- How is the privilege waived?
  - Implied Waiver
    - An implied waiver of the privilege occurs when a privilege holder makes an assertion of fact that in fairness requires examination of protected communications.
    - The Tax Court applies a three-part balancing test to determine if an implied waiver occurs:
      - assertion of the privilege was the result of an affirmative act by the asserting party
      - the asserting party put the protected information at issue through an affirmative act by making it relevant to the case and
      - application of the privilege would deny the opposing party access to information "vital" to its defense

Attorney-Client Privilege

- Scope of Waiver
  - The waiver generally applies to all communications of the same "subject matter," but the scope of how to define "subject matter" differs significantly among courts.
    - Some courts limit the scope of the waived "subject matter" to material actually disclosed to an uncovered party.
    - Other courts take a much broader approach and treat the waiver as including any privileged material with the same general subject matter of the disclosed communications (e.g., all communications related to a particular transaction).
  - Disclosure of a privileged opinion letter to the Service for penalty protection purposes may be seen as an actual waiver of the attorney-client privilege and, depending upon the application of the "subject matter" test, could result in the waiver of privilege with respect to a much broader set of communications.

Federal Statutory Accountant-Client Privilege

- Applies to communications
  - After July 22, 1998
  - Between "federally authorized tax practitioners" and client
- Intended to apply the same common law protections as the attorney-client privilege
- Only applies to the extent that the communication would be considered a privileged communication if it were between a taxpayer and an attorney
- Does not apply to certain "tax shelter" transactions (i.e., transaction with a "significant" purpose of tax avoidance or evasion)
  - For communications prior to October 22, 2004, does not apply to "corporate" tax shelters
  - For communications after October 22, 2004, does not apply to any tax shelters
- The privilege may only be asserted by a taxpayer or accountant in any noncriminal proceeding before the Service or any noncriminal tax proceeding brought in Federal court.

Federal Statutory Accountant-Client Privilege

- Based upon one court's analysis, tax opinion letters prepared by accountants may not be protected from disclosure by the accountant-client privilege.
  - *United States v. KPMG, LLP*, 237 F. Supp. 2d 35 (D.D.C. 2003)
    - Tax opinion prepared by accountants is not protected by the acco untant-client privilege because the analysis in the opinion letter was "prepared in connection with preparation of a tax return" as the opinion related to a transaction to be disclosed on the taxpayer's tax return.
- Tax opinion letters prepared by accountants may be protected from disclosure to the Service by the work product doctrine. *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998) (see discussion in following slides).

Work Product Doctrine

- What is this protection?
  - Documents prepared “in anticipation of litigation” or for trial by or for another party, or by or for that other party’s representative, are protected from disclosure.
  - Mental impressions of attorneys/other representatives are protected.
  - Substantial need exception may be asserted to overcome the work product protection, but a heightened standard is generally applied by the courts to protect mental impressions as opposed to factual information.

Work Product Doctrine

- What is "in anticipation of litigation"?
  - Because of Litigation Test—Majority Test
    - If in light of the nature of the document and the factual situation in a particular case, the document can be said to have been prepared or obtained because of the prospect of litigation. *See Adlman*, 134 F.3d at 1202.
  - "Primarily to Assist In Litigation" Test—Minority Test
    - The primary motivating purpose behind the creation of the document must be to aid in possible future litigation.
    - Applied by the Fifth Circuit Court of Appeals. *See United States v. Davis*, 636 F.2d 1028 (5th Cir. 1981).

Work Product Doctrine

- How is work product protection waived?
  - Voluntary disclosure to an adversary in litigation automatically waives work-product protection with respect to the items disclosed. *See In re Steinhard Partners, L.P.*, 9 F.3d 230 (2d Cir. 1993).
  - However, voluntary disclosure of work product to a third-party who is not an adversary does not necessarily waive the protection for other materials unless the disclosure "substantially increases the opportunity for potential adversaries to obtain the information." *In re Grand Jury*, 561 F. Supp. 1247 (E.D.N.Y. 1982).
  - Some courts have also limited a waiver of the work-product protection to only factual materials disclosed, maintaining the protection with respect to documents involving "core attorney mental processes." *In re Kidder Peabody Security Litigation*, 168 F.R.D. 459 (S.D.N.Y. 1996).

