

# **PREVENTING COMPELLED DISCLOSURE OF SENSITIVE TAX ANALYSIS**

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Presented to Tax Executives Institute, Inc.  
New Jersey Chapter

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# WHY BE CAREFUL WHAT YOU PUT IN WRITING?

- Extent of tax avoidance motive vs. business and regulatory motives, critical to whether transactions are respected
- Contemporaneous, written evidence of tax avoidance motive is smoking gun for IRS
- Even privilege and work product protection are not absolute, in event of dispute over protection
- Increased IRS demands for emails and other potentially sensitive documents

# WHY PRIVILEGE MATTERS

- IRS has broad summons power
  - Physical evidence
  - Testimony
  - IRS can request anything that “may” be relevant
- Privilege and work product protection are *only* grounds for withholding sensitive documents

# SPECIAL CONCERNS/AGENDA

- Presentations
  - Distribution
  - Which department is driving the project?
- Email
  - Instantaneous
  - Prone to distribution
  - Forever
  - Easy to retrieve
- Workpapers and Spreadsheets
  - Economic analysis and modeling
  - Legal advice embedded in worksheets
  - Outside auditor requests

# ATTORNEY-CLIENT PRIVILEGE – ELEMENTS

- Confidential communication
- From client to attorney for the purpose of obtaining legal advice; or
- From attorney to client and either (i) contains legal advice or (ii) reveals confidential information on which client seeks advice
- Dual purpose documents: primary purpose test

# CORPORATE CONTEXT

- Privileged legal advice can be shared among employees who “need to know”
- Presumption in favor of privilege if:
  - Distribution limited
  - Distributees warned not to further distribute
  - Document relates to recipients’ responsibilities
- In-House Counsel?
  - GC’s Office
  - Tax Department

# SECTION 7525 / ACCOUNTANT-CLIENT PRIVILEGE

- Enacted in 1998
- With respect to tax advice, communications between a taxpayer and any “federally authorized tax practitioner” are privileged to the same extent as communications with an attorney

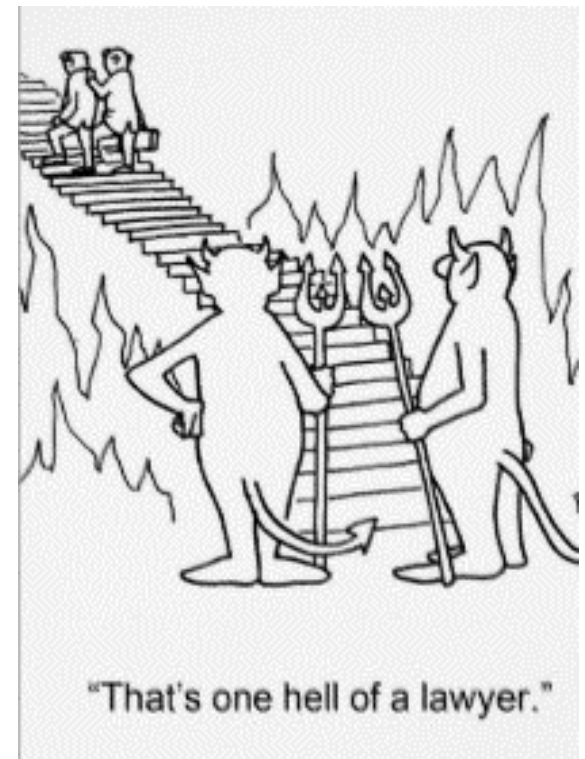
## SECTION 7525 - LIMITATIONS

- Only applies to tax advice
- Does not apply to foreign accountants
- Only applies in federal tax proceedings
  - State tax proceedings
  - Shareholder and regulatory litigation
  - Waiver for federal tax purposes!
- Cannot be asserted in any criminal matter
- Does not apply to communications relating to the promotion of any tax shelter
- Accountants wear lots of hats
  - Internal relationship within accounting firm may not be respected
  - In camera review more likely



