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Selective Waiver and the Tax Practitioner Privilege

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Selective Waiver and the Tax Practitioner Privilege

By **Amandeep S. Grewal**

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According to Grewal, Congress blundered badly by defining the federally authorized tax practitioner privilege by cross-reference to the attorney-client privilege. The relationship between a client and a FATP is wholly different from that between a client and an attorney, argues Grewal, and the application of attorney-client principles to the FATP privilege has given rise to confused judicial opinions.

This report attempts to stem the confusion with respect to one aspect of the FATP privilege. The proper application of the selective waiver doctrine to the FATP privilege remains an open question, though courts seem poised to reject it, writes Grewal. He points out that they have rejected it numerous times in the context of attorney-client privilege claims, and generally find the doctrine incompatible with that privilege's basic purposes.

This report argues that courts should accept the selective waiver doctrine whenever the FATP privilege is at issue.

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I. Introduction

The U.S. government is fortunate that the Geneva Conventions do not apply to its war on tax shelters.¹ Although its battles have produced many just victories, many unnecessary casualties have resulted from the government's aggressive tactics.² The federally authorized tax practitioner privilege (the FATP privilege), codified in section 7525, has been a particularly unfortunate victim of the government's zeal.³

Since section 7525 was enacted in 1998, the FATP privilege has been the subject of much controversy. Although the statute purports to protect communications pertaining to tax advice between a client and his tax adviser (when those communications would be considered privileged if they were between a taxpayer and an attorney),⁴ the privilege has been narrowly construed by both the courts and the IRS.⁵ In disputes over whether the

¹Then-IRS Chief Counsel B. John Williams established this "war" metaphor in his emphatic "Alamo" speech. *See* IRS Chief Counsel Speech on Privilege and Shelters, *Doc 2002-13696*, 2002 *TNT 110-29* (June 7, 2002) ("I am here to tell you I do not plan to allow a repeat of those Texas tragedies in the battle against abusive tax avoidance transactions. I much prefer to emulate the example set by Sam Houston at the Battle of San Jacinto. Like General Houston and the Texans who delivered a crushing defeat to Santa Anna at San Jacinto, I believe that the IRS is poised to gain the upper hand in its assault against abusive transactions, equipped with the right weapons!").

²*See, e.g.,* William M. Sullivan Jr. and Kevin M. King, "Striking Down The Thompson Memo: New York Court Properly Finds Problems With Government Tactics," *Legal Times*, Aug. 21, 2006 ("[Two recent rulings] hold that government interference with corporate decisions to advance legal fees to employees and government efforts to condition such fee advancements on employees' participation in interviews with investigators are unconstitutional. The rulings mark a significant setback for the Department of Justice.").

³*See generally* Joel S. Newman, "Tax Practice And Privilege: A Tale Of Two Countries," *Tax Notes*, Apr. 21, 2003, p. 422 ("The IRS is at war against abusive tax shelters. In this atmosphere of swirling hostilities, the tax return preparer's privilege is seen more as a battle trophy than as a fundamental freedom. It should not be surprising that it has been seriously eroded.").

⁴Section 7525(a)(1).

⁵*See generally* Danielle M. Smith and David L. Kleinman, "The Federally Authorized Tax Practitioner Privilege: What Remains Under Section 7525?" *BNA Tax Management Weekly Report* (May 22, 2006).

privilege protects the identity of a taxpayer from disclosure,⁶ whether the privilege extends to tax practitioner work product,⁷ or whether the privilege extends to nontax proceedings,⁸ taxpayers have achieved little success in asserting the privilege. Indeed, the various exceptions to the privilege have left it with “more holes than Swiss cheese.”⁹

The federal courts’ rejection of the “selective waiver” doctrine could create yet another hole in the FATP privilege. Although a voluntary disclosure to a third party ordinarily waives a testimonial privilege, the selective waiver doctrine allows a client to continue to assert the privilege if the earlier disclosure was made to the federal government.¹⁰ Section 7525’s narrow scope makes a court’s acceptance of the doctrine critical to the privilege’s survival.¹¹

Unfortunately, the selective waiver doctrine has received a cool reception in the federal courts. Most courts have summarily rejected it, with only one circuit court and a few district courts expressing approval.¹² Courts have not determined if the doctrine applies to the FATP privilege, however, but have examined the doctrine only in the context of attorney-client privilege claims. Nonetheless, because courts tend to define the FATP privilege by reference to the attorney-client privilege, it seems likely that the doctrine will receive another round of rejections.¹³

This report argues that a court should accept the selective waiver doctrine for the FATP privilege, despite the contrary jurisprudence on the attorney-client privilege. Part II briefly discusses the doctrine and outlines the reasons most commonly cited for its adoption or rejection. Part III describes the FATP privilege and details the IRS’s and practitioners’ common assumption that the selective waiver doctrine will not apply to it. Part IV argues that section 7525’s text demands instead that the doctrine *always* apply to the privilege. Part V examines statements in section 7525’s legislative history that may contradict that conclusion.

⁶See *United States v. BDO Seidman*, 337 F.3d 802, Doc 2003-12728, 2003 TNT 142-14 (7th Cir. 2003).

⁷See *United States v. KPMG*, 237 F. Supp.2d 35, 39, Doc 2002-22704, 2002 TNT 194-29 (D.D.C. 2002). See also *United States v. Frederick*, 182 F.3d 496, 502, Doc 1999-14337, 1999 TNT 74-21 (7th Cir. 1999) (stating in *dicta*, “The new statute protects communications between a taxpayer and a federally authorized tax practitioner. . . . (It does not protect work product.)”).

⁸See *Chao v. Koresko*, Slip Copy, 2005 WL 2521886 (3d Cir. 2005), and *Doe v. Wachovia Corp.*, 268 F. Supp.2d 627, 637, Doc 2003-15344, 2003 TNT 123-14 (W.D.N.C. 2003).

⁹Sheryl Stratton, “Lawyers Discuss Postshelter Assault On Privilege,” *Tax Notes*, Apr. 18, 2005, p. 289 (quoting B. John Williams). Section 7525’s key exceptions are statutory, although courts have riddled it with further requirements. See *infra* Part III.B.

¹⁰See *infra* Part II.B.

¹¹See *infra* Part IV.B.

¹²See *infra* Part II.B.1.

¹³See *infra* Part IV.B.

II. The Selective Waiver Doctrine

A. Background: The Attorney-Client Privilege

The attorney-client privilege is the oldest testimonial privilege for confidential communications known to the common law.¹⁴ Its purpose is to encourage full and frank communication between attorneys and their clients, and thereby promote broader public interests in the observance of law and administration of justice.¹⁵ The Supreme Court has long recognized that the privilege encourages clients to make full disclosure to their attorneys.¹⁶

Although courts articulate the elements of the privilege differently, Wigmore summarizes the essential principles governing the privilege as follows: (1) When legal advice of any kind is sought, (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence, (5) by the client, (6) are at his instance permanently protected, (7) from disclosure by himself or by the legal adviser, (8) except when the protection is waived.¹⁷

The common law attorney-client privilege is codified in section 501 of the Federal Rules of Evidence. That rule provides, in relevant part:

Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.

Tax-related communications between clients and their attorneys are governed by the same set of privilege principles as those that govern communications between attorneys and clients generally. Thus, for example, the

¹⁴*Upjohn v. United States*, 449 U.S. 383, 389 (1981) (citing 8 John Henry Wigmore, *Evidence in Trials at Common Law* section 2290 (McNaughton rev. 1961)).

¹⁵449 U.S. at 389.

¹⁶*Id.* (citing *Fisher v. United States*, 425 U.S. 391, 403 (1976)).

¹⁷*United States v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997) (quoting 8 John Henry Wigmore, *Evidence in Trials at Common Law* section 2292 (McNaughton rev. 1961)). The eighth element — waiver — is the focus of this article. There are numerous ways in which a waiver may occur. For example, if the client places his communications with his attorney at issue, the privilege will be deemed waived. See Richard Marcus, “The Perils of Privilege: Waiver and the Litigator,” 84 *Mich. L. Rev.* 1605, 1628 (1986) (“If the [defendant] testifies that he terminated the contract with the plaintiff on advice of counsel, there will be a waiver as to all advice he received on that subject, whether from current counsel or other attorneys.”). More generally, a client may waive the privilege by using the privilege in a manner inconsistent with its purpose. See, e.g., *In re Sealed Case*, 676 F.2d 793, 818 (D.C. Cir. 1982) (“A simple principle unites the various applications of the implied waiver doctrine. Courts need not allow a claim of privilege when the party claiming the privilege seeks to use it in a way that is not consistent with the purpose of the privilege.”). This article addresses waivers effected by voluntary disclosures to third parties.

privilege extends only to tax communications that are legal in nature, such as those made to enable the preparation of a brief or opinion letter, and not to communications made to enable the preparation of a tax return.¹⁸

Although communications between a client and her attorney are generally privileged, the client asserting the privilege must maintain the confidentiality of the communication.¹⁹ If the client voluntarily discloses otherwise privileged communications to a third party, the privilege will be deemed waived.²⁰ The third-party disclosure does not vitiate the privilege per se, but instead is considered strong evidence that the client did not intend that the original communication be made in confidence.²¹

The confidentiality requirement helps ensure that only communications the client made in reliance on the privilege are protected from discovery. If a client voluntarily repeats his communications to third parties, it is likely that the privilege's underlying purpose — encouraging full and frank discussions between an attorney and his client — is no longer served. Rather, if a client freely

reveals his confidences to others, the privilege is superfluous — the client probably would have made the disclosures to the attorney regardless of the privilege, and so the privilege is unnecessary to protect the attorney-client relationship.²²

When a disclosure is involuntary, however, the court will not deem the privilege waived. Although it is not entirely clear what distinguishes a voluntary disclosure from an involuntary one, the Proposed Federal Rules of Evidence do shed some light on the issue.²³ Proposed Rule 512 provides that an involuntary disclosure is one “compelled erroneously” or “made without opportunity to claim the privilege,” such as one made to an eavesdropper or one improperly made available from a computer bank.²⁴ Not all courts have followed the proposed rules, however, because Congress's failure to adopt them deprives them of any legal effect.²⁵

B. Illustrative Cases

“The case law addressing the issue of [selective] waiver is in a state of ‘hopeless confusion.’”²⁶ Although courts generally agree that a voluntary disclosure waives the attorney-client privilege, some have taken different approaches when that disclosure is made to a government agency. A few courts have concluded that this disclosure results only in a “selective” or “limited” waiver, and that the client is free to assert the privilege against other litigants.²⁷ Others have suggested that the privilege will be preserved if the disclosure was made under a confidentiality agreement, but have declined to

¹⁸*United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999) (“Communications from a client that neither reflect the lawyer’s thinking nor are made for the purpose of eliciting the lawyer’s professional advice or other legal assistance are not privileged. The information that a person furnishes the preparer of his tax return is furnished for the purpose of enabling the preparation of the return, not the preparation of a brief or an opinion letter. Such information therefore is not privileged.”).

¹⁹*In re Matter of Cont’l Sec. Litig.*, 732 F.2d 1302, 1314 (7th Cir. 1984). See also *In re Keeper of the Records*, 348 F.3d 16, 23 (1st Cir. 2003) (“The privilege evaporates the moment that confidentiality ceases to exist.”).