Work Product Doctrine

- Courts have reached different conclusions with respect to whether disclosures to outside auditors waive work product protection
  - *Medinol, Ltd. v. Boston Scientific Corp*., 2002 U.S. Dist. LEXIS 20611, at * 10 (S.D.N.Y. 2002) (work product protection waived)
  - *In re Pfizer Inc. Sec. Litig*., 1993 U.S. Dist LEXIS 18215, at *21 (S.D.N.Y. 1993) (work product protection not waived)
  - *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 229 F.R.D. 441 (S.D.N.Y. 2004) (work product protection not waived)

Concerns Regarding Formal Tax Opinions

Are Tax Opinion Letters Privileged?

- Opinion letters prepared by attorneys are generally privileged

- Opinion letters prepared for the specific purpose of disclosure to the Service to avoid potential tax penalties are not privileged

How Can Privileged Opinion Letters Be Protected from Disclosure to the Service?

- If you want a privileged opinion letter, but also need penalty protection, make sure you obtain separate opinions.
  - It would be prudent to engage separate firms to prepare opinion letters for each purpose.
- If possible, avoid providing opinion letters to independent auditors as part of your audit workpapers (e.g., in support of reserve analyses) as this will immediately waive the privilege and potentially result in a subject matter waiver.
  - See more detailed discussion below regarding this issue.
- Keep opinion letters separate from non-privileged documents to avoid the possibility that they will be inadvertently disclosed to third parties, resulting in a waiver of privilege/work-product protection.

How Can Privileged Opinion Letters Be Protected from Disclosure to the Service?

- If an opinion letter has been prepared for penalty protection purposes and you intend to disclose it to the Service, do not treat the opinion as a privileged document in your files and do not claim the document as privileged in response to IDRs, as this will reduce the possibility that the production of the document may be treated as a waiver of privilege.

- At a minimum, if you decide to produce opinion letters to the Service for penalty avoidance purposes for which you have previously asserted a privilege, try to obtain an agreement with the Service that it will not assert in the future that the production of the opinion constituted a subject matter waiver.

U.S. v. Roxworthy

- In *U.S. v. Roxworthy*, 457 F.2d 590 (6th Cir. 2006) the Sixth Circuit held that two memoranda prepared by KPMG for Yum! Brands, Inc. were protected from disclosure to the IRS under the work product doctrine
- The memoranda were addressed to in-house "corporate counsel" at Yum's predecessor company, Tricon Global Restaurants, Inc. The memoranda analyzed the tax consequences of certain transactions entered into by Yum pertaining to the creation of a captive insurance company and related stock transfers. The memoranda discussed possible arguments the IRS might raise against the transactions and potential counterarguments.
- The magistrate judge ruled that the documents were not protected because they were prepared irrespective of the prospect of litigation to support Yum's tax return and avoid penalties. The district court agreed with the magistrate judge, even after Yum filed supplemental affidavits describing the purpose of the memoranda to prepare for likely litigation with the IRS over the tax consequences of the controversial transactions.

U.S. v. Roxworthy

- The Sixth Circuit reversed and held that the memoranda were protected by the work product doctrine.
- In particular, the Sixth Circuit ruled that the memoranda were prepared in anticipation of litigation and that the anticipation of litigation was objectively reasonable given the nature of the transactions.
  - "In the absence of any evidence to the contrary, the affidavits and deposition testimony supplied by Yum are adequate to demonstrate that Yum did not commission the memoranda as part of the ordinary course of business of completing the transactions and that Yum in fact anticipated litigation because of the certainty of an IRS audit, the conspicuousness of the $11 2 million discrepancy between tax and book loss, and the unsettled law surrounding captive insurance."
  - The Sixth Circuit applied the "because of" standard and stated, "the documents do not lose their work product privilege 'merely because [they were] created in order to assist with a business decision,' unless the documents 'would have been created in essentially similar form irrespective of the litigation.'"

Concerns Regarding Tax Accrual Workpapers

Tax Accrual Workpapers – In General

- Tax accrual workpapers include documentation of the company's analysis of tax contingencies and reserves reported on financial statements, including roll-forwards of changes to the reserves.
- The workpapers may include memoranda, analyses and schedules that reflect the company's hazards-of-litigation determinations.
- The workpapers may be prepared by company attorneys, company accountants, and other company personnel, and by outside legal or accounting advisers.
- The workpapers may be reviewed by or provided to various persons, both inside and outside the company.