# KOVEL ARRANGEMENTS

- Attorney-client privilege extends to confidential communications with experts assisting lawyer in providing legal advice. *U.S. v. Kovel* (2d Cir. 1961)
- Elements of *Kovel* Arrangement
  - Expert engaged must be necessary or at least highly useful, for effective consultation between client and lawyer
  - Expert must be employed by, and acting at the direction of, the attorney, not independently or at the direction of the client
  - Privilege only applies to communications after the date of the engagement



# USING KOVEL ARRANGEMENTS

- Use when expert advisor (economist, financial specialist, accountant) needed to assist attorney
- Separate engagement letter, billing and file maintenance
- Limit direct communication between expert and client

# WORK PRODUCT PROTECTION – ELEMENTS

- Prepared in anticipation of litigation, or in other words “because of” the prospect of litigation
- By or for a party or its representative
- Protects litigation strategies and analyses of litigation hazards
- Joint purpose document: would it have been prepared in substantially similar form if litigation had not been anticipated?
- When is litigation anticipated in tax planning?
  - Likely IRS Appeals?
- Steps
  - Documentation? Litigation hold?
  - Much easier to establish when an attorney directs the preparation of documents to be protected

# WAIVER

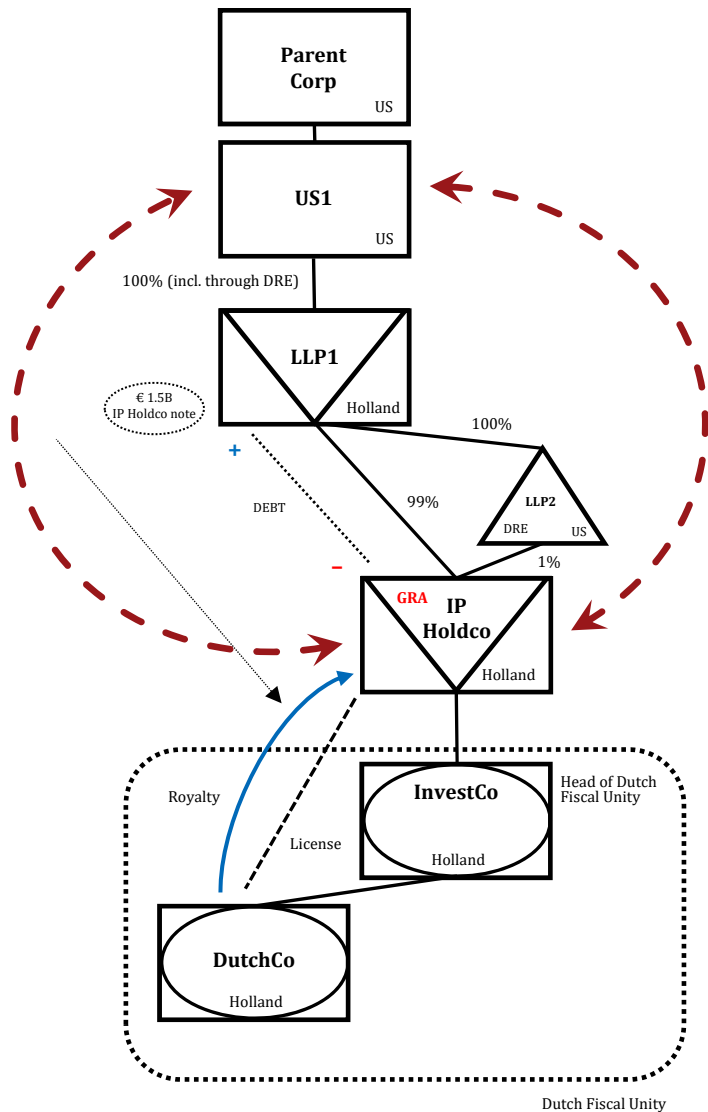
- Attorney-client and section 7525
  - Voluntary disclosure to a third party results in broad waiver as to all communications concerning the same subject matter
  - Notes and drafts
- Work product protection
  - Waiver only as to specific document
  - Waiver only when disclosure is inconsistent with purpose of maintaining secrecy from adversaries
- Compare:
  - *U.S. v. Textron* (1st Cir. 2009) (Textron waived *attorney-client privilege* by disclosing to outside auditor);
  - *U.S. v. Deloitte* (DC Cir. 2010) (Dow Chemical did not waive *work product protection* by disclosure to outside auditor)