²⁰Courts have recognized small circles of third parties to whom confidential communications may be revealed without vitiating the privilege. See *United States v. MIT*, 129 F.3d 681, 684, *Doc 97-32547*, 97 TNT 231-13 (1st Cir. 1997) (“Even where the cases are limited to those involving a deliberate and voluntary disclosure of a privileged communication to someone other than the attorney or client, the case law is far from settled. But decisions do tend to mark out, although not with perfect consistency, a small circle of ‘others’ with whom information may be shared without loss of the privilege (e.g., secretaries, interpreters, counsel for a cooperating co-defendant, a parent present when a child consults a lawyer.”); *United States v. Kovel*, 296 F.2d 918, 920 (2d Cir. 1961) (“assistance of these [secretaries, file clerks, telephone operators, messengers, clerks not yet admitted to the bar, and aides of other sorts] being indispensable to his work and the communications of the client being often necessarily committed to them by the attorney or by the client himself, the privilege must include all the persons who act as the attorney’s agents.”); *United States v. Evans*, 113 F.3d 1457, 1467 (7th Cir. 1997) (The common interest doctrine “generally allows a defendant to assert the attorney-client privilege to protect his statements made in confidence not to his own lawyer, but to an attorney for a co-defendant for a common purpose related to the defense of both.”) (citations omitted). The selective waiver doctrine is concerned with disclosures made to persons outside these special circles.

²¹See *United States v. Bigos*, 459 F.2d 639, 643 (1st Cir. 1972) (“While we agree that the presence of a third party commonly destroys the privilege, it does so only insofar as it is indicative of the intent of the parties that their communication not be confidential.”).

²²Comment, “Stuffing the Rabbit Back into the Hat: Limited Waiver of the Attorney-Client Privilege in an Administrative Agency Investigation,” 130 *U. Pa. L. Rev.* 1198, 1207 (1982). See also *Powers v. Chicago Transit Auth.*, 890 F.2d 1355, 1359 (7th Cir. 1989) (“Any voluntary disclosure by the holder of the attorney-client privilege is inconsistent with the attorney-client confidential relationship and thus waives the privilege.”).

²³Although the rules are not authoritative, their approval “by the Supreme Court establishes that [they] constitute ‘a convenient comprehensive guide to the federal law of privileges as it now stands.’” *Transamerica Computer Co. v. IBM Corp.*, 573 F.2d 646, 651 (9th Cir. 1978) (quoting *United States v. Mackey*, 405 F. Supp. 854, 857-858 (E.D.N.Y. 1975) (Weinstein, J.)). For a discussion of the cases that have referred to Rule 512, see *Hopson v. Mayor & City Council of Baltimore*, 232 F.R.D. 228, 242 (D. Md. 2005).

²⁴Proposed Fed. R. Evid. 511, 51 F.R.D. 381 (1971), advisory committee note.

²⁵For example, courts have not always followed the proposed rules’ conclusion that a disclosure “compelled erroneously” is involuntary. See *Gray v. Bicknell*, 86 F.3d 1472, 1483-1484 (8th Cir. 1996) (discussing the various approaches courts have taken to “inadvertent disclosures”).

²⁶*In re Columbia/HCA Healthcare*, 293 F.3d 289, 294-295 (6th Cir. 2002).

²⁷This controversial approach has spawned much commentary. See, e.g., Andrew J. McNally, Comment, “Revitalizing Selective Waiver: Encouraging Voluntary Disclosure of Corporate Wrongdoing by Restricting Third Party Access to Disclosed Materials,” 35 *Seton Hall L. Rev.* 823 (2005); Beth S. Dorris, Note, “The Limited Waiver Rule: Creation of an SEC-Corporation Privilege,” 36 *Stan. L. Rev.* 789 (1984); Ashok M. Pinto, “Cooperation and Self-Interest Are Strange Bedfellows: Limited

(Footnote continued on next page.)

adopt any per se rule.²⁸ Most courts, however, have held rigidly to the rule that any voluntary disclosure permanently waives the privilege.

The cases discussed below illustrate the reasons most commonly cited for accepting or rejecting the selective waiver doctrine. All deal with the doctrine in the context of attorney-client privilege claims.²⁹ Although it is not certain that a court will follow its jurisprudence on that privilege when determining the scope of the FATP privilege, that approach seems likely.³⁰ Thus, it is useful to examine attorney-client privilege cases before considering the selective waiver doctrine's application to section 7525.

1. Selective waiver doctrine accepted. In *Diversified Industries v. Meredith*,³¹ the Eighth Circuit explicitly adopted the selective waiver doctrine, holding that a disclosure to a government agency would not waive the client's privilege vis-à-vis other litigants.

The petitioner in the case, Diversified, manufactured and processed metals,³² and sold those metals to numerous customers, including Weatherhead. In 1974 and 1975, during proxy fight litigation involving Diversified, facts surfaced indicating that Diversified had established a slush fund to bribe purchasing agents of companies with whom Diversified dealt.³³ Weatherhead, on learning of those facts, filed a complaint against Diversified, alleging that the company's employees had bribed Weatherhead's purchasing agents, causing them to accept inferior metals in exchange for payments from the slush fund.

Weatherhead sought access to an internal report examining Diversified's questionable business practices. Diversified had hired an outside law firm to conduct an internal investigation of the company's misconduct, and the law firm had prepared an extensive report detailing the findings of its investigations. Although the report undoubtedly contained communications within the scope of the attorney-client privilege and would nor-

mally be protected from disclosure, Diversified turned the report over to the Securities and Exchange Commission in response to an administrative subpoena. Weatherhead then argued that Diversified had waived its privilege regarding the report, since Diversified did not keep the communications in the report confidential. Diversified countered that the disclosure of the report to the SEC did not operate to waive its privilege, and that the company could not be compelled to disclose the report to private litigants.

On rehearing *en banc*, the Eighth Circuit found that the report was protected by the attorney-client privilege and concluded that the privilege had not been waived:

We finally address the issue of whether Diversified waived its attorney-client privilege with respect to the privileged material by voluntarily surrendering it to the SEC pursuant to an agency subpoena. As Diversified disclosed these documents in a separate and nonpublic SEC investigation, we conclude that only a [selective] waiver of the privilege occurred. See *Bucks County Bank and Trust Co. v. Storck*, 297 F. Supp. 1122 (D. Haw. 1969). Cf. *United States v. Goodman*, 289 F.2d 256, 259 (4th Cir.), vacated on other grounds, 368 U.S. 14, 82 S.Ct. 127, 7 L.Ed.2d 75 (1961). To hold otherwise may have the effect of thwarting the developing procedure of corporations to employ independent outside counsel to investigate and advise them in order to protect stockholders, potential stockholders, and customers.³⁴

Although the Eighth Circuit's opinion is short on analysis, its holding is clear: A voluntary disclosure to a government agency in a nonpublic investigation will not result in waiver of the attorney-client privilege.

A few district courts have adopted similar approaches,³⁵ but no circuit court has expressly embraced *Diversified*.

2. Selective waiver doctrine rejected. Several circuits have rejected the "selective waiver" doctrine, holding that any disclosure to a third party waives the privilege, even if that party is the government. Although they acknowledge that the doctrine encourages compliance with government investigations, they find that this noble policy goal does little to further the purposes of the attorney-client privilege.

For example, in *Permian Corp. v. United States*,³⁶ the D.C. Circuit completely rejected the selective waiver doctrine. At issue in *Permian* were documents that Occidental Petroleum (Permian's parent) had provided to the SEC on the legality of Permian's pricing practices for

Waiver of the Attorney-Client Privilege through Production of Privileged Documents in a Government Investigation," 106 *Va. L. Rev.* 359 (2004).

²⁸See *infra* note 64.

²⁹Those cases also devote considerable attention to the waiver of the work-product privilege. That privilege is not directly relevant to the issues discussed here, and the courts' analyses of the work-product privilege are thus omitted. Standards governing waiver of the work-product privilege do not necessarily mirror those governing waiver of the attorney-client privilege. See Gary G. Lynch and Robert E. Underhill, *Internal Investigations*, 1085 *PLI/Corp* 369, 378 (1998) ("Disclosure to a third-party does not automatically waive work-product protection. Rather, the issue is whether the disclosure substantially increases the likelihood that an adversary will gain access to protected information."). For a discussion of waiver of work product, see McNally, *supra* note 27, at 831-833. Whether FATPs are entitled to a work-product privilege, and if so, whether a disclosure to a third party waives that privilege, is not considered in this report.

³⁰See *infra* Parts III and IV.

³¹572 F.2d 596 (8th Cir. 1977) (*en banc*).

³²*Id.* at 607.

³³*Id.*

³⁴*Id.* at 611.

³⁵See *In re Grand Jury Subpoena Dated July 13, 1979*, 478 F. Supp. 368, 373 (D. Wis. 1979) ("I believe that such cooperation [with the government] should be encouraged, and therefore I will not treat the release of the Quarles & Brady report to the Securities and Exchange Commission, Internal Revenue Service, or the New York grand jury as a waiver of the corporation's attorney-client privilege with regard to the notes."); *Saito v. McKesson HBOC, Inc.*, No. Civ. A. 18553, 2002 WL 31657622, at *3 (Del. Ch. Nov. 13, 2002), *aff'd*, 870 A.2d 1192 (Del. 2005).

³⁶665 F.2d 1214 (D.C. Cir. 1981).

crude oil.³⁷ Occidental (under a confidentiality agreement) disclosed the documents to the SEC, seeking a favorable ruling from the agency on a pending transaction.³⁸

Later, the Department of Energy (DOE) wished to investigate whether Occidental had violated federal energy laws and tried to obtain the documents despite the company's privilege claim. The DOE argued that Occidental had waived its privilege by producing the documents to the SEC, regardless of the confidentiality agreement.

The D.C. Circuit agreed, concluding that Occidental had waived whatever testimonial privileges may have attached to the documents by disclosing them to the SEC, finding the selective waiver theory "wholly unpersuasive."³⁹ The court noted that a voluntary disclosure is necessarily inconsistent with the attorney-client privilege's confidentiality requirement:

We cannot see how the availability of a "[selective] waiver" would serve the interests underlying the common law privilege for confidential communications between attorney and client. . . . The privilege depends on the assumption that full and frank communication will be fostered by the assurance of confidentiality, and the justification for granting the privilege 'ceases when the client does not appear to have been desirous of secrecy.' 8 J. Wigmore, *Evidence* s 2311, at 599 (McNaughton rev. 1961). The Eighth Circuit's "[selective] waiver" rule has little to do with this confidential link between the client and his legal advisor. Voluntary cooperation with government investigations may be a laudable activity, but it is hard to understand how such conduct improves the attorney-client relationship. If the client feels the need to keep his communications with his attorney confidential, he is free to do so under the traditional rule by consistently asserting the privilege, even when the discovery request comes from a "friendly" agency.⁴⁰

The court then suggested that the selective waiver doctrine was inherently unfair to third-party litigants:

The client cannot be permitted to pick and choose among his opponents, waiving the privilege for some and resurrecting the claim of confidentiality to obstruct others, or to invoke the privilege as to communications whose confidentiality he has already compromised for his own benefit. . . . The attorney-client privilege is not designed for such tactical employment.⁴¹

The court refused to allow Occidental to use the attorney-client privilege as both a sword and a shield. Occidental had disclosed privileged documents to the SEC to obtain a favorable ruling from the agency, but then wished to assert the attorney-client privilege against

the DOE to prevent that agency from discovering evidence of the company's wrongdoing. The D.C. Circuit, observing the inherent inequity of this "tactical employment," rejected the selective waiver doctrine altogether.