Outside Auditor’s Interest in Tax Accrual Workpapers

Outside Auditor's Interest in Tax Accrual Workpapers

- AICPA Audit Standards
  - Outside auditors will seek to review tax accrual workpapers.
  - AICPA Professional Standards require that "sufficient competent evidential matter" be obtained "to afford a reasonable basis for an opinion regarding the financial statements under audit." AICPA Professional Standards, AU section 326, *Evidential Matter*.
  - The Standards specifically require that audit documentation include "sufficient competent evidential matter about the significant elements of the client's tax liability contingency analysis." AICPA Professional Standards, AU section 9326.12, *Evidential Matter: Auditing Interpretations of Section 362.*

Outside Auditor's Interest in Tax Accrual Workpapers

- PCAOB Audit Standards
  - Sarbanes-Oxley created the Public Company Accounting Oversight Board (PCAOB). PCAOB has adopted audit documentation requirements in Auditing Standard No. 3 - Audit Documentation.
  - That Standard requires documentation that:
    - Demonstrates the audit complied with PCAOB standards
    - Supports the auditor's conclusions regarding every relevant financial statement assertion
    - Demonstrates the underlying accounting records agreed or reconciled with the financial statement
  - All significant findings are required to be documented, including "uncertainties as well as related management assumptions."

IRS Interest in Tax Accrual Workpapers

The Service's General Policy

- In *United States v. Arthur Young & Co.*, the Supreme Court held that tax accrual workpapers enjoy no special protection against disclosure to the Service.

- Nevertheless, in Announcement 84-46, the Service stated that it would demonstrate "administrative sensitivity" and generally would not request tax accrual workpapers.

- Until 2002, the Service would request tax accrual workpapers only in unusual circumstances.

The Service's New "Tax Shelter" Policy

- In 2002, responding to tax shelter developments, the Service adopted a new tax accrual workpaper policy, under which workpapers will be requested from taxpayers that engage in "listed transactions."

- The Service's goal was to reduce the corporate appetite for tax shelters by telling companies that, if they engage in "listed" tax shelter transactions, they will be required to disclose their tax accrual workpapers.

- The new policy was initially set forth in Announcement 2002-63, was augmented in LMSB Questions & Answers and in Chief Counsel Notice 2004-010, and was finally memorialized in Internal Revenue Manual section 4.10.20.

The Service's New "Tax Shelter" Policy

- If a taxpayer engages in one listed transaction, and properly discloses that transaction, the Service will request only the portion of the tax accrual workpapers concerning that transaction.

- However, the Service will request all tax accrual workpapers if:
  - The listed transaction is not properly disclosed, or
  - The taxpayer engages in multiple listed transactions, or
  - There are reported financial irregularities regarding the taxpayer

- This new policy applies to tax returns filed after July 1, 2002 (some returns filed earlier also may trigger a request, if listed transactions were not disclosed).

Conflicts Between Taxpayers and the IRS Over Disclosure of Tax Accrual Workpapers

The Tug-of-War Over Tax Accrual Workpapers

- Because of the increasing number of "listed transactions" identified by the Service (presently 31 transactions), the chance that a taxpayer's tax accrual workpapers will be requested by the Service has increased significantly.

- "Listed transactions" also include transactions that are "substantially similar" to an expressly listed transaction.

- Regulations state that the "substantially similar" standard is to be broadly construed in favor of treating transactions as within the scope of the expressly listed transactions.

- Disclosure is required even for transactions that become a listed transaction at a subsequent time

The Tug-of-War Over Tax Accrual Workpapers

- As noted above, there is no special, blanket protection that can be claimed for tax accrual workpapers.
- However, when the Service requests tax accrual workpapers, a tax payer may be able to assert three potential defenses:
  - Attorney-client privilege
  - Work product protection
  - The section 7525 tax practitioner-client privilege
- These defenses cannot be asserted as blanket protections, but must be asserted and established on a document-by-document basis.

The Tug-of-War Over Tax Accrual Workpapers

- To prevail, the taxpayer first must prove that, given the circumstances in which each workpaper was created, the asserted privilege or protection initially applied to the document.
- This involves an analysis of:
  - What is the document?
  - Why was the document created?
  - Who created the document?
  - What are the contents of the document?
  - Was the document intended to kept confidential?

The Tug-of-War Over Tax Accrual Workpapers

- To prevail, the taxpayer also must prove that, given the circumstances in which the workpapers were thereafter maintained, the asserted privilege or protection was not waived.

- This involves an analysis of:
  - Who within the company had access to the document?
  - Was the document stored in secure file?
  - Was the document disclosed outside the company?

- The privilege can be waived for a single document. Also, the disclosure of one document can waive the privilege for all documents that concern the same subject matter.

The Tug-of-War Over Tax Accrual Workpapers

- Tax accrual workpapers may not be privileged or protected if:
  - They are not created by or at the direction of persons who can create privileged or protected documents
  - They contain solely business advice
  - They were not intended to remain confidential
- Tax accrual workpapers may lose any existing privileged status if:
  - They are widely distributed within the company
  - They are not maintained in a secure fashion
  - They are turned over to a third party, including outside auditors
- In either case, they may become subject to disclosure to the Service.

