No. 07-2631

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

UNITED STATES,
Petitioner-Appellant

v.

TEXTRON INC. and Subsidiaries,
Respondent-Appellee

ON APPEAL FROM THE JUDGMENT
OF THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

BRIEF FOR THE APPELLANT

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JURISDICTIONAL STATEMENT

The Government filed a petition in the United States District Court for the District of Rhode Island seeking enforcement of an Internal Revenue Service (IRS) summons served on Textron, Inc. and Subsidiaries (Textron). (A6-9.)[1] The court had jurisdiction under §§ 7402(b) and 7604(a) and 28 U.S.C. §§ 1340 and 1345. On August 29, 2007, the court (Senior Judge Torres) entered a memorandum and order denying the Government's petition. (Add1-34.) The judgment (entered on that same day) is final, disposing of all claims of all parties. (Add35.)

The Government filed a timely notice of appeal on October 22, 2007. (A332-333; *see* 28 U.S.C. § 2107 and Fed. R. App. P. 4(a)(1)(B)). This Court has jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES

1. Whether tax-accrual workpapers prepared by Textron (a public corporation) in order to comply with the federal securities laws, and made available to an independent auditor during a regular financial audit, are protected by the work-product doctrine from disclosure in response to an IRS summons.

2. Assuming that Textron's tax-accrual workpapers are protected by the work-product doctrine, whether disclosure of that information to an independent auditor waives the work-product protection.

3. Whether, although it ultimately held that the attorney-client privilege and the tax practitioner-client privilege (§ 7525) did not apply because they were waived, the District Court erred in concluding that Textron satisfied the requirements for invoking those privileges.

4. Whether the District Court erred in not enforcing the summons to the extent that it requested tax-accrual workpapers prepared by the independent auditor.

STATEMENT OF THE CASE

The Government filed a petition to enforce an IRS summons issued to Textron. (A6-9.) Following an evidentiary hearing, the District Court denied the Government's petition. (Add1.) The Government now appeals.

STATEMENT OF THE FACTS

A. Background

This case concerns an IRS summons issued to Textron by Edward Vasconcellos, the revenue agent in charge of investigating Textron's federal income tax liability for (as relevant here) 2001. The summons sought all tax-accrual workpapers created by Textron and its independent auditor for Textron's 2001 tax year. (A19-24.) Tax-accrual workpapers, generally speaking, are documents supporting a company's tax reserve for deferred or contingent tax liabilities and related representations in the company's audited financial statements. *See* Announcement 2002-63, 2002-2 C.B. 72 (A27-28); *United States v. Arthur Young & Co.*, 465 U.S. 805, 808 (1984).

The federal securities laws require public corporations like Textron to file with the Securities and Exchange Commission (SEC) financial statements that have been certified by an independent auditor to fairly represent the company's financial condition in compliance with generally accepted accounting principles (GAAP). *Arthur Young*, 465 U.S. at 810-811, 818-819 & nn.13-14; *see* 15 U.S.C. §§ 78*l*, 78m; 17 C.F.R. § 210 *et seq*. "An important aspect of the auditor's function is to evaluate the adequacy and reasonableness of the corporation's reserve account for contingent tax liabilities." *Arthur Young*, 465 U.S. at 812. Tax-accrual workpapers compute the amount necessary for that reserve account and record a company's analysis of its potential exposure to the requirement to pay additional taxes, if positions on its tax returns are challenged by the IRS. *Id*. at 813.

Tax-accrual workpapers are generated by both independent auditors and company employees. At Textron, tax-accrual workpapers are initially prepared by Textron employees, and are then reviewed by the independent auditor, Ernst & Young (E&Y). (A93.)

In 1984, the Supreme Court unanimously confirmed the IRS's right to obtain tax-accrual workpapers under the broad summons authority of § 7602. *Arthur Young*, 465 U.S. 805. In that case (discussed in more detail below in the Argument), the tax-accrual workpapers were summoned from the independent auditor, not the taxpayer, although

the Supreme Court noted that (i) the auditor's workpapers recorded the taxpayer's own confidential tax-accrual analysis, and (ii) it was IRS policy to first seek this "highly relevant" information from the taxpayer before summoning it from the independent auditor. *Id*. at 812-815, 820-821 & n.17.

Even after the Court recognized the IRS's right to, and need for, tax-accrual workpapers, the IRS followed a policy of restraint, requesting tax-accrual workpapers only in unusual circumstances, and not as a standard examination technique. *See* Announcement 84-46, 1984-18 I.R.B. 18. In 2002, in an effort to curb abusive tax shelters, the IRS modified its policy under which it would seek tax-accrual workpapers. (A27-28.) The revised policy responds to certain tax shelters referred to as "listed transactions," which are "transaction[s] that [are] the same as or substantially similar to one of the types of transactions that the [IRS] . . . has determined to be a tax avoidance transaction." Treas. Reg. § 1.6011-4(b)(2). (A231-232.)

Pursuant to the revised policy published in Announcement 2002-63, the IRS seeks a taxpayer's tax-accrual workpapers for a listed transaction if a taxpayer claims tax benefits from that transaction. (A27.) If a taxpayer claims benefits from multiple listed transactions, the IRS seeks all of a taxpayer's tax-accrual workpapers for that tax year. (*Id*.) As demonstrated below, Textron's 2001 tax return triggered this revised policy because it claims tax benefits from multiple listed transactions.

B. The summons

In 2003, the IRS began an audit to determine Textron's corporate income tax liability for 1998-2001.[2] (A80.) Textron is a conglomerate with over 190 subsidiaries, for which it files one consolidated return. (A10-11, 227.) As part of that audit, the IRS examination team determined that one of Textron's subsidiaries, Textron Financial (TFC), had entered into nine transactions in 2001 that were the same as or substantially similar to a listed transaction known as a "Sale-In, Lease-Out" ("SILO") tax shelter. A SILO is a highly structured transaction that is designed, as a matter of form, to be a sale/leaseback with a tax-exempt entity. According to the IRS, SILOs are not true sale/leasebacks but are, in substance, a sale of tax benefits. (A29-37.) The IRS designated SILOs as listed transactions in Notice 2005-13, 2005-1 C.B. 630. (*Id*.)

When the IRS issued Notice 2005-13, the IRS agents auditing Textron were already aware of TFC's SILO transactions, having learned about them from the IRS's Office of Tax Shelter Analysis. (A235, 265-266.) The designation of the SILOs as listed transactions, however, triggered the IRS's policy of seeking tax-accrual workpapers. (A13-16, 238.)

Consistent with Announcement 2002-63 and Notice 2005-13, Agent Vasconcellos requested Textron's tax-accrual workpapers for 2001. (A12-16.) After Textron refused, he issued an administrative summons to Textron for all its tax-accrual workpapers, including those created by Textron's independent auditor (E&Y), for 2001. (A11.) The summons defined the "tax accrual workpapers" to include:

> [A]ll accrual and other financial workpapers or documents created or assembled by [Textron], an accountant for [Textron], or [Textron's] independent auditor relating to any tax reserve for current, deferred, and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to any footnotes

> disclosing reserves or contingent liabilities on audited financial statements.

(A20.)

The summons made clear that Textron was obligated to produce E&Y's tax-accrual workpapers even if Textron did not physically possess those documents. Specifically, the summons instructed that "Tax Accrual Workpapers include any and all documents meeting the above definition that are in the actual or constructive possession, custody, or control of [Textron] ... or in the actual or constructive possession of [Textron's] current or prior independent auditor" and that such items are in Textron's control if it "has access upon inquiry or through a legal right to obtain." (A21.) The summons required Textron to take certain steps if it believed that the summons sought information beyond its control, including providing the IRS documentation of its attempts to obtain such information. (*Id*.)

Textron refused to comply with the summons. (A12.) There is no evidence in the record that Textron took any steps to obtain E&Y's tax-accrual workpapers, as the summons required. In 2006, the Government commenced the instant suit to enforce the summons.

C. The summons-enforcement proceeding

In an IRS summons-enforcement proceeding, the Government need only make a "minimal" initial showing that the summons was issued for a legitimate purpose, that the information sought may be relevant to that purpose, that the IRS does not possess the information, and that the statutorily required administrative steps have been followed. *United States v. Powell*, 379 U.S. 48, 57-58 (1964). Once the Government makes its *prima facie* showing under *Powell*, a taxpayer opposing enforcement bears a "heavy" burden to overcome that showing. *United States v. LaSalle Nat'l Bank*, 437 U.S. 298, 316 (1978). The Government's petition for enforcement was supported by declarations from (i) Agent Vasconcellos, who addressed the *Powell* requirements, and (ii) an accounting expert, Professor Douglas Carmichael (the former Chief Auditor of the Public Company Accounting Oversight Board, the regulatory body for auditors of public companies (A38)), who discussed the significance of, and accounting standards for, a company's tax-accrual workpapers, and the access that independent auditors must have to them. (A10-18, 38-47, 99-101.) In its brief accompanying the petition, the Government argued that it had made the required *Powell* showing, and that if Textron were to claim that the documents were protected by privileges, it had the burden of proving that the privileges applied on a document-by-document basis. (Doc. 1.)

Textron objected to the petition, contending that *Powell*'s legitimate-purpose requirement was not satisfied and that the workpapers were protected by the attorney-client and tax practitioner-client (§ 7525 [3]) privileges and the work-product doctrine. (A48-77.) In support, Textron provided affidavits from (i) Edward Andrews, Textron's in-house accountant in charge of tax audits; (ii) Roxanne Cassidy, Textron's in-house accountant responsible for creating its tax-accrual workpapers; (iii) Debra Raymond, TFC's in-house accountant responsible for creating its tax-accrual workpapers; [4] (iv) Norman Richter, Textron's chief tax counsel and manager of its Tax Department; and (v) Mark Weston, an E&Y partner. (A79-98.) The affiants described the company's tax-accrual workpapers and how they were generated.