Other courts have followed the D.C. Circuit's lead. In *Westinghouse Elec. Corp. v. Republic of Philippines*,⁴² the Third Circuit analyzed the "celebrated and controversial selective waiver theory."⁴³ The petitioner, Westinghouse, had allegedly obtained construction contracts by bribing foreign officials. Westinghouse retained Kirkland & Ellis to conduct an internal investigation into whether company officials had in fact made improper payments.⁴⁴ During the internal investigation, Kirkland & Ellis produced two reports of its findings, and, at the behest of Westinghouse, showed SEC investigators one of the reports. The law firm also orally presented its findings to the SEC, but did not supply the agency with any of the documents underlying the presentation or the report.⁴⁵

The Republic of Philippines, in a civil suit against Westinghouse, sought access to the documents shown to the SEC. The Philippines alleged that Westinghouse obtained a large power plant contract in the Philippines by bribing a henchman of former President Ferdinand Marcos, and believed that the documents were relevant to its complaint.⁴⁶ The Philippines argued that whatever privileges may have attached to the documents had been effectively waived by Westinghouse's disclosures to the SEC. Westinghouse objected, invoking the attorney-client privilege.⁴⁷

The Third Circuit, agreeing in part with the D.C. Circuit, determined that Westinghouse had in fact waived its privilege by showing the documents to the SEC:

We find the first part of the D.C. Circuit's reasoning persuasive. The Eighth Circuit's sole justification for permitting selective waiver was to encourage corporations to undertake internal investigations. . . . Selective waiver does not serve the purpose of encouraging full disclosure to one's attorney in order to obtain informed legal assistance; it merely encourages voluntary disclosure to government agencies, thereby extending the privilege beyond its intended purpose.⁴⁸

The court also agreed with a commentator's suggestion that the privilege is superfluous when a client voluntarily reveals communications to a third party:

If clients themselves divulge such information to third parties, chances are that they would also have divulged it to their attorneys, even without the protection of the privilege. Thus, once a client has

³⁷*Id.* at 1217.

³⁸*Id.* at 1218.

³⁹*Id.* at 1220.

⁴⁰*Id.* at 1220-1221.

⁴¹*Id.* at 1221.

⁴²951 F.2d 1414 (3d Cir. 1991).

⁴³*Id.* at 1423.

⁴⁴*Id.* at 1418.

⁴⁵*Id.* at 1418.

⁴⁶*Id.* at 1417.

⁴⁷*Id.* at 1420.

⁴⁸*Id.* at 1425.

revealed privileged information to a third party, the basic justification for the privilege no longer applies.⁴⁹

The Third Circuit did not, however, adopt the portion of the *Permian* opinion regarding the alleged “unfairness” of the selective waiver doctrine, concluding that the resolution of that issue was unnecessary to its holding.⁵⁰

The First Circuit in *United States v. MIT*⁵¹ also rejected the selective waiver doctrine, but provided an unusual interpretation of the “voluntary disclosure” requirement. The respondent in the case, the Massachusetts Institute of Technology (a section 501(c)(3) organization), had engaged in contract work with the Department of Defense (DOD). Under the DOD’s standard contract review procedures, MIT had disclosed some law firm billing statements to the Defense Contract Audit Agency (DCAA), the DOD’s auditing arm.⁵²

In 1993 the IRS conducted an examination of MIT’s records to determine whether the university still qualified for tax-exempt status and to determine whether it was complying with other requirements imposed by the code.⁵³ To aid its examination, the IRS requested from MIT copies of the billing statements of law firms that had represented MIT. MIT supplied the documents requested but redacted information claimed to be covered by the attorney-client privilege.⁵⁴ The IRS then sought the documents from the DCAA, to which MIT had previously disclosed the statements without redaction.

The DCAA refused to turn over the documents to the IRS without MIT’s consent, which MIT refused to give, citing the attorney-client privilege.⁵⁵ The IRS then served an administrative summons on MIT, seeking production of the documents. MIT’s refusal to comply with that summons led the parties to court.

After considering the parties’ arguments, the First Circuit rejected MIT’s privilege claim, concluding that the university’s disclosure to the DCAA effectively waived its privilege regarding the billing statements. As the D.C. Circuit and the Third Circuit did earlier, the First Circuit expressed skepticism that the selective waiver doctrine did anything to further the purposes of the attorney-client privilege:

MIT, like any client, continues to control both the nature of its communications with counsel and the

ultimate decision whether to disclose such communications to third parties. The only constraint imposed by the traditional rule here invoked by the government — that disclosure to a third party waives the privilege — is to limit selective disclosure, that is, the provision of otherwise privileged communications to one outsider while withholding them from another. *MIT has provided no evidence that respecting this constraint will prevent it or anyone else from getting adequate legal advice.*⁵⁶

MIT also argued that its disclosures to DCAA were involuntary and thus could not operate to waive its privilege claim. The court expressed doubt that MIT’s disclosures were in fact compelled by law,⁵⁷ but concluded that even if they were, MIT voluntarily placed itself in a position to disclose:

MIT further argues that the disclosure to the audit agency was not “voluntary” because of the practical pressures and the legal constraints to which it was subject as a government contractor. The extent of those pressures and constraints is far from clear, but assuming *arguendo* that they existed, MIT chose to place itself in this position by becoming a government contractor. In short, MIT’s disclosure to the audit agency resulted from its own voluntary choice, *even if that choice was made at the time it became a defense contractor and subjected itself to the alleged obligation of disclosure.*⁵⁸

Thus, under the First Circuit’s view, MIT’s disclosures were deemed “voluntary,” even if those disclosures were compelled by a statute or regulation, since it had voluntarily accepted defense contracts.

That definition of voluntary disclosure is different from definitions of it found elsewhere in the case law. Courts usually examine whether the actual act of disclosure was voluntary, rather than whether the client voluntarily placed himself in a position to disclose.⁵⁹ In any event, *MIT* added to the litany of cases rejecting the selective waiver doctrine.

3. Summary. The selective waiver doctrine has not gained much traction in the federal courts, to put it mildly. In addition to the rejections by the D.C. Circuit,

⁴⁹*Id.* at 1424 (quoting Comment, “Stuffing the Rabbit Back into the Hat: Limited Waiver of the Attorney-Client Privilege in an Administrative Agency Investigation,” 130 *U. Pa. L. Rev.* 1198, 1207 (1982)).

⁵⁰*Id.* at 1426 (“Our rejection of the selective waiver rule does not depend, however, on the second reason the D.C. Circuit gave in *Permian* for rejecting *Diversified*. Generally, the ‘fairness doctrine’ is invoked in partial (as opposed to selective) disclosure cases. This case involves selective, rather than partial, disclosure. The courts and commentators disagree about whether there is anything unfair about selective disclosure. Here is it unnecessary to decide the question.”).

⁵¹129 F.3d 681 (1st Cir. 1997).

⁵²*Id.* at 683.

⁵³*Id.* at 682.

⁵⁴*Id.* at 683.

⁵⁵*Id.* at 685.

⁵⁶*Id.* at 685 (emphasis added).

⁵⁷*Id.* at 686 n.5 (“MIT’s main citation for its duty to disclose is not to a statute or regulation but to a procedures manual maintained by the audit agency. There is no actual evidence that MIT would have been denied payment if it had sought to negotiate some lesser disclosure.”).

⁵⁸*Id.* at 686 (citations omitted, emphasis added).

⁵⁹See, e.g., *Transamerica Computer Co. v. IBM Corp.*, 573 F.2d 646, 651 (9th Cir. 1978) (“It is our belief that under the specific circumstances of the accelerated discovery proceedings in the CDC litigation, IBM’s inadvertent production there of some privileged documents does not constitute a waiver of the privilege protecting the production of those documents, for that production was [made involuntarily].”). The Ninth Circuit examined the circumstances surrounding the actual disclosure when determining whether the disclosure was voluntary. It did not examine, for example, whether IBM’s decision to engage in the computer business — and thereby subject itself to lawsuits from competitors — was voluntary.

the Third Circuit, and the First Circuit (discussed above), the selective waiver doctrine has been expressly rejected by the Federal Circuit,⁶⁰ the Fourth Circuit,⁶¹ the Sixth Circuit,⁶² and the Tenth Circuit.⁶³ Only the Eighth Circuit has accepted the doctrine, and even then, it did so without much analysis. Although a few circuits have refused to accept a per se rule regarding selective waiver, their ultimate views on the doctrine are far from clear.⁶⁴

The judiciary's hostility to the selective waiver doctrine is not surprising. Courts have long held that the attorney-client privilege is in derogation of the search for truth and must therefore be construed narrowly.⁶⁵ And, although approaches vary somewhat, courts generally require that the client guard confidential communications closely — even an inadvertent disclosure will waive the privilege in some jurisdictions.⁶⁶ It is thus hardly unusual that a reviewing court will deem the privilege waived whenever a party makes a third-party disclosure, regardless of the third party's identity.⁶⁷

⁶⁰*Genentech, Inc. v. United States International Trade Commission*, 122 F.3d 1409 (Fed. Cir. 1997).

⁶¹*In re Martin Marietta Corp.*, 856 F.2d 619 (4th Cir. 1988).

⁶²*In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 299 (6th Cir. 2002).

⁶³*In re Qwest Communications Int'l, Inc.*, 450 F.3d 1179 (10th Cir. 2006).

⁶⁴*See Dellwood Farms v. Cargill, Inc.*, 128 F.3d 1122 (7th Cir. 1997) (suggesting that a confidentiality agreement may preserve privilege); *United States v. Billmyer*, 57 F.3d 31, 37 (1st Cir. 1995) (“If there were ever an argument for limited waiver, it might well depend importantly on just what had been disclosed to the government and on what understandings. Without intending to preclude such an argument in a future case, we think that it is enough in this one to say that no such claim of limited waiver has been argued to us.”); *Salomon Bros. Treasury Litig. v. Steinhart Partners, L.P. (In re Steinhart Partners, L.P.)*, 9 F.3d 230, 236 (2d Cir. 1993) (suggesting that privilege may be preserved when party enters into confidentiality agreement with government); *Bittaker v. Woodford*, 331 F.3d 715, 720 (9th Cir. 2003) (“Although we do not decide the case under the express waiver doctrine, we note that the law in this area is not as settled as the state would have us believe.”). Those tentative statements provide little comfort to clients. As the Supreme Court observed, “an uncertain privilege . . . is little better than no privilege at all.” *Upjohn*, 449 U.S. at 389.