Can Tax Accrual Workpapers Be Privileged?

- In *El Paso Co.*, the Fifth Circuit said "we would be reluctant to hold that a lawyer's analysis of the soft spots in a tax return and his judgments on the outcome of litigation on it are not legal advice."
  - The court held that disclosure to outside auditors waived any privilege.
  - The case was decided before the enactment of section 7525.
- In *Rockwell International*, the Third Circuit held that the determination of whether a tax reserve analysis is protected by the attorney-client privilege is dependent on several factors:
  - Does it represent legal advice, or business advice, of an attorney?
  - Who was involved in its preparation?
  - Who has control of the file?
  - Was it intended to be disclosed to third parties, such as an independent auditor?
  - Was it actually disclosed to a third party?
  - The court remanded to the trial court for factual findings on these factors
- The Service's position is that a company's auditor is a third party so that disclosure to the auditor waives privilege.
- As discussed later, in *U.S. v. Textron* the District of Rhode Island agreed that disclosure to an independent auditor waives privilege.

Can Workpapers Be Protected As Work Product?

- A tie to anticipated litigation must be firmly established.
  - The author of the document should be involved with tax litigation.
  - The analysis should be used in making litigation decisions.
- Whether "dual purpose" documents are protected varies:
  - In "because of" jurisdictions, having a "dual" litigation and business purpose for creating a document does not prevent work product protection
  - In "primary motivation" jurisdictions, the litigation purpose for creating the document must be primary (or even exclusive)
- Work product protection for legal analyses generally is not waived by disclosure (such as to outside auditors) because work product is usually waived only if disclosed to an "adversary"

Can Workpapers Be Section 7525 Privileged?

- The workpaper must be prepared by a qualifying "tax practitioner."
- The tax practitioner must be giving tax advice.
- The Service and the courts may presume that a tax practitioner is giving business advice, tax return advice, or financial statement advice.
- However, if the tax advice is similar to legal advice that would be attorney-client privileged, than the section 7525 privilege should apply.
- But, tax advice from non-lawyers regarding tax shelters is not protected.
- Also, the privilege can be waived through disclosure.

Textron Litigation

United States v. Textron

Reserved.

THE WALL STREET JOURNAL.

Tax Battle: IRS vs. Textron

The Maker of Aircraft and Golf Carts Tries to Keep Uncle Sam Out of Its Files

By JESSE DRUCKER

TEXTRON INC., AN AEROSPACE and defense contractor, is in an uphill legal battle with the Internal Revenue Service that could win U.S. corporations a significant new weapon in tax disputes.

The conglomerate is resisting demands by the IRS for internal documents about its use of allegedly abusive tax shelters. Tax collectors have become more aggressive in recent years in demanding such records, and most companies comply. Textron is the first company that the federal government has taken to court over the issue, the IRS says. Legal experts say the IRS has the upper hand in the fight, but tax lawyers are watching to see if the case alters the balance of power in corporate tax disputes.

It's unclear how much money is at stake. Textron makes Cessna Aircraft, Bell Helicopters, golf carts, lawn mowers and other products. It had revenue of about $10 billion in 2005, nearly a third of that from its Bell segment, which makes combat helicopters, armored vehicles, munitions and other defense products. Textron's stock, which closed yesterday at $86.67 on the New York Stock Exchange, has risen fairly steadily since the beginning of the Iraq war in early 2003, when it traded near $30.

In 2001, Textron bought several telephone networks and a railroad system overseas and then leased them back to their owners, according to a Justice Department court filing. Such arrangements can produce big tax benefits because depreciation can be claimed on the assets to reduce taxable income.

Some leasing transactions that reduce taxes are legitimate, but the IRS has tried to crack down on aggressive ones it calls "sale in, lease out" deals. In 2004, Congress outlawed future so-called SILOs, and the IRS [illegible]

to SILOs. Toward that end, last year it [illegible]

United States v. Textron: **Facts**

- IRS requests Textron's tax accrual workpapers: first reported case since *Arthur Young*.
- Presence of more than one listed transaction.
- Facts:
  - Attorneys prepare workpapers
  - Kept confidential
  - Content shared with accounting firm

United States v. Textron: **Facts**

- Content of tax accrual workpapers
  - List of issues (uncertain tax positions).
  - List of "hazards of litigation" conclusions, expressed as percentage chance of losing each issue in court.
  - List of monetary value of each issue and reserve.