In claiming that its tax-accrual workpapers were privileged, Textron attempted to distinguish the Supreme Court's decision in *Arthur Young* (which had held that nearly identical workpapers were not privileged) as a case involving workpapers prepared by independent auditors. (A63-64.) In so arguing, Textron disregarded that the summons sought E&Y's workpapers (in addition to Textron's workpapers) and that an independent auditor's workpapers incorporate information from a company's workpapers.

In its reply, the Government disputed Textron's improper-purpose and privilege claims. The Government also emphasized that the summons sought E&Y's workpapers, an aspect of the summons that Textron had ignored. (Doc. 15.)

The District Court held an initial hearing (during which it heard arguments) and then an evidentiary hearing. During the initial hearing, the Government reiterated that the summons sought both Textron's and E&Y's workpapers. (A106-107.) During the evidentiary hearing, the Government presented testimony from its two declarants (Agent Vasconcellos and Professor Carmichael) and Gary Kane (an IRS expert on tax-accrual workpapers), and Textron presented testimony from two of its affiants (Cassidy and Richter).

1. Textron's tax-accrual workpapers

Professor Carmichael stated that federal securities laws require public companies to file annually with the SEC financial statements that have been audited by a public accounting firm and to obtain from the auditors an "unqualified or clean opinion" that the financial statements conform with GAAP. (A40-43, 282-285.) If the company fails to do so, it cannot list its stock on a public exchange. (A283.) As part of that annual financial audit, the independent auditor analyzes the reserves covering tax losses and examines the corporation's support for its tax reserves. (A45-47, 281-282.)

Textron's witnesses concurred. They acknowledged that, as a public corporation, Textron was required by law to file its financial statements with the SEC and to have those statements verified by an independent auditor to ensure that they conformed with GAAP. (A175-176, 208-210.) According to Cassidy, Textron's tax-accrual workpapers were created "to determine whether Textron was adequately reserved [on its financial statements] with respect to any potential disputes or litigations that would happen in the future." (A168-169.) Although Textron's 2001 financial statements did not separately report a tax reserve, but instead aggregated its tax and non-tax liabilities, Textron's tax reserve was separately audited. (A175-177.)

To ensure that Textron's tax reserve complied with GAAP, Cassidy generated a tax-accrual schedule that listed all positions Textron was taking on its tax returns that might require that a reserve be recorded on Textron's financial statements. (A83, 162-165.) Those uncertain tax positions were identified and evaluated by Textron's Tax Department accountants and attorneys.[5] (A80, 83-84, 93-94.) For each uncertain tax issue, the schedule listed a "Probability with Percentage" (identifying the likelihood that the IRS would prevail) and an "Amount of Reserve Required" (calculated by multiplying the tax benefit at issue by the probability percentage). (A83, 88, 162-165.) In addition to this schedule, the tax-accrual-workpapers file included all documents that backed up the issues and calculations on the tax-accrual schedule. (A83, 161.)

2. Relationship of tax reserves to litigation

Professor Carmichael testified that public companies prepare tax-accrual workpapers every year to support the representations in their financial statements, irrespective of whether they anticipate litigation over the issues identified in the workpapers. (A285.) Whether a company anticipates litigation or not, it must generate supporting documentation, even if the company is representing that no reserve is needed for additional tax liabilities. (A285-286.) Moreover, companies create tax reserves without anticipating actual litigation. (A304.)[6]

Agent Vasconcellos, in turn, explained that nearly all disputes between Textron and the IRS were resolved without litigation. For example, during the audit of Textron's 1995-1997 tax years, the IRS audit team issued 312 proposed adjustments to Textron, all of which were resolved between the audit team and Textron. (A249.) During the ongoing 1998-2001 audit cycle, the IRS auditors issued 221 proposed adjustments, 188 of which Textron had agreed to by the time of the summons-enforcement proceeding. (A243-244.) For any proposed adjustment to which Textron disagrees, it can attempt to resolve the issue in a conference with the audit-team manager. (A245.) And for those few issues that are not resolved at the audit stage, there are other administrative procedures within the IRS that the parties can use to resolve those issues without resorting to litigation, including having the issue resolved by the IRS Office of Appeals. (A245-249.)

Textron's witnesses agreed, although they noted that Textron had litigated three issues for tax years 1959-present. (A153-154, 183-189, 215-216.) They did not claim that Textron expected to litigate every uncertain issue, and did not identify a single issue from the 2001 tax-accrual workpapers that Textron specifically anticipated to litigate with the IRS. And they admitted that Textron expected to concede several of the issues identified in the workpapers. (A80, 83.) For those issues, the workpapers listed a probability percentage of 100 percent. (*Id*.)

3. Textron's sharing of its tax-accrual analysis with E&Y

Professor Carmichael testified that public companies do not create their tax-accrual workpapers with an expectation of privacy. Rather, corporations understand that they must provide independent auditors unrestricted access to their tax-accrual workpapers in order to obtain a clean opinion (which public companies need for SEC filing requirements and to keep their securities listed on a stock exchange). (A43, 46-47, 282-284.)

Textron's witnesses agreed, acknowledging that Textron was required by law to provide its auditors with evidence that its tax reserves were adequate. (A176, 208-209.) They described how they provided such evidence to E&Y in a meeting to discuss their tax-accrual schedule and whether its calculations were consistent with GAAP. (A84-85.) During the meeting, Textron revealed its tax-accrual analysis to E&Y by providing a copy of the tax-accrual schedule for E&Y to use during the meeting and then discussing at length each issue on the schedule (A160, 174-175), including "references to tax statutes, tax regulations and rulings, and tax cases" (A76, 84-85).

Textron did assert, however, that it expected E&Y to keep Textron's tax-accrual analysis confidential as required by Section 301 of the AICPA's Code of Professional Conduct. (A199.) In response, Professor Carmichael explained that, although Section 301

generally obligated the independent auditor to keep a company's information confidential, the auditor ultimately owes allegiance to the investing public. (A99-100, 286-287.) He also explained that Section 301 expressly provides an exception to the confidentiality requirement to permit auditors to comply with their legal and professional obligations as well as validly issued subpoenas and summonses. (A99-100, 292-293.)

4. E&Y's workpapers

Professor Carmichael described how independent auditors incorporate a company's tax-accrual analysis into the auditor's own tax-accrual analysis as documented in the auditor's tax-accrual workpapers. (A45-47.) In creating those workpapers, the auditor inspects the company's tax-accrual workpapers, and interviews the company's personnel involved in developing the tax accrual. (*Id*.) The auditor's workpapers will also contain the auditor's own judgment as to the correctness of the company's tax position and an item-by-item analysis of the company's uncertain tax positions. (*Id*.)

Although the summons expressly sought E&Y's workpapers, Textron provided no evidence regarding those workpapers, other than to assert that Textron was not given a copy of them. (A161, 199.) At no point did Textron assert that it was unable to obtain copies of E&Y's workpapers, nor did it provide evidence of its efforts to obtain those workpapers, as the summons instructed (A20-21). Textron did admit that it had access to E&Y's audit files. (A89.)

5. IRS's use of tax-accrual workpapers

The IRS agents explained how the tax-accrual workpapers could assist them in determining Textron's tax liability by providing guidance for navigating the voluminous raw data produced by Textron and by disclosing unidentified issues. (A16-17, 239, 266-267, 315-316.) During the audit, Textron had produced documents filling 9 four-drawer file cabinets. (A80.) Textron's consolidated tax return itself was over 4,000 pages and covered 190 different companies. (A226-228.) As Textron's senior tax attorney stated, given the complexities of Textron's tax return, the IRS is not always able to identify all the uncertain tax positions that Textron has identified in its tax-accrual schedule. (A214.)

In addition to organizing raw data in a comprehendible manner and disclosing unidentified issues, tax-accrual workpapers could also provide the IRS additional information about a transaction that the transaction documents alone would not reveal. (A16-17, 233-237.) As a general rule, tax benefits are based on a transaction's substance, not its form. A transaction's individual documents, however, reflect only its form (such as the sale and lease agreements in SILOs). To understand the substance of the transaction (and thus whether it passes muster under the tax laws), one must be able to view the formal documents in context, a context that the taxpayer is in a unique position to understand.

Finally, Textron's assessment of an uncertain issue's reserve percentage could assist the IRS agents in determining whether to use their limited resources to develop that issue. (A239-240, 267.) The percentage was also relevant to the IRS's determination of whether to assert penalties. (A241-242, 316.) According to Agent Vasconcellos, this penalty-related information was needed during the audit because the tax issues and the

penalties related to those issues are developed "at the same exact time" and assessed in the "same [audit] report." (A242-243.)

D. District Court opinion

The District Court denied enforcement of the petition, determining that Textron's tax-accrual workpapers are protected by the work-product doctrine. The court focused solely on the workpapers created by Textron, and did not explain why it was denying enforcement as to E&Y's workpapers.

The court first determined that the *Powell* requirements for a summons had been satisfied. (Add7-12.) The court then addressed Textron's privilege claims.[7] The court determined that Textron's workpapers are eligible for the attorney-client privilege (which generally protects advice that is both confidential and legal) because Textron used in-house lawyers to identify and assess the uncertain tax positions. (Add15.) The court also found that, to the extent TFC's workpapers reflected similar "legal advice" provided by its in-house accountants, the accountants were performing "lawyers' work" and TFC's workpapers are privileged under § 7525. (Add16-17.) The court did not address whether this "legal advice" was generated with an expectation of confidentiality.

