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PRACTICE POINT

Reasonable-Reliance Defense and Work Product Protection

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In *Estate of Marion Levine v. Commissioner*, Docket No. 13370-13, the United States Tax Court issued a designated Order that granted the petitioner's motion to limit the scope of an IRS subpoena *duces tecum* served on petitioner's prior counsel.[1] Attorneys from the Estate's first law firm of record completed the estate planning during the decedent's life, prepared and filed the estate tax return, defended an IRS examination, and, when the outcome of the examination wasn't favorable to the Estate, filed a petition in Tax Court after the Notice of Deficiency was issued in 2013. The original law firm's representation of the Estate continued through 2015, when new counsel entered an appearance on behalf of the Estate. As litigation proceeded and the petitioner made clear that it would defend against proposed accuracy penalties by arguing reasonable cause (reliance on a professional advisor), the IRS issued a subpoena *duces tecum* to the attorney who did the planning, filed the estate tax return, and defended the audit, or his firm, for all of the files for the decedent and her Estate for the period from January 1, 2007 through July of 2017.

The Estate moved for a protective order, asking the court to limit the subpoena's scope to only documents that predated the Notice of Deficiency issued in April of 2013. The Estate argued that litigation was reasonably anticipated for any document created after the Notice of Deficiency was issued, and that the work product doctrine accordingly shielded such documents from discovery.

The court granted the Estate's motion, and found that notwithstanding the implicit waiver of attorney-client privilege that accompanies a reasonable cause reliance on a professional defense, there was no waiver of the work product "doctrine with respect to documents produced *after* litigation begins."[2] The Court further held that the Commissioner provided no evidence that the Estate relied on its professional advisor *after* the Estate tax return was filed, and so documents created after the Notice of Deficiency was issued were protected from production.[3]

The Levine order is significant because it definitively holds that reasonable cause reliance on a professional defense does not necessarily waive work product protection, notwithstanding the implicit waiver of attorney-client privilege. It also should raise additional questions for practitioners about how attorneys can and should carefully guard information that should be protected from disclosure by the attorney-client privilege

1 Order, Estate of Marion Levine v. Comm'r, Docket No. 13370-13 (U.S. Tax Court Oct. 26, 2017).

2 Order at 3 (emphasis added).

3 There is no mention of documents created by the attorney during the examination stage, and so it is not clear whether any documents were created that the Estate wants to keep private.

and the work product doctrine, and the corresponding obligations that accompany those privileges and protections.

As a key Tax Court case makes clear,

> Litigation is frequently anticipated prior to the time a lawsuit is actually commenced. To show that a document was prepared in anticipation of litigation 'A litigant must demonstrate that the documents were created with a specific claim supported by concrete facts which would likely lead to [the] litigation in mind, not merely assembled in the ordinary course of business or for other nonlitigation purposes.'[4]

As *Levine* points out, in the tax context, some documents created before a tax return is filed, such as more-likely-than-not opinion letters and transfer-pricing decisions, may not be protected from disclosure by attorney-client privilege or the work product doctrine. This is because when a taxpayer places his or her "legal knowledge, understanding, and beliefs into contention, and those topics [are the subject of an opinion letter] . . . it is only fair that [the Commissioner] be allowed to inquire into the basis of that person's knowledge, understanding, and beliefs."[5]

In *Levine*, the IRS appears to have sought information covering the span of what may have been the beginning of the firm's representation through a time period ending only months before the subpoena was served. The court limited the scope, finding that litigation was reasonably anticipated after the Notice of Deficiency was issued, and the files created after that time were protected by the work product doctrine absent the IRS's ability to show "substantial need" for the information. In the life of a tax dispute, however, there are other points at which litigation can reasonably be anticipated, and practitioners seeking to protect documents from discovery should think carefully about moments in time during which litigation is reasonably anticipated. The work product protection doctrine may apply even prior to issuance of a Notice of Deficiency.