United States v. Textron: **Facts**

- Attorneys involved: different facts, different rules
  - Attorney/client privilege
  - FRCP 26(b)(3): protection for attorney work product

***United States v. Textron*: Issues**

- Issues
  - Do workpapers include "legal advice?" If so,
    - Was attorney/client privilege waived by communication to account ing firm?
    - *See* IRC 7525 privilege for accountants providing tax advice.
    - Are auditors providing "tax advice" with respect to the items contained in tax accrual work papers?
  - Were workpapers (all or portion) prepared in anticipation of lit igation? FRCP 26(b)(3) (rules relating to protected attorney "work product.")
    - Are workpapers entitled to "super" protection because in Textron's case they contain "mental impressions and conclusions of attorneys?"
    - Was "work product" protection forfeited when papers were shared with accounting firm?

***United States v. Textron*: Issues**

- Issues (continued)
  - Circuit courts have two different standards for work product protection; Fifth Circuit is most restrictive. To be work product, papers must be primarily prepared for litigation.
  - In *El Paso* (1982), Fifth Circuit rejected taxpayer's "work product" argument.
  - Most other circuits reject this rule and follow what is called "dual purpose" rule.
  - Under the "dual purpose" rule, work product can be "in anticipation of litigation" even if in the first instance it was prepared for non-litigation business purpose. *See State of Maine* (C.A.1).

United States v. Textron: **Decision**

- Court denied IRS petition to enforce summons
- Court reached the following conclusions:
  - Privilege
    - Tax accrual work papers were initially protected by attorney-client privilege and sec. 7525 tax practitioner-client privilege
    - However, the privileges were waived when the workpapers were disclosed to Textron's independent auditors
  - Work Product
    - Tax accrual work papers were protected by work product because they would not have been prepared "but for" the fact that Textron anticipated the possibility of litigation with the IRS.
      - *El Paso* case distinguished because it applied a "primary purpose" test instead of a "because of" test. "But for" test controls in the first circuit.
    - Work product protection was <u>not</u> waived because disclosure to independent auditors did not substantially increase the opportunity for potential adversaries (i.e., the IRS) to obtain the information.

United States v. Textron: **Consequences**

- Textron was a major victory for taxpayers
  - Established limits on IRS ability to obtain information
  - Determined that tax accrual workpapers were legal advice protected by privilege and work product
  - Determined that disclosure to independent auditors is not disclo sure to an adversary that waives work product protection
- However, the full scope of the victory is yet to be determined.
- Important to remember:
  - Tax accrual workpapers at issue were prepared by counsel providing legal advice, not independent auditors
  - Circuit split on application of work product; First Circuit is a "because of" jurisdiction; Others require "primary purpose" for work product to apply
    - Textron court stated that even if the workpapers were needed to satisfy independent auditors for purposes of verifying reserves, the workpapers were still prepared "because of" anticipated litigation
    - Unclear how same question would be resolved in a "primary purpose" jurisdiction.
  - Confidentiality agreement in place between Textron and independe nt auditors
  - IRS will likely both appeal the decision in *Textron* and bring an enforcement action against a different taxpayer in a different circuit to try and e stablish a circuit split

Potential Impact of FIN 48

Issues Arising in IRS Audits in FIN 48 World

- FIN 48 workpapers are tax accrual workpapers.
- Former IRS Large and Mid-Size Business Commissioner Deborah Nolan, speaking at a DC Bar program April 12th, said the IRS is currently considering whether its "policy of restraint" regarding tax accrual work papers should be changed.
- However, acting IRS commissioner Linda Stiff, speaking at a TEI event on October 22nd, stated that the IRS had no current plans to change the policy of restraint. Stiff did, however, note that IRS agents were being trained on financial statement analysis and FIN 48.
- It is unclear what affect, if any, the taxpayer win in *Textron* will have on IRS policy.

Issues Arising in IRS Audits in FIN 48 World

- Since IRS treats FIN 48 workpapers as tax accrual workpapers, taxpayers without listed transactions should use IRS policy to protect these documents.
  - Restraint in asking for tax accrual workpapers is IRS policy. Accordingly, privilege issues and privilege waiver issues should be irrelevant.
  - Taxpayers should rely on the IRS "restraint policy" where appropriate.
  - If "unusual circumstances" are not present, taxpayers should be able to oppose a request for FIN 48 workpapers.