The court then considered the work-product doctrine, which protects materials prepared for trial or in anticipation of litigation. (Add19.) The court did not find that Textron prepared its tax-accrual workpapers to reserve for existing or threatened litigation; the court found that the workpapers were prepared: (i) to ensure that Textron was adequately reserved on its financial statements with respect to any potential disputes or litigation that might arise "in the future"; and (ii) to satisfy E&Y that Textron's contingent-liability reserve complied with GAAP so that the auditor would provide Textron a "clean" opinion regarding its SEC filings. (Add5-6.) Nevertheless, the court concluded that the work-product doctrine applied, reasoning that the workpapers would not have been prepared at all "but for" the fact that Textron anticipated the "possibility" of litigation with the IRS. (Add22-23.)

The court next considered whether Textron had waived the privileges. The court found that Textron's providing its workpapers to E&Y waived the attorney-client and § 7525 privileges,[8] but did not waive work-product protection. (Add24-32.) There was no work-product waiver because, in the court's view, an independent auditor was not a potential adversary, and disclosure to E&Y did not substantially increase the IRS's opportunity to obtain Textron's tax-accrual information. (Add29-31.) In so ruling, the court relied on AICPA Code of Professional Conduct Section 301's confidentiality requirement. (Add29-30.) The court did not address the fact that Section 301 expressly permits disclosure pursuant to a summons, a point emphasized by Professor Carmichael (A99-100, 293).

In concluding that the IRS was not entitled to Textron's tax-accrual workpapers, the court ruled that disclosure would be "unfair" to Textron and that the workpapers had "little bearing on the determination of Textron's tax liability," dismissing as "premature" the IRS's argument that the workpapers would assist in the penalty determination. (Add33-34 & n.5.) In doing so, the court did not address the undisputed testimony that the IRS assesses tax and penalties at the same time (A242-243) or the Supreme Court's ruling in *Arthur Young* that tax-accrual workpapers are "highly relevant" to an IRS audit.

SUMMARY OF ARGUMENT

This case concerns whether tax-accrual workpapers (which identify questionable positions taken by Textron on its federal income tax return) generated by Textron and its independent auditor (E&Y) so that Textron could comply with SEC filing requirements are subject to an IRS summons. Almost 25 years ago, the Supreme Court held, in a unanimous decision, that tax-accrual workpapers - generated by an independent auditor and incorporating a public company's confidential tax-accrual analysis - were not privileged and were subject to an IRS summons. *United States v. Arthur Young*, 465 U.S. 805 (1984).

1. The District Court's ruling that Textron's tax-accrual workpapers are protected work product (i) misapplies *Arthur Young*; (ii) conflicts with this Court's work-product test, which denies protection to documents that would have been created irrespective of litigation (such as the workpapers here, which were generated to satisfy SEC filing requirements); and (iii) unnecessarily creates a direct split with the Fifth Circuit, which has held that a company's tax-accrual workpapers are not protected work product. Further, the premise underlying the court's holding - that a public company need not create tax-accrual workpapers unless it anticipated litigation - contradicts the undisputed facts as well as settled law.

2. Alternatively, the District Court's conclusion that Textron did not waive work-product protection by disclosing its tax-accrual analysis to E&Y cannot withstand scrutiny. Disclosure of work product to a potential adversary, or a potential conduit to a potential adversary, waives the protection. Here, E&Y (which essentially controls whether Textron can remain listed on the stock exchange) is a potential adversary as well as a potential conduit to other potential adversaries, such as the SEC. The court's reliance on E&Y's professional obligation of confidentiality is misplaced because that obligation expressly yields to a valid summons and other legal obligations, a point emphasized by the IRS's auditing expert and overlooked by the court.

3. The District Court also erred by ruling that Textron had satisfied its burden to invoke the attorney-client and § 7525 privileges. Those privileges require that documents be created with an expectation of confidentiality. Here, Textron created tax-accrual workpapers knowing that they must be available for E&Y to review.

4. The summons here also sought E&Y's tax-accrual workpapers. By denying the summons-enforcement petition with respect to those workpapers, the District Court's ruling directly conflicts with *Arthur Young*.

ARGUMENT

I

The District Court erred as a matter of law in determining that the tax-accrual workpapers prepared by a public corporation for a regular financial audit required by federal securities laws are protected by the work-product doctrine from disclosure in response to an IRS summons

Standard of Review

The standard of review in cases involving privilege claims depends on the issue. District court rulings on issues of law (such as the scope of the work-product doctrine) are reviewed *de novo*, factual determinations are reviewed for clear error, and discretionary judgments for abuse of discretion. *Cavallaro v. United States*, 284 F.3d 236, 245 (1st Cir. 2002).

A. Introduction

1. IRS summons enforcement

The United States system of taxation relies on self-assessment and the good faith and integrity of each taxpayer to disclose completely and honestly all information relevant to its tax liability. "Nonetheless, it would be naive to ignore the reality that some persons attempt to outwit the system." *United States v. Bisceglia*, 420 U.S. 141, 145 (1975). Congress has long recognized that if the Treasury is to enforce effectively and fairly the internal revenue laws, it must be able to obtain information with respect to persons who may have violated those laws. Thus, in § 7602,[9] Congress provides the IRS a broad and vigorous summons power through which it can compel a taxpayer to disclose information that sheds light on the accuracy of the taxpayer's self-reporting. *Id.*

Without this broad summons power, the IRS could not effectively evaluate a taxpayer's "self-assessment," and "our national tax burden would not be fairly and equitably distributed." *Arthur Young*, 465 U.S. at 815-816. When one taxpayer escapes its proper share of the nation's revenue needs, other taxpayers are left to pick up the slack. *E.g.*, *Alamo Nat'l Bank v. Commissioner*, 95 F.2d 622, 623 (5th Cir. 1938) (the IRS "in effect represents the interests of all other taxpayers who must bear what the particular taxpayer unjustly escapes"). Accordingly, the Supreme Court has directed that § 7602 be broadly construed to facilitate effective tax investigations. *E.g., Arthur Young*, 465 U.S. at 814. As the Court has explained, "[a]lthough such investigations unquestionably involve some invasion of privacy, they are essential to our self-reporting system." *Bisceglia*, 420 U.S. at 146.

2. The work-product doctrine

The IRS summons authority is subject to both the attorney-client privilege and work-product immunity, two distinct doctrines whose protections sometimes overlap. In general, the attorney-client privilege protects confidential communications between clients and their attorneys to facilitate obtaining legal advice. *United States v. MIT*, 129 F.3d 681, 684 (1st Cir. 1997). In contrast, the work-product doctrine applies only to documents specifically "prepared in anticipation of litigation or for trial." Fed. R. Civ. P. Rule 26(b)(3).

To determine whether documents have been prepared "in anticipation of litigation," courts have applied either the "because of" test or the "primary purpose" test. This Court has adopted the "because of" test, pursuant to which "documents should be deemed prepared for litigation and within the scope of the [work-product rule] if, 'in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained *because of* the prospect of litigation.'" *Maine v. Dep't of Interior*, 298 F.3d 60, 68 (1st Cir. 2002) (quoting *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998)) (emphasis in original).[10] Courts applying the "primary purpose" test provide work-product immunity where "'the primary

motivating purpose behind the creation of the document was to aid in possible future litigation.'" *United States v. El Paso Co.*, 682 F.2d 530, 542 (5th Cir. 1982) (citation omitted).

Courts (including this Court) have made clear that, under either test, work-product protection cannot be extended to "'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation,'" *Maine*, 298 F.3d at 70 (quoting *Adlman*, 134 F.3d at 1202), including documents prepared "pursuant to regulatory requirements," *Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co.*, 967 F.2d 980, 984 (4th Cir. 1992); *accord El Paso*, 682 F.2d at 542 (no work-product protection for documents "'assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation'") (citation omitted). If a document would have been created irrespective of the litigation, it is not protected by the work-product doctrine, "even if the documents aid in the preparation of litigation." *Maine*, 298 F.3d at 70.

The party invoking a recognized privilege "bears the burden of establishing that it applies to the communications at issue and that it has not been waived." *In re Keeper of the Records (XYZ Corp.)*, 348 F.3d 16, 22 (1st Cir. 2003). Moreover, "in the context of IRS investigations," privileges are narrowly construed, "given the 'congressional policy choice *in favor of disclosure* of all information relevant to a legitimate IRS inquiry.'" *Cavallaro*, 284 F.3d at 245 (citation omitted; emphasis in original).

3. Tax-accrual workpapers

The IRS's authority to obtain tax-accrual workpapers through its summons power has been uniformly recognized since 1984, when the Supreme Court unanimously held that accountants' tax-accrual workpapers were "highly relevant" to an IRS audit and were not protected by an accountant's work-product doctrine. *Arthur Young*, 465 U.S. at 815-821. In so holding, the Court resolved an issue upon which the courts were split. The Fifth Circuit had held that tax-accrual workpapers created by a taxpayer were not protected by the work-product doctrine and were therefore subject to an IRS summons. *El Paso*, 682 F.2d at 542-544, *cert. denied*, 466 U.S. 944 (1984). The Second Circuit, in contrast, had held that tax-accrual workpapers created by an independent auditor, and incorporating the taxpayer's confidential tax-accrual analysis, were protected by an accountant work-product doctrine and were not, therefore, subject to an IRS summons. *United States v. Arthur Young & Co.*, 677 F.2d 211, 215-221 (2d Cir. 1982), *rev'd on that ground by* 465 U.S. 805 (1984).

The Supreme Court reversed the Second Circuit's ruling that the accountant's workpapers were protected work product. The Court first confirmed that such documents were not only relevant, but were "highly relevant." 465 U.S. at 815. As the Court explained, tax-accrual workpapers are relevant because they focus the IRS on the "soft spots" on a taxpayer's return and thereby advance the Congressional design of a tax-collection system based on taxpayer self-assessment coupled with broad IRS investigatory powers. *Id*. at 812-816; *accord El Paso*, 682 F.2d at 537, 545.