⁶⁵*Pierce County v. Guillen*, 537 U.S. 129, 144 (2003) (“We have often recognized that statutes establishing evidentiary privileges must be construed narrowly because privileges impede the search for the truth.”); *In re Grand Jury Investigation No. 83-2-35*, 723 F.2d 447, 451 (6th Cir. 1983) (citing *United States v. Weger*, 709 F.2d 1151, 1154 (7th Cir. 1983)); *Baird v. Koerner*, 279 F.2d 623, 631-632 (9th Cir. 1960); *United States v. Pipkins*, 528 F.2d 559, 562-563 (5th Cir. 1976)).

⁶⁶*See* Timothy Glynn, “Federalizing Privilege,” 52 *Am. U. L. Rev.* 59, 116-118, notes 252-255 (2002) (“A few courts have suggested that waiver occurs regardless of the circumstances of the disclosure, including situations in which no blame can be attached to either the attorney or the client.”) (citing *In re Sealed Case*, 877 F.2d 976, 980 (D.C. Cir. 1989) (stating that clients seeking to preserve the privilege must treat the communications “like jewels” and that, short of court-compelled disclosure or other extraordinary circumstances, the court will not engage in an analysis of degrees of voluntariness)).

⁶⁷*See infra* note 20 for the limited exceptions to this rule.

III. Selective Waiver and the Section 7525 Privilege

A. Background

As part of the Internal Revenue Service Restructuring and Reform Act of 1998,⁶⁸ Congress created a right to privileged communications between taxpayers and their nonattorney tax advisers.⁶⁹ No comparable privilege had previously existed under federal law.⁷⁰ Under section 3411(a) of the act, Congress added section 7525 to the code.⁷¹ Section 7525(a)(1) provides:

With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a

⁶⁸P.L. 105-206, 112 Stat. 685 (July 22, 1998) (codified in scattered sections of 26 U.S.C.).

⁶⁹“Federally authorized tax practitioners” include CPAs, enrolled agents, and enrolled actuaries. *See* 31 U.S.C. section 330 and 31 C.F.R. section 10.3. Communications made to tax attorneys continue to be protected by the common law attorney-client privilege, which is generally broader than the FATP privilege. *See* Federal Rule of Evidence 501.

⁷⁰*Couch v. United States*, 409 U.S. 322, 335 (1973).

⁷¹Section 7525, in full, provides:

Sec. 7525. Confidentiality privileges relating to taxpayer communications.

(a) Uniform application to taxpayer communications with federally authorized practitioners.

(1) General rule. With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

(2) Limitations. Paragraph (1) may only be asserted in —

(A) any noncriminal tax matter before the Internal Revenue Service; and

(B) any noncriminal tax proceeding in Federal court brought by or against the United States.

(3) Definitions. For purposes of this subsection —

(A) Federally authorized tax practitioner. The term “federally authorized tax practitioner” means any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code.

(B) Tax advice. The term “tax advice” means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice described in subparagraph (A).

(b) Section not to apply to communications regarding tax shelters. The privilege under subsection (a) shall not apply to any written communication which is —

(1) between a federally authorized tax practitioner and —

(A) any person,

(B) any director, officer, employee, agent, or representative of the person, or

(C) any other person holding a capital or profits interest in the person, and

(2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in section 6662(d)(2)(C)(ii)).

taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

Although section 7525's general rule purports to provide uniform evidentiary rules for communications between taxpayers and their tax advisers, the statute does not completely harmonize the treatment of those communications. Rather, while communications made to tax attorneys continue to receive the broad protections afforded by the attorney-client privilege, communications made to other tax advisers are subject to section 7525's several exceptions. For example, Congress provided that the FATP privilege may be asserted only in noncriminal tax matters before the IRS and in noncriminal tax proceedings in federal court brought by or against the United States.⁷² Further, Congress limited the scope of the privilege by providing that it would not apply to some communications related to tax shelters.⁷³ Lastly, although the attorney-client privilege generally shields communications whenever legal advice of any kind is sought, section 7525 protects only those communications pertaining to tax advice.⁷⁴ As the IRS acknowledges:

Although [section 7525] is partly defined by reference to, and is no broader than, the attorney-client privilege, it is clearly a different privilege, created solely by statute, and defined as much by the statutory language as by reference to the common law attorney-client privilege.⁷⁵

Principles governing the attorney-client privilege are obviously relevant to determining section 7525's scope. For example, as with the attorney-client privilege, the FATP privilege does not protect communications made in the furtherance of a crime.⁷⁶ However, the FATP privilege is ultimately a product of statute, and is therefore governed by congressional intent rather than by the "reason and experience"⁷⁷ of the federal judiciary.

Nonetheless, the IRS and the courts have drawn heavily on attorney-client privilege principles when defining the scope of section 7525. In *United States v. BDO Seidman*,⁷⁸ the Seventh Circuit addressed whether the section 7525 privilege can protect a taxpayer's identity from disclosure.⁷⁹ The unnamed intervenors in the litigation (the Does) sought to prevent the IRS from enforcing an administrative summons ordering BDO to disclose some documents that would reveal the Does' identities.

In determining whether an "identity" privilege existed under section 7525, the court acknowledged the link between the attorney-client privilege and the FATP privilege:

Because the scope of the tax practitioner-client privilege depends on the scope of the common law protections of confidential attorney-client communications, we must look to the body of common law interpreting the attorney-client privilege to interpret the section 7525 privilege.

The court then emphasized that a party that asserts the section 7525 privilege must bear the *same* burdens that a party asserting the attorney-client privilege must bear:

The mere assertion of a privilege is not enough; instead, a party that seeks to invoke the attorney-client privilege has the burden of establishing all of its essential elements. A party that seeks to assert a section 7525 privilege bears the same burden. Among the essential elements of the attorney-client privilege are the requirements that the communication be made to the attorney in confidence, and that the confidences constitute information that is not intended to be disclosed by the attorney . . . the privilege protects only the client's confidences, not things which, at the time, are not intended to be held in the breast of the lawyer.⁸⁰

The court went on to conclude that, while an identity privilege exists under both the attorney-client privilege and the FATP privilege, the Does had not established that confidential communications would be disclosed if their identities were revealed to the IRS. Accordingly, the court denied the Does' motion for intervention.

Others have similarly emphasized attorney-client privilege principles when examining the scope of the FATP privilege. In *United States v. KPMG*, for example, the District Court for the District of Columbia observed that it "must [follow] the text of section 7525. . . [and address] any claims of section 7525 privilege in the same manner as it does for the attorney-client privilege."⁸¹ Similarly, the IRS has ruled that the FATP privilege must be defined by reference to the attorney-client privilege.⁸² The author of the leading treatise on tax procedure writes, "the [section 7525] privilege is coextensive with the attorney-client privilege, [and] the same limitations that apply to the attorney-client privilege apply to the accountant/enrolled agent privilege."⁸³ The courts and

⁷²Section 7525(a)(2).

⁷³Section 7525(b).

⁷⁴Section 7525(a)(1).

⁷⁵IRM 4.11.55.2.3.

⁷⁶Section 7525(a)(1).

⁷⁷Federal Rule of Evidence 501.

⁷⁸337 F.3d 802 (7th Cir. 2003).

⁷⁹Generally, a testimonial privilege protects a client's *communications*, and not his identity. "However, over the years, a limited exception to this general rule has developed; the identity of a client may be privileged in the rare circumstance when so much of an actual confidential communication has been disclosed already that merely identifying the client will effectively disclose that communication." *BDO*, 337 F.3d at 811.

⁸⁰*BDO*, 337 F.3d at 811 (citations, quotations, and punctuation omitted).

⁸¹*United States v. KPMG*, 237 F. Supp.2d 35, 39 (D.D.C. 2002). See also *Cavallaro v. United States*, 284 F.3d 236, 246 (1st Cir. 2002) ("The parties to this litigation recognize . . . that accountant-client communications are privileged if they meet the traditional requirements of the attorney-client privilege.").

⁸²See 2000 IRS NSAR 11040 ("In this case, whether the relationship is accountant client or attorney client, we believe the same general principles will apply to the issue whether the document is protected."), discussed *infra* Part III.

⁸³Michael Saltzman, *IRS Practice and Procedure*, section 13.11[4] (2d ed. Warren, Gorham & Lamont 1991) (updated through 2006).

others have not defined the FATP privilege *in part* by reference to the attorney-client privilege, but seemed to have adopted that privilege's principles *in toto*. That approach could very well sound the FATP privilege's death knell.

B. Current Views

The selective waiver doctrine has found few friends in the judiciary. The courts have proven hostile to the doctrine, having rejected it numerous times in the context of attorney-client privilege claims.⁸⁴ Given that hostility, the IRS and commentators have readily concluded that the courts will not apply the doctrine to the FATP privilege, either.

For example, commentators have assumed that parallel proceedings by the government may lead to a waiver of the FATP privilege.⁸⁵ "Parallel proceedings" involve simultaneous, adjudicative investigations of a taxpayer involving any number of federal agencies.⁸⁶ Although a taxpayer may try to assert the FATP privilege against each of the several agencies investigating him, the privilege is available only against the IRS.⁸⁷ Thus, if the SEC wishes to examine the taxpayer's communications with his tax adviser for possible violations of the securities laws, the taxpayer will have to disclose those communications. That disclosure would then cause the privilege to be deemed waived *vis-à-vis* the IRS. As one commentator concludes:

The [section 7525] privilege does not apply with respect to any regulatory body other than the IRS, such as the Securities and Exchange Commission. Thus, if an otherwise privileged communication between an authorized practitioner and the taxpayer were disclosed to the SEC, the common law doctrine of waiver of the attorney-client privilege by disclosure would apply and the communication would lose its section 7525 protection.⁸⁸

The statement of one senior IRS official echoes that conclusion.⁸⁹

⁸⁴See *supra* Part II.B.

⁸⁵Parallel proceedings involve the simultaneous investigations of multiple agencies into a taxpayer's affairs, or the simultaneous investigations by both the Criminal and Civil Divisions of the IRS.

⁸⁶See Mark D. Hunter, "SEC/DOJ Parallel Proceedings: Contemplating the Propriety of Recent Judicial Trends," 68 *Mo. L. Rev.* 149, 149 (2003).

⁸⁷Technically speaking, the privilege is not available against only the IRS, but may be asserted against (for example) the Department of Justice in a noncriminal tax proceeding. See section 7525(a)(2). For simplicity's sake, this report will refer to the IRS as the only party against which the privilege may be asserted.

⁸⁸Barbara Kaplan, Greenberg Traurig LLP, Practising Law Institute PLI Order No. 6357, October-November 2005, *Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2005*.

⁸⁹See Sheryl Stratton, "Accountant-Client Privilege Proposal Sliced and Diced," *Tax Notes*, May 29, 1998, p. 1097, *Doc 98-16941*, 98 *TNT 103-1* ("The IRS's [Associate Chief Counsel, Procedure & Administration, Deborah Butler] agreed. 'If you are practicing in the Tax Court, for privilege waiver purposes, once

(Footnote continued in next column.)