Issues Arising in IRS Audits in FIN 48 World

- Issues where taxpayers have listed transactions.
  - FIN 48 workpapers may contain very sensitive information concerning litigation/settlement "hazards" analysis.
    - Highly prejudicial if obtained by IRS.
    - Where FIN 48 workpapers are requested, taxpayer must examine facts and law to determine if documents are privileged or protected work product.

Subsequent Recognition – Proposed FASB Staff Position

- FSP FIN 48-a Exposure Draft released February 27, 2007, with comments due March 28, 2007
- Guidance on determining whether previously unrecognized tax position is "effectively settled;" term "ultimate settlement" dropped
  - Taxing authority completed all exam procedures it is required or expected to perform for the tax position
  - No appeal or litigation is intended for any aspect of the tax position
  - Based on taxing authority's "widely understood policy," enterprise considers it highly unlikely that the tax position would be subsequently examined or reexamined, presuming taxing authority has full knowledge of all relevant information
- Final FSP will be effective upon initial adoption of FIN 48; An entity that did not apply FIN 48 consistent with the final FSP FIN 48-a will be required to retrospectively apply the provisions of FSP FIN 48 to the date of the initial adoption of FIN 48.

Recommendations

General Policies

What Steps Can be Taken to Protect Privileged Documents and Communications from Disclosure to the Service?

- Be certain to include counsel meaningfully in communications reg arding legal issues, and document their substantive role.
- Coordinate with General Counsel with respect to privileged tax d ocuments to avoid waiver of privilege in other litigation
- Avoid inappropriate claims of privilege on documents
  - Risk of waiver
  - Credibility issues
- Enter into written agreements through counsel with third -party consultants to whom you wish to disclose privileged information (e.g., *Kovel* arrangement).
- Be aware of the potential limitations of the accountant -client privilege, particularly when considering whether to disclose sensitive docu ments in the context of the preparation of an opinion letter.

What Steps Can be Taken to Protect Privileged Documents and Communications from Disclosure to the Service?

- Limit communications between your independent auditors and your tax advisors (both inside and outside), as these communications may not be privileged; Negotiate with auditors to limit scope of documents reviewed.

- Be aware that the disclosures of information or documents (e.g., tax opinions) to the Service pursuant to the taxpayer disclosure regulations (Treas. Reg. § 1.6011-4) may result in a subject matter waiver of the attorney-client privilege that could reach a wider range of privileged communications.

How Should Privileged, Sensitive Documents be Handled?

- Only disclose legal documents with respect to an issue to other employees/officers on a need-to-know basis.

- Separate and clearly mark legal documents to avoid an inadvertent waiver of privilege/work-product protection.

- No privilege will attach to business documents, so store business documents in a separate location from the legal documents.

Formalize a Tax Litigation Group

- In general:
  - The Group advises the Company on the conduct of tax controversies and litigation, and advises the Company on the hazards of litigating tax issues
  - The Company relies on the Group's advice in deciding whether and how to proceed in litigation, whether to settle, and what settlement terms to propose or accept
- The Group's primary purpose is providing hazards-of-litigation analysis and legal advice regarding the Company's tax litigation.
- Secondarily, the Company uses the Group's hazards-of-litigation advice in establishing financial statement tax reserves.

Formalize a Tax Litigation Group

- The Group's leader should be an attorney, and:
  - Should be responsible for managing tax litigation
  - Should have at least a dotted line to the law department (to enj oy a presumption that the attorney-client privilege applies)
- The Group's work should be done under the leader's direction and control.
- Group members, to the extent possible, should be attorneys or tax practitioners.
- The Group should exclude persons whose responsibilities are solely the preparation of financial statements.

Control Who Creates Documents

- Documents should be created at the direction of, and under the control and supervision of, the Group's leader.

- Documents should indicate that they are prepared by attorneys or tax practitioners.

- Documents should indicate that they are prepared at the request of the Group leader for litigation purposes.

Create Only Defined Types of Documents

- In general:
  - Confine legal analysis to litigation-oriented documents that are most entitled to privilege and work product protection
  - When creating documents, separate legal analysis from:
    - Business advice
    - Tax reserve calculations
    - Other advice not intended to remain confidential
- Create documents for disclosure outside the Group that contain:
  - only hazards-of-litigation percentages
  - only aggregate reserve information

Control How Documents Are Labeled

- Documents should state that they are providing legal advice to be used for litigation purposes.
- Documents should be labeled, as appropriate, to state that they contain confidential legal advice, subject to privilege and protected by the work product doctrine.
- Do not label business advice, tax return advice, or other advice not intended to be confidential, as privileged or protected.
- Do not label documents containing legal analysis and advice as documents that relate to tax reserve analysis or tax contingency analysis.