The Supreme Court then determined that work-product protection was not appropriate because, unlike an attorney acting as an "advocate" and presenting "the client's case in the most favorable possible light," the role of the independent auditor and the tax-

accrual process was to inform the public as to the accuracy of a public company's financial statements and engage in a "'worst-case' analysis in order to ensure that the tax accrual account accurately reflects the full extent of the corporation's exposure to additional tax liability." *Id*. at 812, 817. In so ruling, the Court found that the federal securities laws effectively required corporations to provide their auditors "matters relating to the tax accrual reserve" and to obtain "an unqualified opinion" from the auditor as to the reserve's accuracy. *Id*. at 810-811, 818-819 & nn.13-14.

The Court rejected the taxpayer's "fairness" argument, *i.e.*, that providing the IRS access to its accountant's tax-accrual workpapers "permits the Government to probe the thought processes of its taxpayer citizens, thereby giving the IRS an unfair advantage in negotiating and litigating tax controversies." 465 U.S. at 820. As the Court explained, such "'invasion[s] of privacy'" are "'essential to our self-reporting system'" where the taxpayer possesses all the facts and the IRS is forced to rely, in the first instance, on a taxpayer's self-assessment of its tax liability. *Id*. at 816 (citation omitted). In rejecting the taxpayer's "fairness" argument, the Court noted with approval the IRS's policy of attempting to obtain the information "from the corporation itself before issuing a summons to the independent auditor." *Id*. at 820-821 & n.17.[11]

Although the Supreme Court recognized that the independent auditor's workpapers incorporated and analyzed the taxpayer's confidential tax-accrual analysis, the Court did not directly address whether a taxpayer's tax-accrual workpapers were protected by the work-product doctrine. That question was directly addressed by the Fifth Circuit in *El Paso*. There, the court concluded that the company's tax-accrual workpapers were not protected work product because "[b]usiness imperatives, not the press of litigation, call these documents into being." 682 F.2d at 543-544. As the court explained, documents "'assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation'" are not protected work product, and tax-accrual workpapers are "compelled by the securities laws" in order "to back up a figure on a financial balance sheet." *Id*. at 542-544 (citation omitted). Three weeks after deciding *Arthur Young*, the Supreme Court denied review in *El Paso.* 466 U.S. 944 (1984).

Following the Supreme Court's 1984 reversal in *Arthur Young* and denial of certiorari in *El Paso*, it was generally understood that tax-accrual workpapers generated to comply with GAAP and federal securities laws (compiled by either the independent auditor or the taxpayer) were subject to an IRS summons and were not immunized by the work-product doctrine. *E.g.*, Donald Alexander & Brian Gleicher, IRS Procedures: Examinations and Appeals, BNA Tax Management Portfolio at A-64 & n.745 (2007) (noting that IRS examiners will use "discretion" before requesting a "taxpayer's audit workpapers and/or tax accrual workpapers" but that such workpapers "are not privileged and must be furnished to the IRS if requested"). Indeed, other than the court below, no court has since held that the work-product doctrine protects tax-accrual workpapers. *See United States v. Rockwell Int'l*, 897 F.2d 1255, 1266 (3d Cir. 1990) (instructing district court that taxpayer's tax-accrual file was not protected work product if it were "maintained so that [the taxpayer] may comply with [GAAP] and SEC reporting requirements"); *United States v. ChevronTexaco Corp.*, 241 F. Supp. 2d 1065, 1088 (N.D. Cal. 2002) (recognizing (in a case that did not concern tax-accrual workpapers) that documents generated for "meeting [the taxpayer's] financial reporting obligations or

addressing tax accrual matters" are ineligible for work-product protection). In light of the breadth of the § 7602 summons power, the limited scope of the work-product doctrine, and the non-litigation purpose for which tax-accrual workpapers are created, it is not surprising that no other court has protected tax-accrual workpapers from an IRS summons on the grounds of the work-product doctrine (or any other privilege).

The District Court's departure from the existing precedents is unfounded. As demonstrated below, the court's determination that Textron's tax-accrual workpapers are protected work product (i) misapplies the Supreme Court's *Arthur Young* decision, (ii) conflicts with this Court's work-product test set out in *Maine*, and (iii) unnecessarily creates a conflict with the Fifth Circuit's *El Paso* decision. Moreover, its view that the work-product doctrine applies if a taxpayer anticipates the mere "possibility" of litigation with the IRS threatens to destroy the IRS summons power because all taxpayers are generally aware of the possibility of litigation with the IRS whenever they create any document.

Before turning to those arguments, we briefly address two errors in the District Court's decision that, while not directly part of its work-product analysis, appear to have influenced that analysis. In denying the IRS's right to obtain Textron's tax-accrual workpapers, the court erroneously (and somewhat inconsistently) asserted (Add34) that those workpapers (i) had "little to do" with the determination of Textron's tax liability and (ii) "would put Textron at an unfair disadvantage" in disputes regarding its tax liability. Both assertions are wrong, and were rejected in *Arthur Young*.

The District Court's conclusion that Textron's tax-accrual workpapers had "little bearing on the determination of Textron's tax liability" (Add33) is an unwarranted and erroneous repudiation of the Supreme Court's ruling that such workpapers are "highly relevant" to that determination. *Arthur Young*, 465 U.S. at 815; *accord United States v. Arthur Andersen & Co.*, 623 F.2d 725, 729 (1st Cir. 1980) (tax-accrual workpapers "indicate soft spots where IRS could profitably probe"). Similarly, the court's speculation that it would be unfair for the IRS to obtain Textron's tax-accrual analysis disregards the Supreme Court's rejection of a similar "fairness" argument in *Arthur Young*. 465 U.S. at 820 (rejecting notion that "fundamental fairness precludes IRS access to accountants' tax accrual workpapers").

The District Court (unlike the Supreme Court) failed to comprehend the dynamics of a self-reporting tax system. Tax assessment does not begin on a level playing field. On the contrary, the taxpayer has all the information relevant to its actual tax liability, and self reports its liability in a manner that is (presumably) most favorable to its position. Even where the taxpayer produces all the raw factual data that the IRS has requested (such as the transaction documents related to TFC's SILOs), the IRS is left to parse through the raw data produced by the taxpayer - here, a 4,000-page tax return and a room full of produced paperwork -to try and determine what the taxpayer already knows, *i.e.*, what are the real issues and what is the substance (as distinct from the form) of a taxpayer's transactions. Far from seeking an unfair advantage, the summons here attempts to put the IRS on a more equal footing with Textron as to apprehending Textron's tax positions -a proposition the Court in *Arthur Young* understood, but the District Court did not.[12]

Of course, a taxpayer has no duty to maximize its tax liability. But the taxpayer's obligation is not merely to pay only those amounts as the IRS is able to ferret out. Rather, a taxpayer has a duty to cooperate with the IRS during an audit and is not free to play its cards close to its vest in the hope of going undetected or to turn the tax system into a "sophisticated game of hide and seek." *United States v. Price Waterhouse & Co.*, 515 F. Supp. 996, 999-1000 (N.D. Ill. 1981) (enforcing IRS summons seeking "opinions or judgments with respect to issues not identified by the IRS" contained in independent auditor's tax-accrual workpapers). It does not offend traditional notions of fair play and justice for the IRS, in administering the self-reporting tax system, to review the materials underlying Textron's representations to the SEC and investing public, any more than it would to give the IRS access to other corporate memoranda prepared in the regular course of business (*e.g*., in anticipation of a stockholders' meeting) that contain a candid analysis of a transaction's substance. *E.g., Tribune Co. v. Commissioner*, 125 T.C. 110, 135 (2005) (relying on taxpayer's representations to shareholders that transaction was in substance a sale in case where taxpayer represented to the IRS that transaction was a tax-free reorganization).

By following its own sense of relevance and fairness instead of binding precedent, the District Court disregarded this Court's admonition that § 7602's "reach and strength are not lightly to be reduced." *Arthur Andersen*, 623 F.2d at 727. To deny the IRS the same knowledge of the soft spots that Textron possesses (and has disclosed to an independent auditor) turns the tax audit into a "sophisticated game of hide and seek," a result in contravention of Congress's purpose in enacting § 7602.

B. The District Court's determination that Textron's tax-accrual workpapers are protected work product misapplies the Supreme Court's Arthur Young decision, which determined that essentially identical information in an independent auditor's files was subject to an IRS summons

In *Arthur Young*, the Supreme Court determined that the IRS was entitled to the "confidential," 677 F.2d at 219, "opinions, speculations, and projections of management with regard to unclear, aggressive, or questionable tax positions that may have been taken on prior tax returns" contained in the independent auditor's files, 465 U.S. at 812. If, as the Supreme Court ruled, a company's tax-accrual analysis is not protected by an accountant's work-product doctrine when it is incorporated into the accountant's tax-accrual workpapers, then that same analysis should not be protected by the attorney work-product doctrine when it is revealed to the independent auditor, but kept in the company's files - either because these documents are not work product in the first place or because disclosure to the independent auditor waives the protection.

The tax-accrual workpapers protected by the District Court are not meaningfully different in form or function from those for which work-product protection was denied in *Arthur Young*. As a matter of form, the tax-accrual workpapers here and in *Arthur Young* both identified and evaluated "questionable positions" taken by the taxpayer on its tax returns and recorded an "item-by-item analysis of the corporation's potential exposure to additional liability." 465 U.S. at 808, 812-813; Add4-5. Both "predict[ed] the chances that the taxpayer's position will be upheld by the courts." *Arthur Young*, 677 F.2d at 217; A4-5. As a matter of function, the workpapers here and in *Arthur Young* were created to demonstrate that there were no "potential problems inherent in the corporation's

financial reports." 465 U.S. at 818-819 & n.15; Add5-6. And both were generated "in the course of a routine review of corporate financial statements" required by the SEC, *Arthur Young*, 465 U.S. at 810-811, 815; Add6, not in response to any specific litigation or other non-routine purpose.