Commentators have also observed that because the section 7525 privilege is available only in *noncriminal* tax proceedings, the IRS can easily obtain otherwise privileged communications by instituting a criminal investigation against the taxpayer. As one practitioner warns:

Accounting firms should be aware that the relevant consideration isn't that a civil audit is not the subject of a criminal case today. The crucial factor is whether the audit ever becomes the subject of a criminal investigation, at which time the privilege evaporates retroactively.⁹⁰

Another practitioner expresses disbelief at that construction of the statute, but concludes that section 7525's restrictive wording may very well mandate waiver in those circumstances:

There could be a "retroactive loss" of the privilege. It is almost as if the privilege exists pursuant to statute but it cannot be "asserted" pursuant to the statute. While a first reaction is this could not be what was intended — to give with one hand and take away with the other — one must acknowledge the restrictive wording of the statute. . . . Thus, a client's previously believed confidences with his certified public accountant or enrolled agent representative could be used as evidence first to prosecute the client and perhaps even later in the post criminal civil audit review.⁹¹

Again, the general assumption is that the selective waiver doctrine will not apply to the FATP privilege.

something is disclosed, it is waived for all purposes.' She cited a judge's ruling that 'once the bell has been rung, it is rung for all purposes.' The information can be disclosed in many other contexts where the privilege does not apply, like in SEC or in criminal investigations, she said.'")

⁹⁰Sheryl Stratton, "Lawyers Discuss Postshelter Assault On Privilege," *Tax Notes*, Apr. 18, 2005, p. 289, *Doc 2005-7714*, 2005 *TNT 71-5* (quoting David Aughtry).

⁹¹Theodore A. Sinars and Richard L. Manning, 15 *Mertens Law of Fed. Income Tax'n* section 55A:88 (emphasis in original). See also Michael Wilson, Note, "Careful What You Wish For: The Tax Practitioner-Client Privilege Established by the Internal Revenue Service Restructuring and Reform Act of 1998," 51 *Fla. L. Rev.* 319, 340 ("However, if the tax practitioner-client privilege is destroyed when a civil tax matter becomes a criminal tax matter, the door is opened to potential abuse by the IRS. In the experience of Regina J. Schroder, chair of the Executive Committee of the Taxation Section of the State Bar of California, 'a taxpayer's accountant and other non-lawyer advisors are often subpoenaed as witnesses in a criminal Federal tax proceeding.' Because of this fact, the IRS could attempt to circumvent the tax practitioner-client privilege by using any strained reasoning to turn civil tax matters into criminal tax matters in order to obtain discovery of formerly privileged communications between taxpayers and their non-attorney tax practitioners."). The IRS certainly did not welcome the enactment of the FATP privilege with open arms, which perhaps suggests that it will not hesitate to vitiate it. See Alyson Petroni, Note, "Unpacking the Accountant-Client Privilege Under I.R.C. Section 7525," 18 *Va. Tax Rev.* 843, 847-851 (1999) (detailing Treasury's and the IRS's hostility to the privilege's enactment).

Although the IRS⁹² has not issued any formal rule on the selective waiver doctrine, the agency has rejected it in interpretive guidance. In NSAR 11,040,⁹³ the IRS sought an opinion letter provided to a taxpayer by attorneys associated with an accounting firm. The taxpayer had previously provided the state attorney general's office with a copy of that letter in connection with a restructuring of the taxpayer's business entities, but nonetheless claimed that the letter was privileged.

Before concluding that the disclosure to the state attorney general operated as a waiver, the IRS observed that because the opinion letter was ultimately provided by an accounting firm, the attorney-client privilege might be unavailable. Rather, section 7525 would provide any available protections. However, after reviewing the statute's legislative history, the IRS decided that the same principles that govern the attorney-client privilege should govern the FATP privilege:

In this case, whether the relationship is accountant client or attorney client, we believe the same general principles will apply to the issue whether the document is protected.

The [FATP privilege] applies only to the extent that communications would be privileged if they were between a taxpayer and attorney. The privilege does not apply to any communication between an accountant and client if the communication would not have been privileged between an attorney and the client. S. Rep. No. 105-174. The privilege between the client and accountant can be waived in the same manner as the attorney client privilege. If the taxpayer discloses to a third party the substance of a communication protected by the privilege, the privilege for that communication and any related communications is considered to be waived to the same extent and in the same manner as the privilege would be waived if the disclosure related to an attorney client communication. H.R. Conf. Rep. No. 105-599.⁹⁴

Having decided that the taxpayer's privilege claim must be examined under the principles governing the attorney-client privilege, the IRS concluded that the taxpayer had waived whatever testimonial privileges that may have attached to the opinion letter by disclosing it to the state attorney general's office. The IRS acknowledged the circuit split on the selective waiver doctrine, but followed the majority rule that a voluntary disclosure of privileged communications to a third party necessarily vitiates the privilege, even if that third party is a government agency.

The IRS and practitioners commonly assume that the selective waiver doctrine will not apply to the FATP privilege. They have not specifically considered whether

that result comports with the text of the statute, but instead presume that the FATP privilege may be waived in the same manner as the attorney-client privilege. A more careful analysis may very well lead one to the opposite conclusion.

IV. Selective Waiver Doctrine Should Apply

Before examining the application of the selective waiver doctrine to the FATP privilege, a quick review of the courts' approaches to the doctrine in the context of the attorney-client privilege is in order:

1. Courts are generally hesitant to accept the selective waiver doctrine, but at least one circuit (and a few district courts) has adopted it, citing public policy.
2. Courts that reject the doctrine will acknowledge the strong public policy arguments in favor of its acceptance, but:

- a. they are uncomfortable with the prospect that the client can assert the privilege as a litigation tactic, and thereby treat similarly situated opponents in litigation differently; and
- b. they find acceptance of the doctrine unrelated to attorney-client privilege purposes. Specifically, courts do not believe that acceptance of the selective waiver doctrine does anything to encourage full and frank communication between clients and their attorneys, and is fundamentally inconsistent with the privilege's confidentiality requirement.

Although those counterarguments to the selective waiver doctrine are quite forceful regarding the attorney-client privilege, they are inapplicable to the FATP privilege.

A. Inapplicability of Traditional Arguments

The courts' usual counterarguments to the selective waiver doctrine are readily dismissed when a section 7525 privilege claim is at issue. Congress severely limited the scope of the privilege by allowing its assertion only in noncriminal tax proceedings, and then only against the United States. That narrow scope renders the traditional arguments against the selective waiver doctrine inapplicable.

1. Gamesmanship. The courts have cautioned that acceptance of the selective waiver doctrine may allow a client to "pick and choose among his opponents, waiving the privilege for some and resurrecting the claim of confidentiality to obstruct others."⁹⁵ That gamesmanship threatens the legitimacy of the judicial system as a whole.⁹⁶ When an attorney-client privilege claim is at issue, a private party may be understandably upset when

⁹²The IRS and Treasury are used interchangeably here, although, of course, only Treasury can issue legislative regulations.

⁹³IRS Non-Docketed Service Advice Review (Apr. 13, 2000), available at 2000 WL 34423026.

⁹⁴IRS NSAR 11,040 (2000).

⁹⁵*Permian*, 665 F.2d at 1221.

⁹⁶See Comment, "Developments In The Law: Privileged Communication," 98 *Harv. L. Rev.* 1629, 1646 (1985) (A "judicial system that ignores publicly known information or information known to an adversary risks losing its legitimacy as a truth-seeking process.").

she is denied access to materials that her adversary has already made available to a government agency.⁹⁷

Those concerns, however, are not relevant to the FATP privilege; the client asserting that privilege will not be able to engage in any gamesmanship. Because the privilege is available *only* in noncriminal tax proceedings to which the United States is a party, the client cannot possibly choose to disclose materials to some adversaries and not to others. Absolutely no accountant-client privilege is recognized by the federal common law,⁹⁸ and private parties and government agencies can freely discover communications made between a client and his nonattorney tax adviser. No third party is adversely affected by a client's ability to assert the FATP privilege against the United States in noncriminal tax proceedings.

In some sense, the client is able "to discriminate between parties who are roughly on the same footing."⁹⁹ The client may, for example, reveal tax-related communications to the SEC during a securities-related investigation. If the client is allowed to continue to assert the privilege against the IRS, the agency is discriminated against vis-à-vis the SEC. That "discrimination," however, is hardly cause for alarm, *but is instead the entire point of the privilege*. Congress clearly anticipated that the IRS would be discriminated against when it provided that the privilege would apply only in noncriminal tax proceedings.¹⁰⁰ Any such discrimination is not attributable to the client's "gamesmanship," but to unambiguously expressed congressional intent.¹⁰¹

2. Confidentiality. Because the attorney-client privilege is designed to protect only those communications made in reliance on the privilege, the courts have insisted that the client maintain the confidentiality of her communi-

cations with her attorney.¹⁰² If a client reveals those communications to a third party, the natural inference is that her original statements were not made in confidence and that she would have made the statements regardless of the privilege. The courts have observed that the selective waiver doctrine is fundamentally inconsistent with the confidentiality requirement and does nothing to encourage full and frank communications between clients and their attorneys.

The FATP privilege is quite different from the attorney-client privilege, however, and serves different purposes.¹⁰³ To further those purposes, one must consider the unique scope of the privilege. It does not make sense to adopt attorney-client privilege principles in toto when determining the scope of the FATP privilege. In fact, strictly applying those principles may lead to odd contradictions.

Consider, for example, the application of the attorney-client privilege's "legal advice" requirement to the FATP privilege. Under attorney-client privilege principles, communications between taxpayers and their advisers are privileged only when the client seeks *legal* advice. However, the practitioners covered only by section 7525 are not licensed to practice law, and therefore cannot dispense legal advice. Thus, if the section 7525 privilege carries a "legal advice" requirement, taxpayers can *never* assert the privilege because they will be unable to show that they have sought legal advice from their nonattorney adviser. Congress could not possibly have intended that absurd result, and the statute's language — that the privilege applies only "to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney" — must not be read literally.¹⁰⁴ Under a textual approach, literal interpretations are disfavored, particularly when they produce such silly results.¹⁰⁵

⁹⁷Consider the hypothetical provided by one commentator: "Imagine you have a chronic illness and are admitted to the hospital multiple times. . . . Subsequently, you hear that the hospital miscoded your admissions; therefore, you overpaid the hospital a substantial amount of money, and you decide to sue the hospital. During discovery, you learn the hospital also overcharged the government by miscoding Medicare claims. In fact, the hospital's miscoding was so egregious that the hospital paid the Department of Justice (DOJ) \$840 million in a settlement deal. The evidence, primarily internal audits, used to indict the hospital was then given to the DOJ as part of the settlement deal. However, the hospital will not let anyone else see the results of the audits, which is the proof needed to substantiate your claim against the hospital. The hospital maintains that the audit information does not have to be released to you or any other party because it is confidential information protected by the attorney-client privilege and work product doctrine. The hospital claims that the fact that the DOJ got to see this 'confidential information' is irrelevant. Is this fair?" Jody E. Okresik, Note, "Selective Waiver: Should the Government be Privy to Privileged Information Without Waiving the Attorney-Client Privilege and Work Product Doctrine?" 34 *U. Mem. L. Rev.* 115, 116-117 (2003).

⁹⁸*Couch v. United States*, 409 U.S. 322, 335 (1973).

⁹⁹*Columbia/HCA*, 293 F.3d at 310.

¹⁰⁰Section 7525(a)(2).