# RELATIVE USE OF PROTECTIONS

- Accountant-Client: Least Useful
  - Communications often *not* for purpose of obtaining legal advice.
  - Major exceptions: non-federal-tax proceedings, tax shelters, foreign accountants, criminal matters.
- Attorney-Client: Useful
  - But still easy to waive
- Work Product: Most Useful
  - Can apply to internal documents not involving attorneys or accountants.
  - More difficult to waive
  - But harder to attach

# PRESENTATIONS

# IP INTEGRATION PROJECT



## Preparatory Steps

- IP Valuation
- License income modeling

## Transaction Steps

- Step 1: IP transfer...
- Step 2: Note creation...
- Step 3: Note distribution...
- Step 4: Share swap...

## Dutch Tax Considerations

- Participation exemption issues

## US Tax Considerations

- Consider business purpose for IP transfer
- Consider section 304 antiabuse regulation
- Step 4 intended to be D Reorg if not stepped together with previous steps
- Consider reordering steps 1 and 2

## INTERNAL EMAIL

- *Russian Recovery Fund Ltd. v. U.S.*, 122 Fed. Cl. 600 (Fed. Cl. 2015).
  - Taxpayer's position: hedge fund manager Tiger had real interest in becoming partner in Russian Recovery Fund
  - Internal email between Tiger employees:

“We sold all of our sep 2001 bonds (...) in return for equity in the russian recovery fund. The value of the equity at the time we received it was 14mm dollars. However, we plan to sell the equity in 2 weeks to hopefully receive cash.”



# INTERNAL EMAIL

**From:** Finance Employee

**To:** Tax Department Employee

**Subject:** Project Epic

I have been working with our bankers on the terms they could offer for an exchangeable bond issuance. They've suggested cheaper ways to accomplish the same result.

Can you remind me again why we are doing it this way?

# INTERNAL EMAIL

**From:** Finance Employee

**To:** Tax Department Employee

**Subject:** Tax Considerations

We are having some trouble articulating the tax benefits and risks to our board. Can you let me know the total expected tax benefit, and our chances of success if challenged?

# INTERNAL EMAIL

**From:** Finance Employee

**To:** Tax Department Employee

**Subject:** Project XYZ

I understand you will have a presentation for us Thursday to explain this project to us. Correct?

# INTERNAL EMAIL

**From:** Tax Department Employee  
**To:** Entire Tax Department, Entire Finance Department  
**Subject: FW:** Funding XYZ

Green light re. the capital investment!

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**From:** Jeff Moeller  
**To:** Tax Department Employee  
**Subject:** Funding XYZ

We have concluded there would be at least a reasonable basis to take the position that parent's new investment in XYZ is debt for U.S. tax purposes. . . .

# EXTERNAL EMAIL - COUNSEL

**From:** Tax Department Employee

**To:** Jeff Moeller

**CC:** Entire Tax Department; Entire Finance Department

**Subject:** Project Asteroid

Jeff,

We are getting major push back from above that this transaction conflicts with our long-term strategy. Any further thoughts on our messaging?

# EXTERNAL EMAIL – ACCOUNTING FIRM

**From:** Tax Department Employee

**To:** Big4 Accountant

**Subject:** 2016 E&P Projections

We would appreciate if you could provide an estimate of ABC Corp's E&P for 2016, in the form that you prepared an estimate for 2015.

Also, outside tax counsel advises us that ABC should probably be converted to a partnership in early 2017. Do you have a view on that?