Although the specific workpapers at issue in *Arthur Young* were generated by the independent auditor (instead of, as here and in *El Paso*, the taxpayer itself), the Court recognized that the auditor's workpapers "document the auditor's interviews with corporate personnel" and reflect "the opinions, speculations, and projections of management with regard to unclear, aggressive, or questionable tax positions that may have been taken on prior tax returns." *Id*. at 812. As the Second Circuit explained in *Arthur Young*, the workpapers "reflect what the *taxpayer* - and his accountant - think about transactions that have already taken place." 677 F.2d at 218 (emphasis added); *accord id.* at 220 (an accountant's workpapers reveal "not only the auditor's thoughts but also the *taxpayer*'s basic thinking" and provides "a roadmap of the thoughts and theories of a *taxpayer* and its independent auditor") (emphasis added).

Moreover, as the opinions in *Arthur Young* demonstrate, it is, as a practical matter, impossible to demarcate the work of the auditor and the work of the company. As the Supreme Court emphasized, the auditor's workpapers will incorporate the company's tax-accrual analysis. *Arthur Young*, 465 U.S. at 812-813; *see also* A45-47. And the company, in turn, creates its tax-accrual workpapers for the purpose of defending the accuracy of its financial statements to the independent auditor, and, in doing so, shares its tax-accrual analysis with the auditor, as the undisputed testimony establishes. (A76, 84-85, 160, 174-176, 208-209, 282-284.) Assuming that the auditor provides the taxpayer a clean opinion (as E&Y did here (A296)), there should not be any material deviation in the auditor's and the company's ultimate tax-accrual analysis.

Nevertheless, the District Court failed to apply *Arthur Young* in both its determination that Textron's workpapers qualified as work product and in its determination that Textron's disclosure of its tax-accrual analysis to E&Y did not waive the protection. (Add19-24, 27-32.) That the workpapers in *Arthur Young* were prepared by independent auditors whereas the workpapers here were prepared by Textron - as the District Court pointed out in its discussion of the attorney-client privilege (Add15-16) - is beside the point.[13] Both sets of workpapers were prepared for the same, nonlitigation, ordinary-course-of-business purpose. Moreover, the Supreme Court recognized that creating tax-accrual workpapers is accountants' work. Having attorneys do that accountants' work (as Textron does) does not invest it with work-product protection. *E.g., United States v. Bisanti*, 414 F.3d 168, 171-172 (1st Cir. 2005).

Finally, although the Supreme Court did not directly address whether tax-accrual workpapers maintained by the taxpayer (as opposed to the independent auditor) were subject to an IRS summons, the Court cited approvingly recently enacted "IRS guidelines" in which "the IRS has demonstrated administrative sensitivity to the concerns expressed by the accounting profession by tightening its internal requirements for the issuance of such summonses," including urging its examiners to "first take all reasonable means to *secure the information from the corporation itself*." 465 U.S. at 820-821 & n.17 (citing Internal Revenue Manual (CCH) § 4024.4 (1981)) (emphasis added). As those guidelines spelled out, "[w]hen requesting information pertaining to the

tax accrual, the examiner should first take all reasonable means to secure this information from the corporate officer before looking to the independent auditor to provide the information." 1 Internal Revenue Manual (Audit) (CCH) § 4024.4 (May 14, 1981). That the Supreme Court affirmatively encouraged the IRS to first seek the company's tax-accrual workpapers belies any notion that such workpapers are somehow protected from the reach of an IRS summons.

C. The District Court's work-product ruling conflicts with this Court's work-product test

As this Court has made clear, work-product protection does not apply to "'documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.'" *Maine*, 298 F.3d at 70 (citation omitted); *accord Nat'l Union*, 967 F.2d at 984 (documents prepared "pursuant to regulatory requirements" are not work product). Both the relevant case law and the undisputed facts demonstrate that tax-accrual workpapers are prepared in the ordinary course of a public company's business in order to comply with the federal securities laws, not because of litigation, and would have been prepared even if Textron does not anticipate any specific litigation.

As noted above, the Supreme Court has determined that tax-accrual workpapers are generated pursuant to the federal securities laws. *Arthur Young*, 465 U.S. at 810-812; *accord El Paso*, 682 F.2d at 534-535. Although this Court has not yet addressed the specific question as to whether tax-accrual workpapers are work product, it has previously recognized (consistent with the Supreme Court and the Fifth Circuit) that such workpapers are effectively "required" by the securities laws. *United States v. Arthur Andersen & Co.*, 623 F.2d 720, 722 n.2 (1st Cir. 1980).[14]

The District Court did not make any contrary factual findings regarding Textron's tax-accrual workpapers. The court did not find that the documents were created for either general litigation purposes or in anticipation of any specific litigation. Rather, the court found (consistent with *Arthur Young* and *El Paso*) that the documents were generated to (i) ensure that Textron was adequately reserved for any potential future tax liabilities (as GAAP requires),[15] and (ii) obtain a clean opinion regarding its financial statements from its independent auditor (as the federal securities laws require). (Add5-6.) Moreover, those factual findings are fully supported by the record. Witnesses for both the IRS and Textron testified that the tax-accrual workpapers had been prepared to satisfy Textron's annual filing requirements under the securities laws. (A168-169, 175-176, 282-285.)

Thus, applying *Maine*'s work-product test to the District Court's factual findings, Textron's tax-accrual workpapers cannot be protected. They were prepared in the ordinary course of business to satisfy Textron's obligations under the federal securities laws and would have been created in essentially the same form irrespective of litigation. By failing to recognize the legal consequences of its factual findings under *Maine*, the court erred as a matter of law.

Instead of following *Maine*'s work-product test (which the court noted in passing (Add22)), the District Court instead reasoned that the tax-accrual workpapers "would not have been prepared at all 'but for' the fact that Textron anticipated the possibility of litigation with the IRS" and that if "Textron had not anticipated a dispute with the IRS,

there would have been no reason for it to establish any reserve or to prepare the workpapers used to calculate the reserve." (Add22-23.) That conclusion (i) is refuted by the undisputed facts and (ii) misconstrues this Court's work-product test.

The undisputed facts belie the District Court's unsupported conclusion that there would be no audited tax reserve (and thus no workpapers supporting that reserve) unless Textron anticipated litigation with the IRS for the amounts reserved. First, two of Textron's affiants testified that the reserve at issue included items that Textron intended to concede and that, for those items, the reserve included the full amount of the claimed tax benefit. (A80, 83.) This uncontradicted and noncontroversial testimony cannot be squared with the District Court's no-reserve-but-for-anticipated-litigation conclusion that was critical to its analysis. Second, Professor Carmichael, the former Chief Auditor of the Public Company Accounting Oversight Board, testified, without contradiction, that, because of accounting standards, the workpapers would have been created in substantially the same form whether or not litigation was anticipated, further undermining the District Court's conclusion that anticipated litigation was the *sine qua non* of tax-accrual workpapers. (A285-286, 304.) Third, even if Textron anticipated no tax disputes whatsoever, it would still have reserves for noncontingent taxes (such as the deferred-tax reserve), which the summons sought (A20). (A278, 309-311.) As Professor Carmichael testified (and Textron did not dispute), Textron would have to justify having no contingent-tax reserve to the auditors, and, in doing so, would generate tax-accrual workpapers. (A285-286.) Finally, nearly all of the audit issues between Textron and the IRS were resolved without litigation. (A244-249.) Given those undisputed facts, the court's conclusion that "there would have been no need to create a reserve in the first place, if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding" (Add23) is clearly erroneous.

The District Court's conclusion also fails as a matter of law because it disregards this Court's work-product test. Under that test, if (as here) the documents "'are prepared in the ordinary course of business or [ ] would have been created in essentially similar form irrespective of the litigation,'" then - as a matter of law as well as logic - they were not prepared "because of" the litigation. *Maine*, 298 F.3d at 70 (citation omitted). The court sidestepped that test altogether. Instead, it applied a "but for" analysis that confuses context and content, myopically focusing on Textron's description of its workpapers' content (which analyzed to some degree the "estimated hazards of litigation percentages" (Add22)) instead of the circumstances surrounding the creation of the documents. As this Court has made clear, however, the "mere relation of documents to litigation does not automatically endow those documents" with work-product protection. *Id*. at 69. The "key issue in determining whether a document should be withheld is the function that the document serves," not its "content." *United States v. Roxworthy*, 457 F.3d 590, 595 (6th Cir. 2006). Rather than narrowly focusing on the document's content (as the District Court erroneously did), courts must more broadly determine "the driving force behind the preparation of each requested document" in order to resolve "a work product immunity question." *Nat'l Union*, 967 F.2d at 984; *e.g., In re Royal Ahold Sec. & ERISA Lit.*, 230 F.R.D. 433, 435 (D. Md. 2005) (no work-product protection for documents created to satisfy independent auditors, even though "company was also preparing for litigation"). The driving force here is the SEC (and

Textron's desire to publicly trade its stock), not IRS litigation. That some tax-accrual workpapers may - as a matter of *content* - predict the results of possible IRS litigation does not mean that those workpapers - as a matter of *context* - were prepared because of that litigation.