One common point at which litigation can reasonably be anticipated in a tax dispute is when the taxpayer or practitioner first becomes aware of an IRS examination. At that point, the taxpayer and the practitioner know that there is something about the tax return that the IRS is not accepting at face value. Documents created by practitioners during an IRS exam may be just as sensitive as files created after a Notice of Deficiency, and may contain analysis of strengths and weaknesses of various return positions, as well as discussion of strategy. This makes the moment when the taxpayer and practitioner learn of the IRS examination, and not just the moment when a Notice of Deficiency is issued, a good point for the practitioner to re-evaluate the representation, including the scope of work to be performed, who the client is, and what the intended and unintended consequences are of continuing the representation without reconsidering the scope of the engagement.

Upon learning of an IRS exam, practitioners may better protect documents created during the audit defense stage from discovery by considering the following questions.

- Is a new engagement letter needed?
    - Would it benefit me or my client to define my role in defending against the IRS exam in a new or updated engagement letter?

4 Bernardo v. Commissioner, 104 T.C. 677, 688 (1995) (internal citations omitted).
5 AD Investment 2000 Fund LLC v. Comm'r, 142 T.C. 248, 257 (2014).

- Has the client changed? (*Compare* Decedent *with* Estate)
- Will setting up a new matter make it easier to define the point in time when litigation became anticipated?

There may very well be good reasons why a new engagement letter is not needed or desired. Even if one is needed, practitioners should think hard before committing to representation during litigation without knowing more about how the client handles an IRS exam. (For example: Do I work well with the client? Does the client tell the truth? Provide documents I need to defend the case? Respond quickly? Pay bills on time?). Having a new engagement letter that expands the scope of representation is not a fool-proof way to ensure work product protection for attorney's files when the taxpayer raises a reasonable cause defense, but it may well provide a clear point demonstrating that the taxpayer and representative agreed that the nature of the representation, and what that representation involved, shifted to reflect the possibility of litigation.

- Am I the right person to continue this engagement? Is my firm the right firm to continue this engagement?

Although *Levine* does not touch on this issue expressly, the Order points out that the attorney whose files were the subject of the subpoena was a "key player in the case."[6] That attorney created the estate plan, prepared the estate tax return, and defended the IRS examination. A tax practitioner who prepared an estate plan and/or an estate tax return may very well be called as a witness at trial if there is one. Among other ethical rules, Tax Court Rule 24, which addresses conflicts of interest and attorneys as witnesses, must be carefully considered before proceeding to litigation. The point at which the taxpayer and practitioner learn of the IRS exam is a good time to think ahead about these issues, as well as considering how best to preserve work product protection (and other ethical issues beyond the scope of this article).

- Are we as a firm taking all of the right steps both to preserve work product protection and to fulfill our other professional obligations?

Anticipation of litigation carries benefits (work product protection) as well as burdens (the obligation to implement a litigation hold). As the court held in *Levine*, once litigation is reasonably anticipated, work product protection is triggered even if attorney-client privilege is implicitly waived. By claiming that work product protection shields certain documents created as of a certain date from discovery, a taxpayer is expressly representing that litigation was foreseeable from at least the date the first document he or she is trying to protect from discovery was generated. The duty to preserve material evidence, including "electronic documents, emails, and back-up tapes" begins "when a party reasonably should know that evidence may be relevant to anticipated litigation."[7]

Parties who claim work product protection without having had a proper litigation hold in place from the date of the first work product protection claim open themselves up to a claim of spoliation of evidence. For example, in *Glenmark Pharmaceuticals,*[8] the court granted a motion for an adverse inference against a party who claimed that certain documents were protected by work product protection as of February 2006 but had not implemented a litigation hold until the middle of 2007. The party seeking to protect documents

6 Order at 1.

7 Consolidated Edison Co. of New York v. United States, 90 Fed. Cl. 228 (2009).

8 Sanofi-aventis Deutschland GmbH v. Glenmark Pharmaceuticals Inc., Docket No. 07-cv-8588 (DMC-JAD), 2010 WL 2652412, (D. N.J. July 1, 2010).

from discovery asserted the work product protection as of a certain date, and the court accordingly held that by that party's own admission the duty to preserve documents for litigation also arose on that same date.[9]

Put differently, if a party is seeking to protect documents from discovery by using the work product doctrine, and a litigation hold was not in place from the same time period, protection may be available only in exchange for a losing battle against a spoliation claim. ■

9 *Id*. at *5.