Control Access to Documents Inside the Company

- Restrict access to confidential documents.
- In each instance, distribute the least confidential document pos sible.
- Establish a central storage file, and restrict access to it.
- Password protect electronic files.
- Discourage the keeping of personal files, paper and electronic.
- Avoid “broadcast” emails and limit email “chains.”
- Do not place legal memoranda and analyses into tax accrual workp aper files.

Dealing with Auditor Requests for Information

Negotiate Disclosures to Outside Auditors

- Does disclosure to outside auditors constitute a privilege waiver?
  - *El Paso* held "yes," but possibly only because there was then no accountant-client privilege (decision was pre-section 7525)
  - No waiver now due to I.R.C. section 7525?
  - Are the auditors providing protected tax advice?
  - Can disclosure be restricted to tax attorneys in the auditing fi rm, who could then be considered "specialists" under AICPA Professional Standards, AU section 336? Would such an arrangement be permitted under Sarbanes-Oxley standards?
  - Is the auditor's duty of confidentiality sufficient to avoid waiver?
- Disclosure is not likely to compromise work product protection

Negotiate Disclosures to Outside Auditors

- Negotiate with the auditors to disclose only the least confidential types of tax accrual workpapers.

- AU section 9326.22 allows:
  - Rather than the "actual advice," the disclosure of "other sufficient documentation"
  - "Redacted or modified opinions"
  - A summary analysis of an opinion
  - A representation that "the client has not received any advice or opinions that are contradictory to the client's support for the tax accrual"

- Consider giving the auditors only the list of issues reflected i n the tax reserves, and the aggregate amount of the reserves.

Negotiate Disclosures to Outside Auditors

- Enter into a confidentiality agreement with the auditors.
- Enter into a common interest agreement with the auditors, specifying that the Company is providing access to documents solely for the purpose of the parties' common interest in performing the audit, that confidentiality will be maintained, and that no waiver of privilege is intended.
- Include in auditor engagement letters a representation regarding non-adversarial relationship.
- The general rule is that, with respect to an attorney's analysis and mental impressions, work product protection cannot be waived merely by disclosure.
  - Resist disclosure of the documents most clearly prepared in anticipation of litigation.

Dealing with IRS Requests for Information

How Should I Respond To IRS Requests For Information?

- Revenue agents are authorized to examine books and records, and to examine persons. Code § 7602(a)(1). Agents ask for information using Form 4564, Information and Document Requests (IDRs).
- If the taxpayer fails to produce the required information or person, the Service can issue an administrative summons. Code § 7602(a)(2).
- Care must be taken to read IRS information requests closely. If a request is ambiguous or incomplete, the taxpayer must consider whether it has options to comply narrowly or broadly, and must weigh the pluses and minuses of those options.
- Care must be taken when an IRS request for information encompasses information and documents that are privileged or protected.

How Should I Respond To IRS Requests For Information?

- The Service can request to interview employees. Sometimes the Service will accept written responses in lieu of an employee interview. This permits the taxpayer to provide a more considered response. If the Service insists on an interview, great care should be exercised.
  - The scope of the interview, and the topics to be addressed, should be negotiated. The questions to be posed should be requested in advance of the interview.
  - The Service may record the interview. Alternatively, the examining agents may simply take notes.
  - Statements made (or not made) by the interviewee become a "prior statement" of that person. Subsequently, they will be available as evidence, and can be used to impeach that person in later proceedings. Thus, these interviews can be critically important.

Information From Third Parties: The Statutory Framework

- The Service's examination power is extremely broad. I.R.C. § 7602.
  - Most information is considered "relevant or material."
  - The Service can summons any person it "may deem proper."
  - The Service can obtain documents, and take testimony under oath.
- If the Service wants to contact third parties, it must give "reasonable notice in advance to the taxpayer" that contacts may be made. I.R.C. § 7602(c).
- Taxpayer should send a written request to the Service for a list of third party contacts.
- When issuing a third-party summons, the Service must follow the special procedures set forth in section 7609.
- The taxpayer's officers and employees are not "third parties."

Timing of the Notice and Response to the Summons

- When it serves a third-party summons, the Service must notify the taxpayer within 3 days of the service date. I.R.C. § 7609(a).
- The date set for a response to the summons cannot be sooner than 24 days after the date that notice is given to the taxpayer .
- During that period:
  - The summoned party cannot comply with the summons
  - The Service cannot accept any information sought in the summons

Challenging the Summons

- No later than 20 days after notice of the summons, the taxpayer may bring suit in District Court to quash the summons. I.R.C. § 7609(b).
  - The summoned party has the right to intervene in that proceeding.
  - During the proceeding, the limitations period for assessment against the taxpayer is suspended.
- If the summoned party fails to respond, the Service may bring suit in District Court to enforce the summons.
  - The taxpayer has the right to intervene in that proceeding.
  - If the taxpayer intervenes, the limitations period for assessmen t against the taxpayer is suspended.