Even if the tax-accrual workpapers actually discussed specific anticipated litigation (and there is no evidence that they did), that does not mean that they were created "because of" that litigation. In *Adlman*, the court addressed a memorandum that evaluated the "likely outcome of litigation expected to result from [a proposed] transaction" and remanded the case to the district court to determine whether the memorandum was generated "as part of the ordinary course of business of undertaking the restructuring." 134 F.3d at 1197, 1204. Similarly, in *Rockwell*, the court applied the "because of" standard to a taxpayer's tax-accrual workpapers and remanded the case to the district court to determine whether the workpapers were created to comply with GAAP and SEC reporting requirements (as the IRS argued) or to aid Rockwell in future litigation with the IRS (as the taxpayer argued). 897 F.2d at 1266. Here, the District Court expressly found (Add5-6) that Textron's tax-accrual workpapers were created to comply with GAAP and SEC reporting requirements. Given that finding, the work-product doctrine cannot apply as a matter of law.[16]

Moreover, even if (contrary to settled law and the undisputed facts) Textron's tax-accrual workpapers would not have been created "but for" litigation, the District Court nevertheless erred as a matter of law by providing blanket protection to all of Textron's tax-accrual workpapers based only on the proposition that Textron generally anticipates the "possibility of litigation" with the IRS (Add22) instead of identifying the specific litigation for which each withheld document was created, as this Court requires. *Maine*, 298 F.3d at 69. The "general possibility of litigation" is insufficient for work-product protection. *Nat'l Union*, 967 F.2d at 984. Rather, "the documents must at least have been prepared with a specific claim supported by concrete facts which would likely lead to litigation in mind." *Coastal State Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 865 (D.C. Cir. 1980). As this Court has held, a party claiming work-product protection must "make the correlation between each withheld document and the 'litigation for which the document was created.'" *Maine*, 298 F.3d at 69 (citation omitted). If the party asserting the work-product doctrine fails to do so, the doctrine is inapplicable. *Id*.

Here, the District Court did not make the required correlation between each withheld document and the litigation for which it purportedly was created. Without such findings, the court erred as a matter of law in providing blanket protection to all of Textron's tax-accrual workpapers. That those workpapers generally listed "items that might be challenged by the IRS" (Add22) does not mean, as the court concluded, that all of those items "w[ere] likely to result in litigation" (Add23). Indeed, that unsupported conclusion contradicts (i) Textron's admission that it did *not* anticipate litigation for several of the issues in the tax-accrual workpapers (A80, 83), and (ii) the undisputed testimony as to how most -if not all - disputed issues were resolved without litigation for any given audit cycle (A244-249). Similarly, that Textron had litigated three issues with the IRS in the past does not mean that Textron is likely to litigate in the future the specific issues listed in its tax-accrual workpapers (but not identified in the record), as the District Court

wrongly suggests (Add23).[17] Under the court's reasoning, every document generated by the IRS would be protected work product because the IRS is constantly in litigation.

Unless reversed, the District Court's articulation of the work-product doctrine threatens to immunize nearly every document generated by lawyers because clients can always be said to be aware of possible litigation. Under that interpretation, the work-product doctrine would swallow the attorney-client privilege, and would encompass essentially all legal advice. Such an expansion of the work-product doctrine conflicts with settled law, *e.g., Adlman*, 134 F.3d at 1204 (company not entitled to work-product protection merely because it "had the prospect of litigation in mind when it" created a document), as well as the mandate that privileges should be narrowly construed in IRS investigations.

D. Affirming the District Court would create a direct (and unnecessary) conflict with the Fifth Circuit

In *El Paso*, the Fifth Circuit correctly concluded that a public company's tax-accrual workpapers are not protected work product because they are created in the ordinary course of business "to comply with SEC regulations" and to "demonstrate to the accountant that a balance sheet does not portray an overly-rosy view of a corporation's financial health." 682 F.2d at 534, 544; *accord Arthur Andersen*, 623 F.2d at 722 n.2 & *Arthur Andersen*, 623 F.2d at 729 (noting (in two companion opinions) that tax-accrual workpapers are effectively "required" by the federal securities laws and "are used by accountants in attempting to determine whether financial statements give a fair picture of the company's financial position"). These workpapers are not work product even though they "forecast the cumulative results of IRS audit, settlement, and litigation," because they are "not prepared to respond to a specific charge by the IRS or to any pending or impending lawsuit," but instead are generated to ensure that the tax reserve is "sufficient" and thereby "comply with the securities laws." *El Paso*, 682 F.2d at 534-535. Accordingly, they "carr[y] much more the aura of daily business than [they do] of courtroom combat." *Id*. at 544. The Fifth Circuit's analysis is persuasive, mirrors the result in *Arthur Young*, and should be adopted by this Court.

The District Court's perfunctory dismissal of *El Paso* cannot withstand scrutiny. The court asserted that *El Paso* was "not persuasive" for the sole reason that the Fifth Circuit applies the "primary purpose" test for work product whereas this Court applies the "because of" test. (Add23.) The District Court, however, failed to recognize that under both tests, documents generated in the ordinary course of business (such as annual compliance with SEC regulations) are not entitled to work-product protection. As this Court has previously recognized, a court's conclusion that certain documents are not work product is "unaffected" by its erroneous use of the "'primary [purpose]' standard" *if* the documents "were prepared in the ordinary course of business" or "would have been created in essentially similar form irrespective of the litigation." *Maine*, 298 F.3d at 70.

Whatever difference the two tests may produce in another context, there is no divergence here because the Fifth Circuit found that the workpapers were "[w]ritten ultimately to comply with SEC regulations." *El Paso*, 682 F.2d at 544. Similarly, the District Court found (Add5-6) that "Textron's ultimate purpose" in creating its workpapers was to have a GAAP-compliant reserve on "financial statements filed by

Textron with the SEC." *See also El Paso*, 682 F.2d at 544. (workpapers were created for "sole" - not just primary - purpose of "back[ing] up a figure on a financial balance sheet"). Indeed, the Third Circuit (which, like this Court, applies the "because of" work-product test) incorporated this same analysis in its remand instructions in another case involving a taxpayer's tax-accrual workpapers. *Rockwell*, 897 F.2d at 1266.

Instead of following a decision directly on point, the District Court relied on two inapposite decisions, *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, 237 F.R.D. 176 (N.D. Ill. 2006) and *Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987). (Add24.) As a preliminary matter we note that neither case involved § 7602 and the corollary principle that privilege claims are narrowly construed in "IRS investigations," *Cavallaro*, 284 F.3d at 245. *See United States v. Noall*, 587 F.2d 123, 126 (2d Cir. 1978) (enforcing IRS summons for internal audit reports and related workpapers and distinguishing "non-tax cases where discovery of internal reports or other information was denied" because "the collection of the revenue stands apart").

In *Jaffe*, the court held that audit letters were protected work product because they "were not prepared due to some remote possibility of litigation but, rather, summarize pending and actually threatened litigation." 237 F.R.D. at 181. Here, in stark contrast, there is no evidence in the record that there was pending or threatened litigation for any (let alone every) uncertain issue identified in Textron's tax-accrual workpapers. Indeed, Textron conceded that, for some of the issues, there would never be any litigation. (A80, 83.) Further, tax-accrual workpapers must be created whether the company anticipates litigation or not (A285-286), whereas the opinion letters in *Jaffe* would not have been generated without the pending or threatened litigation. *Id*. at 182.

Similarly, *Searle* concerned internal risk-management documents related to products-liability actions that were actually "pending." 816 F.2d at 399. There, the court held that individual case reserves calculated by Searle's attorneys "for a specific case" were protected work product. *Id*. at 399, 401. Here, again, there was no identified pending litigation for any (let alone all) of the uncertain issues described in Textron's tax-accrual workpapers.

II

Alternatively, the District Court erred in concluding that Textron's disclosure of its tax-accrual analysis to an independent auditor did not waive work-product protection

Standard of Review

The District Court's categorical ruling that disclosure to an independent auditor does not waive work-product protection poses "an abstract issue of law and review is plenary." *United States v. MIT*, 129 F.3d 681, 683 (1st Cir. 1997).

A. E&Y is a potential adversary as well as a potential conduit to potential adversaries

Even if Textron's tax-accrual workpapers are protected work product (and, as demonstrated above, they are not), any protection they enjoyed was waived when

Textron shared the documents or their contents with E&Y. Although "work-product protection is not as easily waived as the attorney-client privilege" (which is generally waived by disclosure to any third party (Add24-25)), "disclosure to an adversary, real or potential, forfeits work product protection." *MIT*, 129 F.3d at 687; *see Raytheon*, 218 F.R.D. at 360 (disclosure to "conduit to a potential adversary" waives work-product protection). This is true even if the parties agree "that the information disclosed will remain confidential as against the rest of the world." *Griffith v. Davis*, 161 F.R.D. 687, 699-700 (C.D. Cal. 1995). As demonstrated below, an independent auditor is both a potential adversary and a potential conduit to potential adversaries. As such, Textron's disclosure of its tax-accrual analysis to E&Y waived any work-product protection.[18]

In *MIT*, this Court found that the IRS could summon documents that had been created in anticipation of litigation. The Court ruled that work-product protection was waived when MIT (a Defense Department contractor) provided the documents to the auditing agency of the Defense Department, even though the agency's regulations and practices had led MIT to expect the agency to preserve the documents' confidentiality and the agency in fact refused to produce the documents to the IRS. 129 F.3d at 683. There, this Court determined that the auditor was a "potential adversary" because it did not "share[ ] a common legal interest" with MIT, and its review of "MIT's expense submissions" created "the potential for dispute and even litigation." *Id.* at 687.

Similarly, here, Textron and E&Y have a potentially adversarial relationship (depending on how accurate Textron's financial statements are). *E.g.*, *Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113, 116-117 (S.D.N.Y. 2002) (disclosure to independent auditor waives work-product protection); Wright & Graham, 23 Fed Prac. & Proc.: Evidence § 5427 at 809 (1980) ("ethical duties to persons relying on the accountant's reports puts him in a much more adversarial role with respect to the client"). In the proceeding below, Textron attempted to distinguish *MIT* on the ground that the auditor there "had the ability to disallow the expenses" claimed by MIT. (A124.) That reasoning applies equally here where E&Y undisputedly has the ability to effectively "disallow" Textron's financial statements by issuing an "adverse opinion" as to their accuracy. Such an adversarial result could preclude Textron from having its stock publicly traded (A283), a far more devastating outcome than the denial of expenses at issue in *MIT*. *See Arthur Young*, 465 U.S. at 819 n.14.