## EXTERNAL EMAIL – COUNTERPARTY

- *Pritired 1, LLC v. U.S.*, 816 F. Supp.2d 693 (D. Iowa 2011)
  - Principal Financial Group’s position: “PC Swap” had business purpose
  - Email from Principal Financial Group to Citi Capital Structuring Group:

“Lillian Chen, V.P. Corporate Tax, has requested that we identify/articulate the business purpose for the allocation of French taxes to the perpetual certificateholders. Her question concerns why the perpetual certificateholders (i.e. SPV 2) would agree to swap a return of LIBOR plus 100 for a return of LIBOR plus the SAS Spread minus the French Tax Amount. This is an excellent point in that even if the structure holds up otherwise, the allocation of taxes could still be challenged on the basis that there is no business purpose for the perpetual certificateholders to be allocated the entire tax burden.”

# EXTERNAL EMAIL – COUNTERPARTY

**From:** Tax Department Employee

**To:** Target Employee

**Subject:** Percentage stock consideration

We have been advised by outside counsel that the cash consideration in this deal may be too high for treatment as a tax-free reorg. We'd like to discuss whether additional stock consideration would work for you.



# COMMON INTEREST DOCTRINE

- If two clients are *actively working together* to pursue a common *legal* interest, communications among the clients and their attorneys to further the common legal interest are protected by attorney-client privilege
  - Common business or commercial interest not sufficient.
- Can facilitate sharing of confidential tax analyses in M&A contexts
  - Protocols
  - Common interest agreement

## EMAIL – KEY TAKEAWAYS

- Start by assuming IRS or a judge will read
- “Need to know”—keep distribution lists tight
- When in doubt, pick up the phone
  - Email: “Let’s discuss this by phone”
- When in doubt, involve counsel
- Chain emails
  - Cut off chains
  - Do not mix and match threads for different projects
- Push back on “put it in writing”

# LABELING EMAIL

- If done correctly:
  - Forces you to think
  - Evidence of confidentiality
  - Discourages redistribution
  - Evidence of anticipation of litigation
  - Easier to identify
- Risks:
  - Cumbersome
  - Difficult to get right (e.g., email chains, lack of expertise)
    - Adverse inferences
    - Overuse
- Need to decide on consistent policy and commit
- Designated “privilege” distribution list

# WORKPAPERS

- Two types:
  - Return preparation: calculations and analyses during return preparation
  - Tax accrual: calculations and analyses to establish financial statement reserves
- Includes:
  - Excel spreadsheets
  - Emails and memos (external and internal)
  - Outside tax opinions

# RETURN PREPARATION WORKPAPERS

- In general, no protection for:
  - Spreadsheets
  - Emails, memos and notes with no legal analysis.
- Attorney-client or 7525 privilege applies, and work product protection may apply, to outside tax opinions and other legal analysis (e.g., in emails and memos)
- But line often unclear

# RETURN PREPARATION WORKPAPERS

- Assign each professional either return preparation or legal advice function
- Know what hat you wear
- Avoid excerpting legal advice
- Save to separate “privileged” and “non-privileged” files

# TAX ACCRUAL WORKPAPERS

- Generally held privileged, at least in large part, due to legal analysis of uncertain tax positions
  - But disclosure to outside auditors waives
- Courts take different approaches to whether work product protection applies
  - But disclosure to outside auditors *does not* waive work product protection, if sufficient confidentiality protections
- IRS historically followed “policy of restraint” but
  - Introduced exception in 2002 for “listed transactions”
  - Bar has trended lower – any hint of abuse

# TAX ACCRUAL WORKPAPERS

- Front end
  - Know law in your jurisdiction
  - Keep close track of what protections apply
  - Segregate unprotected, privileged only, and work product
- Interactions with outside auditors
  - Include sufficient confidentiality protections in engagement
  - Have auditor talk to counsel
    - Why do you need opinion?
    - Prepare separate memo
    - Have auditor review key documents but not take copies



# SPECIAL CONCERN

- Embedding Legal Advice in Excel Spreadsheets
- Options:
  - Stop
  - Create two versions of spreadsheets—limited access to legal version
  - Notebook
  - Links
  - References

## OTHER HAZARDS

- Legal advice embedded in Powerpoints
- Legal advice embedded in approval committee minutes
- Legal memos and opinions with dedicated fact sections
  - Only communication is privileged, not facts
  - Separate fact section for opinions and memos when waiver is expected
- Friends and family