Dangers of the Interview as "Deposition"

- The Service can take testimony under oath, and have it transcribed by a court reporter. I.R.C. § 7602(a)(2).
- Such testimony will constitute a "prior statement" that can be used to impeach the witness in later proceedings.
- The interview is effectively the same as a deposition.
- IRS counsel (or the agent) may conduct the questioning.
- The Service can use the interview to:
  - Lock the witness into specific factual testimony
  - Establish that the witness has no recollection of certain facts
- Note that this is occurring very early in the controversy process.

Ability to Participate in the "Deposition"

- The case law uniformly holds that the taxpayer has no right to attend or participate in the questioning, holding that:

> "Neither taxpayers nor their attorneys have the right to be present when the summoned parties produce records nor to participate actively in such proceedings. Nor does the taxpayer have a right to be present and cross examine witnesses when the IRS agent questions them."

Daffin (4th Cir. 1981); *Traynor* (10th Cir. 1979); *Newman* (5th Cir. 1971); *Jones* (D.C.S.C. 1999); *Lamberth* (E.D. Va. 1979)

Ability to Participate in the "Deposition"

- However, the person summoned does have the right to legal counsel, and to the counsel of his choice. IRM 25.5.5.4.2.
- Counsel for the taxpayer may, unless a conflict exists, and after full and complete disclosure, represent the witness. IRM 25.5.5.5.
- The Service calls this a "dual representation."
- Circular 230 does not prevent attorneys from representing both parties, if there is express consent of the parties after full disclosure.
- The IRM states that dual representation is permitted, unless the attorney seeks to impede or obstruct the interview.
- Obstruction occurs if the attorney makes "frivolous objections," asserts "frivolous privileges" or otherwise disrupts the interview.

Ability to Participate in the "Deposition"

- Moreover, the IRM states that the person summoned "is permitted to have other persons present during the interview." IRM 25.5.5.4.8.
- The IRM says that "such person may be excluded from the interview."
- However, the IRM then states that "if the witness refuses to be interviewed if that person is excluded . . . the interview will proceed unless the interviewing officer makes a determination that continuation of the interview will impede development of the case."
- Obtaining the prior cooperation of the witness thus is essential .
- It is necessary to negotiate with the Service to gain access to each interview.

Obtaining Copies of the Materials and Transcript

- The person summoned has the right to audio (but not video) recor d the proceeding. The taxpayer could request that this be done.
- The taxpayer could arrange to have the witness represented by ot her counsel. The witness may consent to have that counsel cooperate with the taxpayer's attorney. Preparing a joint defense agreement usually is a good practice to keep future communications about t he issue between the witness and the taxpayer confidential.
- Otherwise, the taxpayer can request the witness transcripts, und er the Freedom of Information Act (FOIA) if necessary
  - The Service may resist, claiming that, under FOIA Exemption #7, disclosure would interfere with their audit investigation
  - Whether interference would result depends on the specific facts
  - The interviewee may raise confidentiality or Privacy Act issues

Joint Defense Agreement

- When the Service has targeted several parties to a transaction, the parties can agree to a joint defense agreement.

- These agreements allow the parties to disclose to each other confidential materials related to matters of common interest without waiving a privilege or protection.

Negotiate Disclosures to the Service

- Require approval of the Group's leader before documents are disclosed to the Service.
- Establish a screening process to prevent disclosures that could result in a waiver of privilege.
- In tax accrual workpaper IDR responses, emphasize the litigation function of the Group, and emphasize the legal content and confidential nature of the documents.
- Prepare a detailed privilege log, stating the specific grounds that support the claim for privilege and protection.
- Be careful about representations to the Service when negotiating disclosure.

Negotiate Disclosures to the Service

- Consider disclosing the least confidential documents to the Service.
  - Do not seek protection for non-confidential documents.
  - Disclose to the Service those documents that contain no legal analysis or advice.
  - Beware of creating a subject matter waiver.
- Focus the controversy on the most protected documents.
  - Withhold those documents that contain legal analysis and advice.
  - Force the Service to determine whether it wishes to press the issue against a taxpayer that has cooperated, but that has taken careful steps to create and maintain confidential documents.