The independent auditor is also a conduit to other potential adversaries, such as the SEC. As the Supreme Court noted in *Arthur Young*, the SEC is "entitled" to obtain a company's tax-accrual information from the independent auditor. 465 U.S. at 820; *see also* 15 U.S.C. § 78j-1 (imposing duty on independent auditors to make certain disclosures to the SEC). Because E&Y is both a potential adversary and a potential conduit to other potential adversaries, Textron's disclosure to E&Y waived any work-product protection for its tax-accrual workpapers.

B. The District Court's contrary determination cannot withstand scrutiny

The District Court's attempt to distinguish *MIT* is unavailing. That E&Y "had no obligation to the IRS to determine whether Textron's tax return was correct" (as the court notes (Add31)) is not dispositive - the audit agency in *MIT* similarly had no obligation to the IRS and the IRS was nevertheless permitted to summon the materials because the auditor was a potential adversary (as well as a conduit to a potential

adversary). In addition, *MIT* does not (as the court erroneously suggests (Add31)) preclude waiver if the recipient of the work product is "independent" and "not acting on behalf of a potential adversary." On the contrary, any disclosure "in a way inconsistent with keeping it from an adversary waives work product protection." *MIT*, 129 F.3d at 687. *E.g., Ricoh Co. v. Aeroflex Inc.*, 219 F.R.D. 66, 70 (S.D.N.Y. 2003) (disclosure to "third-party who was likely to be an independent witness" waived work-product protection); Wright, Miller & Marcus, 8 Fed. Prac. & Pro.: Civil 2d § 2024 at 369 (1994) (waiver where disclosure "substantially increased the opportunities for potential adversaries to obtain the information").

Moreover, the District Court's assertion that an independent auditor does not act "on behalf of a potential adversary" disregards the Supreme Court's contrary determination in *Arthur Young*. There, the Court - emphasizing the auditor's "public watchdog" role - determined that the auditor's "ultimate allegiance [is] to the corporation's creditors and stockholders, as well as to the investing public," *i.e.*, to potential adversaries. 465 U.S. at 818. In discharging its public obligations, the auditor is required to "notif[y] the investing public of possible potential problems inherent in the corporation's financial reports." *Id*. Indeed, to deny that E&Y acts on behalf of the public (as the District Court erroneously did (Add31)) is to deny the very purpose of having public companies file audited financial statements.

The District Court's suggestion (Add29-30) that an independent auditor could agree not to provide information to the IRS (or other parties such as the SEC) is baseless. Section 301 of the auditor's Professional Rules of Conduct (relied on by the District Court (Add29-30)) is expressly subject to the accountant's "obligation to comply with a validly issued and enforceable subpoena or summons" as well as with "applicable laws and government regulations," AICPA Professional Standards (CCH) § 301 (1993) - a point emphasized by Professor Carmichael (A99-100, 293) and overlooked by the District Court. If disclosure to an auditor waives work-product protection, the fact that the parties deemed the information "confidential" is no barrier to production. Indeed, in *Arthur Young*, the Court held that a company's tax-accrual analysis that had been provided to an independent auditor was subject to an IRS summons, 465 U.S. at 812, even though the parties deemed the information "confidential," 677 F.2d at 215, 217, 219.

In this regard, the District Court's statement that "E&Y expressly agreed not to provide the information to any other party" (Add30 (citing Raymond and Weston affidavits)) is factually inaccurate and legally irrelevant. Neither affidavit provides that the parties had such an agreement. Raymond (TFC's in-house accountant) merely stated that she "had an expectation that E&Y would respect the confidentiality of the information contained in [TFC's] tax accrual workpapers." (A90.) Weston (an E&Y partner), in turn, did not describe any agreement between the parties and expressly stated that Section 301's confidentiality requirement permits certain "exceptions" (A98), echoing Professor Carmichael's testimony that independent auditors are permitted to disclose confidential information in order to comply with applicable laws and validly issued summonses. Thus, there is *no* evidence of any agreement that E&Y would not comply with an IRS summons.

But even if (as a factual matter) there were such an agreement - and there was not - it would not (as a legal matter) be dispositive. *See In re Columbia/HCA Healthcare Corp.*

Billing Practices Lit., 293 F.3d 289, 306-307 (6th Cir. 2002) (confidentiality agreement did not prevent waiver of work-product immunity); *MIT*, 129 F.3d at 683, 686-688 (practice of confidentiality did not prevent waiver of work-product immunity). Simply put, private parties cannot contract around applicable laws, including their statutory obligation to comply with validly issued IRS summonses.

Finally, the District Court's reliance (Add28-29) on district court decisions holding that disclosure of information to independent auditors does not waive work-product protection is misplaced. First, none of these cases address the IRS summons authority under § 7602. *See Noall*, 587 F.2d at 126. Second, the District Court ignored contrary decisions, such as *Medinol*, holding that disclosure to an independent auditor *does* waive work-product protection. Third, the decisions finding waiver are more persuasive than those reaching a contrary conclusion because they recognize the independent auditor's public-watchdog function outlined in *Arthur Young* and its potentially "adversarial role" (to use the words of the treatise to which the "formulation" of this Court's work-product test has been attributed (*Maine*, 298 F.3d at 68)) regarding the company's financial statements, Wright & Graham, above, at 809. *See Medinol*, 214 F.R.D. at 114 ("in order to be effective, [independent auditors] must have interests that are independent of and not always aligned with those of the company"); *In re Diasonics Sec. Lit.*, 1986 WL 53402, *1 (N.D. Cal. June 15, 1986) (disclosure to independent auditor waives work-product protection because auditor "has responsibilities to creditors, stockholders, and the investing public which transcend the relationship").

In contrast, courts finding no waiver are of the view that the company and the auditor "'shared common interests'" and therefore the auditor could not be "'a conduit to a potential adversary.'" *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 446 (S.D.N.Y. 2004) (quoting *In re Pfizer Inc. Sec. Lit.*, 1993 WL 561125, at *6 (S.D.N.Y. Dec. 23, 1993)). These courts reasoned that finding a waiver would "discourage corporations from conducting a critical self-analysis and sharing the fruits of such an inquiry" with their auditors. *Merrill Lynch*, 229 F.R.D. at 449 (citing *United States v. Arthur Young & Co.*, 677 F.2d 211, 220 (2d Cir. 1982), *rev'd on this point by* 465 U.S. 805 (1984)). Whatever the merits of that reasoning on the facts of those non-tax cases, it cannot sustain the District Court's ruling because it was expressly rejected in the IRS summons context by the Supreme Court in *Arthur Young*. 465 U.S. at 818-819.

Indeed, not only did the Supreme Court reject the argument (espoused by the Second Circuit in *Arthur Young* and by district court decisions like *Merrill Lynch*) that disclosure would have a chilling effect on candid analysis, see above n.11, the Court further opined that "insulation of tax accrual workpapers from disclosure might well undermine the public's confidence in the independent auditing process." *Id*. at 819 n.15. The District Court's no-waiver ruling has that same impermissible effect.

III

The District Court erred in concluding that Textron satisfied the requirements for invoking the attorney-client and § 7525 privileges

Standard of Review

The District Court's conclusion that the tax-accrual workpapers qualified for the attorney-client and § 7525 privileges, even though the workpapers were not created with an expectation of confidentiality, relates to the scope of those privileges and, therefore, raises a legal issue reviewed *de novo*. *United States v. Bisanti*, 414 F.3d 168, 170-171 (1st Cir. 2005).

The District Court correctly concluded that neither the attorney-client privilege nor the analogous § 7525 privilege protected Textron's tax-accrual workpapers. In so ruling, the court determined that the privileges (i) applied to the documents, but (ii) were waived when Textron revealed their contents to E&Y. Although we disagree with the first determination, the second determination is, in our view, correct and dispositive. Nevertheless, we briefly address the court's first determination out of an abundance of caution that this Court might consider it new matter if we were to wait until our reply brief to raise the issue. If, however, Textron does not challenge the court's waiver determination in its responsive brief, then this Court need not address those privileges.

As with its claim to work-product protection, Textron bears the burden of demonstrating that the attorney-client and § 7525 privileges apply to its tax-accrual workpapers. *Bisanti*, 414 F.3d at 170.[19] Because these privileges hamper the search for truth, they "must be narrowly construed," *XYZ Corp.*, 348 F.3d at 22, particularly in "IRS investigations," *Cavallaro*, 284 F.3d at 245. To establish that the privileges apply, the claimant must demonstrate several "essential elements," including that the communications were made "in confidence" and to obtain "legal advice." *Id.*; *see Maine*, 298 F.3d at 71-72. As we argued below (Doc. 1 at 13-14), Textron cannot satisfy its burden of proof and establish the privileges' essential elements.

Textron has failed to establish that its tax-accrual workpapers were created in confidence because they were intended to be disclosed, and were in fact disclosed, to third parties. "The attorney-client privilege does not apply to communications that are intended to be disclosed to third parties or that in fact are so disclosed." *Rockwell*, 897 F.2d at 1265; *accord United States v. Bump*, 605 F.2d 548, 551 (10th Cir. 1979). As the Fifth Circuit observed in *El Paso*, "[c]onfidentiality as to [company-created tax-accrual workpapers] is neither expected nor preserved, for they are created with the knowledge that independent accountants may need access to them to complete the audit." 682 F.2d at 540.

Here, the District Court's findings, as well as the undisputed testimony, demonstrate that Textron failed to establish that its communications with its in-house attorneys and accountants were made in confidence. The court found (Add5-6) that Textron created the workpapers in order "to satisfy an independent auditor that Textron's reserve for contingent liabilities satisfied [GAAP requirements]." And, as counsel for Textron acknowledged during the initial hearing, in order to be satisfied, Textron's independent auditor would "[a]bsolutely" want to see Textron's tax-accrual workpapers before certifying its financial statements. (A123.) That concession was confirmed by Professor Carmichael's undisputed testimony that public companies must provide their independent auditors unrestricted access to their tax-accrual workpapers. (A43, 282-284.) At no point did any Textron witness assert that it created a single workpaper with the expectation that it could be withheld from E&Y. The District Court's determination that the attorney-client and § 7525 privileges apply because Textron's workpapers were

"legal advice" (Add15-17) is therefore legally insufficient because those privileges also demand an expectation of confidentiality. *Cavallaro*, 284 F.3d at 245.