¹⁰¹See section 7525. Note that the "intent" referred to in this report is an "objectified" intent, rather than the "subjective" intent of the legislators. See *infra* note 136.

¹⁰²See *supra* Part II.

¹⁰³The privilege serves the limited purpose of providing confidentiality protections for tax-related communications in noncriminal tax matters, subject to some exceptions. See section 7525.

¹⁰⁴See also Robert T. Smith, "After the Alamo: Taxpayer Claims of Privilege and the IRS War on Tax Shelters," *Tax Notes*, Jan. 13, 2003, p. 233, *Doc 2003-1200*, 2003 *TNT* 9-47 ("This view has the potential for turning the entire section 7525 privilege on its head because nonattorney tax practitioners are not permitted to provide legal advice. Even attorneys working for accounting firms have traditionally not been able to render legal services lest the firm be engaged in the unauthorized practice of law. Thus, to the extent the tax practitioner privilege applies only to tax advice that would be considered legal advice if provided by a lawyer, serious questions remain.").

¹⁰⁵See, e.g., *Green v. Bock Laundry Mach. Co.* 490 U.S. 504, 527 (1989) (Scalia, J., concurring) ("We are confronted here with a statute which, if interpreted literally, produces an absurd, and perhaps unconstitutional, result. Our task is to give some alternative meaning . . . that avoids this consequence."). See also *Pub. Citizen v. United States Dep't of Justice*, 491 U.S. 440, 471 (1989) (Kennedy, J., concurring), and *Smith v. United States*, 508 U.S. 223, 241 (1993) (Scalia, J., dissenting) ("It is . . . a 'fundamental principle of statutory construction (and, indeed, of

(Footnote continued on next page.)

Indeed, courts have not imposed a “legal advice” requirement on the FATP privilege,¹⁰⁶ but they *have* insisted that the attorney-client privilege’s confidentiality requirement does apply.¹⁰⁷ But that insistence is misguided. Although the attorney-client privilege is a broad privilege, available during legal proceedings of any kind and against virtually all adversaries, the FATP privilege is available only in noncriminal tax proceedings and only against the IRS.¹⁰⁸ Given that the privilege is usually unavailable to the client, protecting the confidentiality of

language itself) that the meaning of a word cannot be determined in isolation, but must be drawn from the context in which it is used.”) (citations omitted). Although critics of textualism sometimes confuse it with literalism, it is worth emphasizing that the two approaches to statutory interpretation are quite different. See, e.g., John F. Manning, “Textualism as a Nondelégation Doctrine,” 97 *Colum. L. Rev.* 673, 696 (1997) (“Textualism is not literalism. Not even the most committed textualist would claim that statutory texts are inherently ‘plain on their face,’ or that all interpretation takes place within the four corners of the Statutes at Large.”); Jonathan R. Siegel, “Textualism and Contextualism in Administrative Law,” 78 *B.U. L. Rev.* 1023, 1028 (1998) (“Textualists agree that textualism should not be confused with literalism. Textualism is not ‘wooden’; it recognizes that consulting context is part of the interpretive process.”); Robert A. Kearney, “The Coming Rise of Disparate Impact Theory,” 110 *Penn St. L. Rev.* 69, 109 (2005) (“Textualism is not the same as literalism, which, though generally useful as a mode of statutory interpretation and true to Congress’ chosen words, is also capable of producing strange — if not ‘perverse and absurd’ — statutory interpretations.”); Daniel J. Bussel, “Textualism’s Failures: A Study Of Overruled Bankruptcy Decisions,” 53 *Vand. L. Rev.* 887, 894 (2000) (“Scalia’s textualism is not simply philistine literalism, but Scalia’s rhetoric defending textualism does invite its caricature as such.”).

¹⁰⁶But see *United States v. Frederick*, 182 F.3d 496, 502 (7th Cir. 1999) (stating in *dicta*, “Nothing in the new statute suggests that these nonlawyer practitioners are entitled to privilege when they are doing other than lawyers’ work.”). One court has cited *Frederick* for the “lawyers’ work” proposition, but held only that tax return preparation did not qualify as lawyers’ work, without further suggesting that a FATP must actually be engaged in the practice of law. *United States v. KPMG*, 237 F. Supp.2d 35, 39 (D.D.C. 2002). It seems unlikely that a court will explicitly hold that a FATP must perform lawyers’ work.

¹⁰⁷See *BDO*, discussed *supra* Part IV.A.

¹⁰⁸Section 7525(a)(2). See *Chao v. Koresko*, Slip Copy, 2005 WL 2521886 (3d Cir. 2005) (“We agree with the District Court that the tax preparer privilege does not apply here. . . . This case, a civil proceeding by DOL to enforce an administrative subpoena, is [outside the scope of the statute]. Respondents’ primary concern seems to be that DOL will share information it receives with the IRS, but they have not cited any authority that expands the tax preparer privilege beyond its express statutory limits.”), and *Doe v. Wachovia Corp.*, 268 F. Supp.2d 627, 637 (W.D.N.C. 2003) (Section 7525 “is limited to [any noncriminal tax proceeding before the IRS] and ‘any noncriminal tax proceeding in Federal court brought by or against the United States.’” 26 U.S.C. section 7525(a)(2). This case does not fall within one of these limitations, as there is clearly no proceeding in which the United States has appeared, and the issuance of an administrative summons to a bank, as opposed to a taxpayer, does not appear to be a ‘tax proceeding’ before the IRS.”).

her communications is nearly impossible¹⁰⁹ and Congress could not possibly have required her to do so.

The close relationship between a taxpayer’s state income tax liability and his federal tax liability illustrates the fragility of the FATP privilege. Whenever a taxpayer’s federal income tax liability is at issue, his state income tax liability is also likely at issue — most states determine a taxpayer’s income tax liability by referring to his federal income tax liability.¹¹⁰ Consequently, a state tax agency may seek disclosure of a taxpayer’s communications with his adviser as part of its determination of the taxpayer’s tax liability. Because state law generally does not provide a privilege comparable to section 7525,¹¹¹ the disclosure of those communications is easily compelled.

The communications produced by the client will almost certainly constitute “tax advice” within the meaning of section 7525 — that is, by complying with the request from the state revenue authority, the client will have revealed information pertinent to the determination of his *federal* tax liability.¹¹² The IRS could then argue that the client has waived the FATP privilege by disclosing the tax-related communications to the state revenue authority, and ask that a court compel disclosure.¹¹³

¹⁰⁹See, e.g., Louis F. Lobenhofer, “The New Tax Practitioner Privilege: Limited Privilege And Significant Disruption,” 26 *Ohio N. U. L. Rev.* 243, 255-256 (“Because [the privilege] applies only to tax matters, the non-lawyer FATP could be required to disclose information revealed in confidential tax planning interviews to other federal agencies, such as the Securities and Exchange Commission or Pension Benefit Guaranty Corporation. A party opposing an FATP’s client in federal civil litigation could also force the FATP to disclose client confidences.”).

¹¹⁰See Harley T. Duncan, “Tax Administrators Detail State Use of IRS Tax Data,” *Tax Notes*, Nov. 8, 1999, p. 732, *Doc 1999-35243*, 1999 *TNT* 214-26 (“37 of the 42 states with a broad-based income tax conform to a ‘federal starting point,’ i.e., they begin the calculation of state income tax liability with a federal figure. Twenty-six states begin with Adjusted Gross Income, 8 states with federal taxable income, and 3 states base state tax liability on federal tax liability.”).

¹¹¹While a few states do provide accountant-client privileges, the FATP privilege reaches communications made not only to accountants, but also to enrolled agents and enrolled actuaries. Communications made to agents and actuaries do not enjoy any state law privilege protections.

¹¹²See Jonathan Z. Ackerman, “With Privilege Comes Responsibility: The New Accountant-Client Privilege,” *Federal Bar Association Section of Taxation Report*, Summer 1999, 1999-SUM Fed. B.A. Sec. Tax’n Rep. 1 (“Disclosures during the course of a state tax audit in a state without accountant-client privilege could leave a confidential client information prone to discovery in a subsequent IRS investigation.”). A client could perhaps avoid that result by hiring one accountant to prepare his state tax return and another to prepare his federal tax return.

¹¹³See also Chelsea A. Helme, “Practitioners Must Change Their Ways to Protect New Privilege,” *Tax Notes*, Aug. 23, 1999, p. 1126, *Doc 1999-25955*, 1999 *TNT* 156-2 (“For example, [Joyce Bauchner and Dan Mendelson] said, if the state tax advice is based on federal tax advice, the federal aspects may be privileged against the IRS, but not against the state taxing authority. . . . The client could face a potential waiver situation when the communication is provided to the state tax authority.”).

It is hard to believe that Congress intended an “eggshell” waiver of the privilege. Congress could not have enacted section 7525 with the intention that it would be dead on arrival. A court’s rejection of the selective waiver doctrine, however, could very well vitiate the privilege entirely.¹¹⁴

The courts should recognize that the arguments for requiring a client to maintain the confidentiality of his communications with his attorney are inapposite to the client-tax practitioner relationship. Section 7525’s text indicates that the substance of the taxpayer’s communications will be freely discoverable by various federal and state agencies.¹¹⁵ A taxpayer will never make communications to her nonattorney tax adviser believing that those communications will be held confidential, and it is not sensible to impose a confidentiality requirement.¹¹⁶ Section 7525 does not serve the broad purpose of encouraging full and frank communication between a taxpayer and her tax adviser, but simply provides limited privilege protections for tax-related communications during non-criminal tax proceedings.¹¹⁷

B. Recommended Approach

A taxpayer should be able to assert the FATP privilege against the IRS despite any previous disclosures to government agencies.¹¹⁸ Concluding otherwise may de-

¹¹⁴See also Alicia K. Corcoran, “The Accountant-Client Privilege: A Prescription For Confidentiality Or Just A Placebo?” 34 *New Eng. L. Rev.* 697, 712 (2000) (“This backdoor approach to obtaining information is a large gap in the [FATP] privilege to which the attorney-client relationship is not subject, and it severely thwarts the privilege’s purpose of allowing taxpayers to consult with other qualified tax advisors in the same manner they currently may consult with advisors that are licensed to practice law.”).

¹¹⁵Section 7525(a)(2). See also Alyson Petroni, “Unpacking The Accountant-Client Privilege Under I.R.C. Section 7525,” 18 *Va. Tax Rev.* 843, 858 (1998) (The FATP’s “limitations may serve to destroy the very privilege that section 7525 just created because taxpayers are left completely exposed to testimony by their accountants in all private civil actions, all criminal proceedings, and in civil tax proceedings where written communications regarding corporate tax shelters are involved.”).

¹¹⁶Indeed, as two practitioners observe, “Many accounting firms are no longer advising their clients that the privilege will protect their confidential communications.” Smith and Kleinman, *supra* note 4. It’s hard to imagine that anyone would reveal his deepest-held confidences to his tax adviser, given that those confidences are protected only vis-à-vis the IRS. The privilege cannot possibly serve the purpose of encouraging full and frank communications between taxpayers and their tax preparers, and taxpayers should not be expected to guard communications as if it did. See also Smith, “After the Alamo: Taxpayer Claims of Privilege and the IRS War on Tax Shelters,” *Tax Notes*, Jan. 13, 2003, p. 233, *Doc 2003-1200*, 2003 *TNT* 9-47 (“The privilege afforded to tax practitioners is so narrow and uncertain in its application that clients should exercise extreme caution before disclosing information to a nonattorney tax practitioner that is intended to remain privileged.”).