Moreover, in our view, the District Court's "legal advice" ruling is also incorrect because establishing a GAAP-compliant tax reserve is an accounting function, not a legal one.[20] But even if the workpapers contained legal advice, the court's determination that the privileges therefore apply must nevertheless be reversed because the court did not - and, given its own findings and the undisputed facts, could not - find that the workpapers were generated with an expectation that they would not be shared with others.

IV

The District Court erred in not enforcing the summons with respect to E&Y's workpapers

Standard of Review

Because the District Court did not analyze E&Y's tax accrual workpapers, its failure to enforce the summons with regard to those documents should be reviewed *de novo*.

As the District Court recognized (Add3), the summons here seeks not only the tax-accrual workpapers created by Textron, but also those created by its "independent auditor," *i.e.*, E&Y. (A20.) The court broadly concluded (Add1) that the tax-accrual workpapers sought by the summons were protected by the "work product privilege," but did not explain how E&Y's workpapers could be so protected.

The District Court's failure to enforce the summons at all, even as to the workpapers created by E&Y, is baseless, and directly conflicts with *Arthur Young*, which held that workpapers created by an independent auditor were relevant, not privileged, and therefore subject to an IRS summons. Because (as the court found (Add7-12)) the Government made a *prima facie* showing under *Powell*, Textron bore the burden of demonstrating either that it did not possess, and could not obtain, E&Y's workpapers or that the workpapers were somehow privileged. *See United States v. Lawn Builders of New England, Inc.*, 856 F.2d 388, 392-393 (1st Cir. 1988) ("lack of possession or control of summoned documents is a valid defense to application for enforcement order as to which party resisting enforcement bears burden of producing credible evidence that he does not possess or control the documents sought"). Textron, however, made no attempt to do so.

Textron provided no evidence that it lacks control as to E&Y's workpapers or that they were privileged. Rather, Textron addressed all of its arguments to the workpapers it generated and ignored that the summons was not so limited. *See* A63-64 (distinguishing *Arthur Young* on the basis that workpapers there were prepared by independent accountants, whereas "[h]ere the IRS seeks the taxpayer's workpapers"). Although Textron's witnesses testified that E&Y does not, as a practice, give Textron its workpapers (A161, 199), they never asserted that E&Y's workpapers were not available to them on request. Textron's failure cannot be dismissed as an oversight, because the summons is clear and explicit on this point (A20). Moreover, throughout the summons-enforcement proceeding, the Government emphasized both on brief and at oral

argument that the summons sought E&Y's workpapers. (Doc. 15 at 15; A106-107.) Indeed, during oral argument, the court interrupted Government counsel and stated "I think you've made your case as far as the Ernst & Young papers." (A107.) For its part, Textron never attempted to make *its* case regarding the E&Y papers.

That E&Y is an independent auditor whose substantive work is beyond Textron's control does not mean, as a procedural matter, that obtaining *copies* of its substantive work is beyond Textron's control. On the contrary, one of Textron's affiants stated (A89) that she had recently reviewed E&Y's files, indicating that E&Y's workpapers *were* available to Textron upon request. *See Mercy Catholic Med. Ctr. v. Thompson*, 380 F.3d 142, 160-161 (3d Cir. 2004) ("so long as the party has the legal right or ability to obtain the documents from another source upon demand, that party is deemed to have control" (citing Fed. R. Civ. P. Rule 34(a)). But, at all events, Textron has failed to provide *any* evidence that it could not obtain E&Y's workpapers, and, therefore, as a matter of law, has failed to satisfy its burden of proof on this issue. Given that failure, this Court should order that the summons be enforced as to E&Y's workpapers, as well as to Textron's workpapers.

CONCLUSION

The District Court's judgment should be reversed and the summons enforced.

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Dated: January 25, 2008

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It is hereby certified that nine paper copies of this brief and one copy on computer diskette in WordPerfect format were sent to the Clerk by FedEx on this 25th day of January, 2008, and that service of this brief was made on counsel for the appellee on this 25th day of January, 2008, by sending two paper copies thereof and one copy on computer diskette by FedEx in an envelope properly addressed as follows:

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ADDENDUM

Description of Addendum Item	Addendum Page
Memorandum & Order of the District Court, dated August 28, 2007 (District Court Docket No. 24, filed August 29, 2007)	1
Judgment of the District Court, dated August 29, 2007 (District Court	35

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[1] "A" refers to the separately bound appendix. "Add" refers to this brief's addendum. "Doc." refers to the record documents. Unless otherwise indicated, "§" references are to the Internal Revenue Code (26 U.S.C.) as in effect during the years at issue.

[2] The IRS audits every federal income tax return filed by Textron, which is standard practice for taxpayers of its size. (A10-11, 79.)

[3] Section 7525(a)(1) generally extends "[w]ith respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney ... to a communication between a taxpayer and any federally authorized tax practitioner [including accountants] to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney."

[4] Because Textron and TFC had separate audited financial statements, Textron provided affidavits from employees for each entity. The affidavits generally track each other. (A82-90.)

[5] TFC did not employ its own tax attorneys and relied on its accountants and Textron's Tax Department to create its tax-accrual schedule. (A88.)

[6] Both Professor Carmichael and Agent Kane testified that tax-accrual workpapers include more than workpapers related to the reserve for contingent tax losses. They also include support for all tax assets and liabilities shown in financial statements, including deferred tax assets and liabilities. (A278, 309-311.)

[7] Textron did not submit the documents that it claimed were privileged for *in camera* review.

[8] The court dismissed Textron's argument that there was no waiver because E&Y was providing tax advice privileged under § 7525, observing that "it ignores reality to describe an independent auditor responsible for reporting to the investing public whether a company's financial statements fairly and accurately reflect its financial condition, as providing 'tax advice' to the company when the auditor seeks to determine the adequacy of amounts reserved by the company for contingent tax liabilities." (Add26.)

[9] Section 7602 generally permits the IRS to "examine any books, papers, records, or other data which may be relevant" to determining a taxpayer's tax liability.

[10] As noted in *Maine*, 298 F.3d at 68, the "because of" test was formulated by Wright's *Federal Practice* treatise and subsequently adopted by certain courts.

[11] The Court also rejected the Second Circuit's reasoning that permitting IRS access to tax-accrual workpapers would chill communications between public companies and independent auditors. 465 U.S. at 818-819; *accord El Paso*, 682 F.2d at 544-545.

[12] The District Court's misunderstanding caused it to erroneously equate (Add34) the disclosure opposed by Textron here with the disclosure opposed by the IRS in *Delaney, Migdail & Young, Chtd. v. IRS*, 826 F.2d 124 (D.C. Cir. 1987).

[13] The District Court's attempt to distinguish *Arthur Young* overlooks that the summons here also sought E&Y's workpapers, an error addressed below in Part IV.

[14] In *Arthur Andersen*, the district court held that an auditor's tax-accrual workpapers were relevant to the IRS audit, not privileged, and therefore subject to an IRS summons. The auditor produced the workpapers to the IRS and then appealed the court's determination that the workpapers were relevant. This Court did not reach the

merits of the appeal, finding that the appeal was "moot" due to the auditor's production of the documents. 623 F.2d at 725.

[15] Textron does not set aside funds to cover the "reserve." Rather, the "reserve" is merely a balance-sheet item.

[16] Although the District Court did not so find, a Textron witness testified (A200) that Textron's tax-accrual analysis could be useful in future litigation. That testimony cannot, as a legal matter, justify work-product protection. If (as here) documents would have been created irrespective of the litigation, they are not protected by the work-product doctrine, "even if the documents aid in the preparation of litigation." *Maine*, 298 F.3d at 70; *see In re Raytheon Sec. Lit.*, 218 F.R.D. 354, 359 (D. Mass. 2003) (documents assembled in ordinary course of business or pursuant to public requirements are not work product '"even if the party is aware that the document may also be useful in the event of litigation"') (citation omitted).

[17] The court erroneously stated (Add2, 23) that Textron litigated three issues for tax years 1980-present. The parties stipulated that Textron had litigated three issues for tax years 1959-present. (A153-154.) The court also erroneously referred (Add2, 23) to Textron's appealing issues to an "IRS Appeals Board," which does not exist. Textron has appealed issues to the Office of Appeals, an independent branch of the IRS that attempts to resolve disputed tax issues within the agency so that the parties need not resort to litigation. (A188-189.)

[18] No appellate court has directly addressed the specific question whether disclosing information to independent auditors waives work-product protection, and the district courts are split on the issue, as described below. As previously noted (Part I.B), however, the result in *Arthur Young* suggests that, to the extent that a company's tax-accrual workpapers are work product in the first place (a proposition with which we disagree), disclosure to an independent auditor waives that protection.

[19] We analyze the attorney-client and § 7525 privileges together because the § 7525 privilege "only extends to communications that would be privileged were they between a taxpayer and an attorney" and therefore provides "no further protection than the attorney-client privilege," *Bisanti*, 414 F.3d at 170 n.1, as the District Court recognized (Add17).

[20] As Professor Carmichael explained, establishing an appropriate reserve is based on *accounting* judgments that must apply GAAP's *accounting* standards. (A40-42, 101.) Using a lawyer instead of an accountant to prepare the accounting paperwork cannot change its nature or purpose. *Bisanti*, 414 F.3d at 171-172; *United States v. Frederick*, 182 F.3d 496, 500-501 (7th Cir. 1999).