¹¹⁷Section 7525(a)(1).

¹¹⁸The second and third approaches suggested would allow a client to continue to claim the FATP privilege despite previous disclosures to private litigants as well. This report focuses primarily on the effect of previous disclosures to government

(Footnote continued in next column.)

stroy the privilege entirely, rendering the statute a dead letter. There are at least three approaches that a court can use to ensure the viability of the FATP privilege.

The simplest approach would involve a court’s adoption of the Eighth Circuit’s reasoning in *Diversified*. A court may conclude that, with respect to the FATP privilege, the selective waiver doctrine furthers important public policies. In turn, the doctrine should apply to the privilege.

That approach, though simple, stands on a shaky theoretical foundation. The FATP privilege is quite different from the attorney-client privilege, and applying jurisprudence on the latter when construing the former is questionable.¹¹⁹ Further, courts that have summarily rejected the Eighth Circuit’s reasoning may find it unpalatable (or even hypocritical) to adopt it when a FATP privilege is at issue.

Another approach would require a court to refine its definition of involuntary disclosure in the context of testimonial privileges. To protect the FATP privilege from eggshell waiver, a court can adopt a definition of involuntary disclosure similar to that in Proposed Federal Rule of Evidence 512. (Recall that involuntary disclosures generally do not cause waiver of a privilege.) Proposed Rule 512 provides that a disclosure is involuntary if it is “made without opportunity to claim the privilege.” Because a taxpayer has no opportunity to claim the FATP privilege against anyone other than the IRS, any disclosure to (for example) the SEC in a securities-related proceeding would be deemed involuntary, and the privilege would be preserved — only *voluntary* disclosures waive the privilege. A few circuits have, in fact, followed Proposed Rule 512 when construing the attorney-client

agencies, however, since the government’s institution of parallel agency investigations has caused the most concern. See, e.g., Mary Jo White, *The Current Enforcement Environment: The Best of Times/The Worst of Times — Can We Reach a Reasonable Middle Ground?*, Practising Law Institute, Corporate Law and Practice Course Handbook Series, 1456 PLI/Corp 997 (“The use (and, at times, abuse) of parallel proceedings has increased dramatically in the current corporate scandal climate. One result is that the companies feel tremendous pressure to settle with the SEC or Attorney General on the civil side on terms they consider far beyond fair in order to lift the crushing weight and adverse publicity of long-running parallel civil and criminal investigations, as well as the threat of a company-threatening criminal indictment.”), and Sheryl Stratton, “Government, Lawyers Trade Views on Parallel Shelter Proceedings,” *Tax Notes*, Apr. 10, 2006, p. 151, *Doc 2006-6730*, 2006 *TNT* 67-5. The government (we would hope) would not collude with private parties to compel disclosure of a client’s confidences — a backdoor waiver of the FATP privilege is less likely to occur when a taxpayer’s adversary is a private party. Nonetheless, under the arguments in Part IV.B, a taxpayer’s previous disclosure to a private-party adversary should not waive the privilege vis-à-vis the IRS.

¹¹⁹Of course, courts have done just that. See *supra* Part III.A.

privilege, and perhaps the FATP privilege is safe in those jurisdictions.¹²⁰ The First Circuit, though, is obviously hostile to the rule.¹²¹

A third approach would acknowledge that the FATP privilege is a product of statute and does not necessarily carry the same requirements as the attorney-client privilege. Specifically, a court could conclude that there is no “confidentiality” requirement for the FATP privilege. Since a client’s tax-related communications are generally discoverable by private parties and government agencies, the statute (unless read literally) could not possibly impose a confidentiality requirement on the FATP privilege.¹²²

Under that approach, courts need not bother with the doctrine of selective waiver. Courts usually reject the selective waiver doctrine because it is inconsistent with the attorney-client privilege’s confidentiality requirement.¹²³ If the FATP privilege carries no requirement, there is no need to even analyze whether a selective waiver is inconsistent with the privilege. However, that approach requires courts to retreat from their insistence

that the attorney-client privilege’s confidentiality requirement applies with equal force to the FATP privilege, and they may be hesitant to depart from their earlier precedents.

Of the three approaches described, the third, although not perfect, is probably the best. The first approach — adopting *Diversified* — unnecessarily entangles a court’s attorney-client privilege jurisprudence with its FATP privilege jurisprudence. A court should be hesitant to define the FATP privilege by referring to attorney-client privilege cases.¹²⁴ Similarly, the Rule 512 approach is less than ideal. If a court adopts Rule 512 for the FATP privilege, it is perhaps obliged to adopt it regarding other testimonial privileges — Rule 512 provides a general definition applicable to all testimonial privileges, not just those to which the court wants to apply it. A court’s conclusion that a disclosure made without the opportunity to claim a privilege is involuntary when the FATP privilege is at issue — but voluntary when other testimonial privileges are at issue — would be difficult to justify.

Contrarily, if a court decides that section 7525 does not carry a confidentiality requirement, that conclusion would be grounded in the statute’s text.¹²⁵ A court can reasonably conclude that “confidentiality” is not an element of the section 7525 privilege although it is an element of the attorney-client privilege. The lack of symmetry between the FATP privilege and other testimonial privileges would thus not be cause for concern.¹²⁶ Indeed, Congress granted the privilege an extremely limited scope, and a reasonable inference is that the communications protected by the statute need not be kept confidential.¹²⁷ Although it may seem odd that a testimonial privilege could attach to widely disclosed communications, section 7525 is itself a very odd statute.¹²⁸

¹²⁰See *Hopson v. Mayor & City Council of Baltimore*, 232 F.R.D. 228, 242 (D. Md. 2005) (describing courts that have followed Proposed Rule of Evidence 512).

¹²¹The First Circuit in *MIT* concluded that a voluntary disclosure occurs whenever a client voluntarily places himself in a position to disclose, even if the actual disclosure was compelled by a statute or regulation. See *supra* Part III.B. Under a broad reading of *MIT*, a taxpayer who engaged in the conduct of a business in State A and who, under statute, disclosed tax-related communications to the State A tax agency, could be deemed to have voluntarily engaged in business in the state and thus to have voluntarily waived the privilege. The IRS made a similar argument in NSAR 11,040, although the document’s heavy redaction makes it difficult to determine the precise circumstances surrounding the taxpayer’s disclosures. IRS NSAR 11,040 (2000) (“The opinion letter was provided to the Attorney General and Master solely to gain an advantage, i.e. to solicit the concurrence of the recipients in the decision of ***, *** and *** to reorganize. The taxpayers did not have to reorganize. *** made that decision which ultimately was advanced by their soliciting and producing an opinion letter analyzing the tax consequences of the restructuring. There was no compulsion, either statutory or judicial.”). The redacted facts do not indicate whether the taxpayer disclosed without an opportunity to claim the privilege, but the IRS suggested that because the underlying business transaction was undertaken voluntarily, any disclosures made to the state were voluntary as well. *Id.* But some language in the NSAR suggests that the IRS will accept that a disclosure made under statute is involuntary. (“To the extent [the district court’s holding] suggests that compliance with banking laws is not voluntary and that compliance is not in any way related to any decision by the party providing the record, that case is distinguishable and not inconsistent with *Steinhardt*.”). NSAR 11,040 is no less confusing than the judicial decisions addressing the selective waiver doctrine. Those disinclined to parse its cryptic reasoning may take comfort knowing that the ruling lacks precedential value. See section 6110(j)(3).

¹²²Section 7525(a)(2).

¹²³See *Westinghouse Electric Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1427 (3d Cir. 1991) (“Under traditional waiver doctrine a voluntary disclosure to a third party waives the attorney-client privilege even if the third party agrees not to disclose the communications to anyone else.”).

¹²⁴See *supra* Part IV.A.2.

¹²⁵Section 7525(a)(2).

¹²⁶Although Congress granted the judiciary the authority to define testimonial privileges, that power is subject to any contrary act of Congress. See Federal Rule of Evidence 501. Congress can modify the elements of a testimonial privilege — or create a new one — if it so wishes.

¹²⁷See *supra* Part IV.A.2.

¹²⁸The privilege should be available vis-à-vis the IRS even if the agency obtains access to the privileged communications through other means (for example, by seeking privileged documents from another agency that has compelled their disclosure). Again, it may seem odd to bar the IRS from using documents in its possession, but that “now you see it, now you don’t” approach is not completely unprecedented. See Richard L. Marcus, “The Perils of Privilege: Waiver and the Litigator,” 84 *Mich. L. Rev.* 1605, 1635-1636 (“In inadvertent disclosure cases, courts that enter privilege-preservation orders sometimes provide that privileged materials be returned once identified as such.”).

V. Legislative History

Although the case for selective waiver seems strong, section 7525's legislative history might refute the approach described above. While its use is controversial,¹²⁹ legislative history continues to receive some authoritative weight in statutory interpretation.¹³⁰ Thus, to complete this report's analysis, that history must be examined.

In NSAR 11,040, the IRS quoted the following statement from the conference committee report accompanying the Internal Revenue Service Restructuring and Reform Act:

The privilege between the client and accountant can be waived in the same manner as the attorney client privilege. If the taxpayer discloses to a third party the substance of a communication protected by the privilege, the privilege for that communication and any related communications is *considered to be waived to the same extent and in the same manner as the privilege would be waived if the disclosure related to an attorney client communication.*¹³¹

Relying in part on that statement, the IRS concluded that the judiciary's rejection of the selective waiver doctrine for the attorney-client privilege applied with equal force to the FATP privilege.¹³²

It is hardly clear, however, that the "same waiver" rule should apply in the manner described, since the IRS's position is based on incomplete analysis of section 7525's legislative history. The Senate report accompanying the legislation also contains statements pertinent to the selective waiver doctrine's application. The report states:

The privilege granted by the provision may only be asserted in noncriminal tax proceedings before the IRS and in the Federal Courts with regard to such noncriminal tax matters in proceedings where the IRS is a party. The privilege may not be asserted to prevent the disclosure of information to any regulatory body other than the IRS. The ability of any other regulatory body, including the Securities and Exchange Commission (SEC), to gain or compel

information is unchanged by the provision. No privilege may be asserted under this provision by a taxpayer in dealings with such other regulatory bodies in an administrative or court proceeding.

As that statement shows, Congress¹³³ was aware that communications protected by the FATP privilege would be readily disclosed to the SEC and other regulatory agencies. Congress contemplated parallel proceedings by the government and did not suggest that those proceedings should operate to vitiate the privilege. Rather, Congress recognized that the SEC could compel disclosure of a taxpayer's communications, and that the privilege could continue to be asserted during noncriminal tax proceedings.¹³⁴

The Senate report calls the IRS's conclusions into question. The IRS cited the portion of the legislative history suggesting the same waiver rule, but did not cite the portion contemplating preservation of the privilege during parallel proceedings. As the Supreme Court recently warned, "investigation of legislative history has a tendency to become . . . an exercise in 'looking over a crowd and picking out your friends.'"¹³⁵ In NSAR 11,040, the IRS picked out a friendly face, but ignored an even meaner scowl.

Ultimately, the IRS's reliance on the committee report is misplaced. The text of the statute does not replicate the same waiver rule found in the committee report. In fact, the narrow scope of the privilege, as indicated by section 7525(a)(2), suggests just the opposite.

Further, a committee report represents (at most) the subjective intentions of the committee members — it cannot possibly serve as an authoritative expression of

¹³³The Senate report is treated as a statement of Congress solely to refute the IRS's interpretation of section 7525's legislative history. As a general matter, congressional reports should not serve as a statement of the legislature's intent. See *infra* notes 136-138.

¹³⁴Admittedly, this analysis of the legislative history is uncertain. It is very difficult to determine what individual members were thinking when they voted in favor of section 7525's enactment. A search for subjective intent may be futile. See Hon. Maura D. Corrigan and J. Michael Thomas, "'Dice Loading' Rules of Statutory Interpretation," 59 *N.Y.U. Ann. Surv. Am. L.* 231, 238 ("Judges cannot depose legislators to ask them what they meant to say. Courts have no institutional capacity to discover what each individual legislator subjectively believed. Even if courts had that ability, they lack the authority to elevate legislators' subjective intentions above the law itself. The law, not the lawmaker's intent, is what matters in our system of government." "It is simply hard to maintain a rigorously analytical attitude when the point of departure for the inquiry is the fairyland in which legislative history reflects what was in 'the Congress's mind.'" *Bank One Chi., N.A. v. Midwest Bank & Trust Co.*, 516 U.S. 264, 280-281 (1996) (Scalia, J., concurring) (punctuation omitted).)

¹³⁵*Exxon Mobil Corp. v. Allapattah Servs.*, 125 S. Ct. 2611, 2626 (2005) (Kennedy, J., for the Court) (quoting Wald, "Some Observations on the Use of Legislative History in the 1981 Supreme Court Term," 68 *Iowa L. Rev.* 195, 214 (1983) (quoting the late Judge Harold Leventhal)).

¹²⁹Compare, e.g., *Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 457 (2002) (Thomas, J., for the Court) ("Floor statements from two Senators cannot amend the clear and unambiguous language of a statute. We see no reason to give greater weight to the views of two Senators than to the collective votes of both Houses, which are memorialized in the unambiguous statutory text."), with 534 U.S. at 469 ("The Court's cavalier treatment of the explanations of the statute provided to their colleagues by Senators Rockefeller and Wallop is disrespectful, not only to those Senators, but to the entire Senate as well.") (Stevens, J., dissenting).

¹³⁰See, e.g., reg. section 1.6662-4(d)(3)(iii) ("the following are authority for purposes of determining whether there is substantial authority for the tax treatment of an item . . . congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill's managers; General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book)").

¹³¹IRS NSAR 11,040 (2000) (citing H.R. Conf. Rep. No. 105-599) (emphasis in original).

¹³²See *supra* Part III.B.

congressional intent.¹³⁶ Congress speaks, and thereby communicates its “intent,” only through the statutes at large.¹³⁷ Neither house of Congress voted on the committee report, and the report was not presented to the president for signature.¹³⁸ If the congressional staffer who wrote the committee report wished to see the same

¹³⁶Congressional intent should be defined not by the thoughts floating around in the legislators’ heads, but by the intent that a reasonable member of the public would infer from an examination of the statutory text (that is, an “objectified” intent). See Antonin Scalia, *A Matter of Interpretation* 17 (Princeton University Press, 1997). Legislative history materials may very well represent the context in which legislators understand statutory language, but this is not relevant. The powers granted to the legislature by the Constitution are to be exercised in favor of the people, and not the legislators. See U.S. Const., Preamble. Thus, it follows that statutory language should be defined by the context in which the public understands those words, and *not* by the context in which legislators understand them. Using legislative history places one on the wrong side of the statute — the question is what the reader would objectively understand, rather than what the writers subjectively intended. See Oliver Wendell Holmes, “The Theory of Legal Interpretation,” 12 *Harv. L. Rev.* 417, 419 (1899) (“We do not inquire what the legislature meant; we ask only what the statute means.”).

¹³⁷See *Begier v. IRS*, 496 U.S. 53, 68 (1990) (Scalia, J., concurring) (“Congress conveys its directions in the Statutes at Large, not in excerpts from the Congressional Record.”).

¹³⁸An oft-cited floor exchange between two legislators demonstrates the perils of assuming that a committee report reflects the intentions of the legislature as a whole:

MR. ARMSTRONG: My question, which may take [the chairman of the Committee on Finance] by surprise, is this: Is it the intention of the chairman that the Internal Revenue Service and the Tax Court and other courts take guidance as to the intention of Congress from the committee report which accompanies this bill?

MR. DOLE: I would certainly hope so. . . .

MR. ARMSTRONG: Mr. President, will the Senator tell me whether or not he wrote the committee report?

MR. DOLE: Did I write the committee report?

MR. ARMSTRONG: Yes.

MR. DOLE: No; the Senator from Kansas did not write the committee report.

MR. ARMSTRONG: Did any Senator write the committee report?

MR. DOLE: I have to check.

MR. ARMSTRONG: Does the Senator know of any Senator who wrote the committee report?

MR. DOLE: I might be able to identify one, but I would have to search. I was here all during the time it was written, I might say, and worked carefully with the staff as they worked. . . .

MR. ARMSTRONG: Mr. President, has the Senator from Kansas, the chairman of the Finance Committee, read the committee report in its entirety?

MR. DOLE: I am working on it. It is not a bestseller, but I am working on it.

MR. ARMSTRONG: Mr. President, did members of the Finance Committee vote on the committee report?

MR. DOLE: No.

MR. ARMSTRONG: Mr. President, the reason I raise the issue is not perhaps apparent on the surface, and let me just state it: . . . The report itself is not considered by the Committee on Finance. It was not subject to amendment

(Footnote continued in next column.)

waiver rule enacted into law, he should have asked his boss to prepare a bill to that effect.¹³⁹

In any event, this article’s conclusions are based on a textual approach to the FATP privilege’s interpretation. Under that approach, no statement in section 7525’s legislative history is treated as an authoritative expression of congressional intent, regardless of whether it supports or rebuts this article’s conclusions. A textual reading of the statute should lead one to the conclusion that a disclosure of tax-related communications to a third party does not waive the FATP privilege. However, if one adopts an intentionalist (or even a literalist) approach to interpretation, one could possibly conclude that the selective waiver doctrine is inapplicable.

VI. Conclusion

Courts should save section 7525 from imminent death and adopt the selective waiver doctrine whenever the FATP privilege is at issue. Although courts may have rejected the doctrine in the attorney-client privilege context, Congress did not instruct them to mechanically apply attorney-client privilege principles to the FATP privilege. The FATP privilege serves purposes different from those served by common law attorney-client privilege, and equation of the two is inappropriate.

by the Committee on Finance. It is not subject to amendment now by the Senate. . . . If there were matter within this report which was disagreed to by the Senator from Colorado or even by a majority of all Senators, there would be no way for us to change the report. I could not offer an amendment tonight to amend the committee report. . . . For any jurist, administrator, bureaucrat, tax practitioner, or others who might chance upon the written record of this proceeding, let me just make the point that this is not the law, it was not voted on, it is not subject to amendment, and we should discipline ourselves to the task of expressing congressional intent in the statute. 128 *Cong. Rec.* S8659 (daily ed. July 19, 1982) (as quoted in *Hirschey v. F.E.R.C.*, 777 F.2d 1, 6, 7-8 n.1 (D.C. Cir. 1985) (Scalia, J., concurring)). Even if one could prove that all members had in fact read a committee report, the report could not be treated as an authoritative expression of congressional intent. The Constitution prescribes rigorous procedures that must be observed before a text can be enacted into law. See U.S. Const. art. I, section 7. Merely thinking about a text (no matter how hard one thinks) is insufficient. See also *Aldridge v. Williams*, 44 U.S. 9, 24 (1844) (“If every member of the legislature had preferred that the regulations under the act of 1832 should not have been sanctioned by that of 1833, it would not have been effective to repeal the act of 1832, *unless they had expressed their wish in a legislative form.*”) (emphasis in original).

¹³⁹See U.S. Const. art. I, section 7. Although the courts have yet to reject the use of legislative history entirely, the weight given to subjective intentions has dwindled in recent years. See, e.g., *Black & Decker Corp. v. United States*, 436 F.3d 431, 437, *Doc 2006-2133*, 2006 *TNT* 23-8 (4th Cir. 2006) (“The legislative history argument does not persuade us. The prototypical transaction Congress had in mind in drafting section 357(c)(3) may well have been one in which a corporation exchanged liabilities as part of a transfer of an entire trade or business to a controlled subsidiary, but nothing in the section’s plain language embraces such a limitation.”).

Unfortunately, even if the doctrine is accepted, the privilege will remain in critical condition. Under information-sharing agreements with state revenue authorities, the IRS may be able to sidestep section 7525 and obtain privileged communications directly.¹⁴⁰ The IRS has even issued an administrative summons to a state tax agency, successfully compelling the release of sensitive taxpayer information.¹⁴¹ As the case law surrounding the FATP privilege continues to develop, Congress should determine whether courts have rendered section 7525 a dead letter and should, if needed, amend the statute to clarify its intent.

Some commentators have argued that the enactment of section 7525 reflects a bad policy decision.¹⁴² The statute resulted from intense lobbying by the accounting industry and it is hardly clear that the privilege operates to further the public interest. However, that second-guessing cannot justify the judiciary's hostility to the privilege. The courts are obliged to effectuate the legislature's intent, not substitute their own for that of Congress. Adopting the selective waiver doctrine for the FATP privilege would be a good step toward fulfilling that obligation.

¹⁴⁰See Duncan, *supra* note 110.

¹⁴¹See *Martini v. United States*, 97 AFTR2d 2592, Doc 2006-12066, 2006 TNT 125-12 (D. Nev. 2006) ("The court agrees with the analysis of those cases concerning the authority to subpoena state agencies and concludes that the IRS may constitutionally subpoena records of individual taxpayers from the Nevada Department of Taxation.").

¹⁴²See generally Linda M. Beale, "Tax Advice before the Return: The Case for Raising Standards and Denying Evidentiary Privileges," 25 *Va. Tax Rev.* 583 (2006); Steve R. Johnson, "The Proposed Tax Advisor-Client Privilege: An Idea Whose Time Should Never Come," *Tax Notes*, Feb. 23, 1998, p. 1041, Doc 98-7027, 98 TNT 35-89. One practitioner has even suggested that elimination of the attorney-client privilege (during civil tax proceedings) may serve the public interest. See Bruce Kayle, "The Tax Adviser's Privilege in Transactional Matters: A Synopsis and a Suggestion," 54 *Tax Lawyer* 509, 550-553. (2001). Although those commentators' arguments are compelling, courts should be reminded that the task of repeal ultimately belongs to Congress. Courts should endeavor to give section 7525 a hospitable interpretation, even if its enactment reflects a poor policy choice.

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