A DOUBLE-EDGED SWORD CUTS BOTH WAYS: HOW CLIENTS OF DUAL CAPACITY LEGAL PRACTITIONERS OFTEN LOSE THEIR EVIDENTIARY PRIVILEGES

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I. INTRODUCTION

Today's consumers of professional services demand the expertise and efficiency of a dual capacity legal practitioner.[1] Consumers expect that these practitioners will also maintain client confidences.[2] Unfortunately, courts and legislators oppose expanding evidentiary privileges to communications or to

1. *See* discussion *infra* Part II.
2. *See* discussion *infra* Part III.

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documents that do not relate to the provision of legal advice.[3] This rule presents a problem for dual capacity practitioners, courts, and clients when mixed business and legal communications between dual capacity attorneys and their clients are summonsed.[4] In determining whether an attorney-client privilege applies to mixed business and legal communications between an attorney-executive and a corporate client, courts look to whether the communication predominantly relates to legal advice.[5] If so, the entire communication will enjoy privilege.[6] But in the context of the attorney-tax accountant, courts reason that because a mixed business and legal communication is infected by the business communication, the entire communication is unprivileged.[7] While the former test strikes a desirable balance between policy considerations, the latter does not. Nor is the latter test supported by legal precedent.

The benefits of the dual capacity practitioner are well-documented.[8] The dual capacity practitioner, by virtue of being dually accredited and experienced, delivers a higher quality product with greater efficiency.[9] For example, the dual capacity practitioner is better able to give complete advice and less likely to miss interdisciplinary issues because the need to pass off problems to a separate practitioner is avoided.[10] In addition, because the dual capacity practitioner can resolve a multidisciplinary problem without assistance, both transaction and production efficiencies are realized.[11] Because both small businesses and large corporations demand multidisciplinary expertise at the lowest possible costs, the dual capacity practitioner would appear to be their provider of choice.[12] After reviewing empirical data, consumer demand for the dual capacity legal practitioner is evident.[13]

Currently, small businesses and sole proprietorships make up the vast majority of business entities in the United States.[14] Because these entities make more mistakes with respect to tax compliance than any other taxpayer and are audited twice as much, they spend twice as much on tax advice.[15] But

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3. *See* discussion *infra* Part IV.
4. *See* discussion *infra* Part IV.
5. *See* discussion *infra* Part IV.A.2 (discussing the attorney-client privilege in the context of the dual capacity attorney-executive).
6. *See* discussion *infra* Part IV.A.2.
7. United States v. Frederick, 182 F.3d 496, 501 (7th Cir. 1999).
8. *See* discussion *infra* Part II.A.
9. *See* discussion *infra* Part II.A (discussing the general benefits of the dual capacity practitioner).
10. *See* discussion *infra* Part II.A.
11. *See* discussion *infra* Part II.A.
12. *See* discussion *infra* Part II.B-C.
13. *See* discussion *infra* Part II.B-C.
14. U.S. Census Bureau, *Statistics About Business Size (including Small Business)* (Census 2000), *available at* http://www.census.gov/epcd/www/smallbus.html (last visited Apr. 4, 2004).
15. *See* discussion *infra* Part II.C (demonstrating the demand for the dual capacity attorney-tax accountant by showing the market for dual capacity services).

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statistics show that two-thirds of these entities close after two years and one-half close after four years.[16] To survive, small businesses must receive the highest quality professional advice at the lowest possible cost.[17] Because the dual capacity attorney-tax accountant provides the highest quality tax advice, more efficiently and with lower transaction costs (than separate practitioners), the demand for the attorney-tax accountant is high.[18] Unfortunately, statistics show that only 44,000 dually accredited attorney-accountants are in practice compared to approximately 1.5 million small businesses.[19] Because of the discrepancy between the supply of dual capacity attorney-tax accountants and the demand for dual capacity services, lawmakers should encourage attorney-tax accountants to operate in their dual capacity.[20]

During the past ten years, corporate America has seen an unprecedented increase in the number of attorneys employed. For example, in 1991, the top ten Fortune 500 companies employed an average of 287 in-house attorneys; by 2000 that figure increased more than 47% to 407 in-house attorneys.[21] These corporations claim to employ more attorneys because they save costs, they are familiar with the business of the corporation, they are accessible and work well with other executives, and they can manage legal risks.[22] In addition to their legal duties, in-house counsel are increasingly being assigned business roles.[23] Corporations attribute this dual capacity role to the demand for simultaneous legal and business advice in a highly regulated business environment.[24] In fact, a study performed by the American Corporate Counsel Association showed that an overwhelming number of in-house counsel also serve as corporate officer or division manager.[25] Because of the necessity for competent legal and business advice in the contemporary corporate

16. Small Business Association Office of Advocacy, *Small Business by the Numbers-Answers to Frequently Asked Questions* (2002), *available at* http://www.sba.gov/advo/stats/sbfaq.pdf (last visited Apr. 4, 2004).

17. *See* discussion *infra* Part II.C.

18. *See* discussion *infra* Part II.C.

19. American Association of Attorney-Certified Public Accountants, *Membership*, (2003), *at* http://www.attorney-cpa.com/membership.html ("Of approximately one million lawyers and 450,000 Certified Public Accountants in the U.S., only about three percent are dually qualified in both professions."). I computed the number of dually qualified practitioners as: three percent of a total 1,450,000 practitioners (1,000,000 lawyers plus 450,000 CPAs) is 43,500. *See id.*

20. *See* discussion *infra* Part II.B.

21. Chad R. Brown, *In-House Counsel Responsibilities in the Post-Enron Environment*, 21 NO. 5 ACCA DOCKET 92, 93 (May 2003); Janet B. Wright, *The Practice Setting for You?*, CORPORATE COUNSEL 18, NO. 1 GPSOLO 45, 45 (2001).

22. Brown, *supra* note 21, at 93; AMERICAN CORPORATE COUNSEL ASSOCIATION, A COMPANY'S FIRST GENERAL COUNSEL, 2-4 (2002), AN ACCA INFOPAK, *at* http://www.acca.com/infopaks/firstgc.html.

23. Wright, *supra* note 21, at 45.

24. Brown, *supra* note 21, at 92-94.

25. *Id.* at 101 (citing Nonlegal Function of General Counsel, ACCA online poll (July 29-Sep. 28, 2002), *at* http://www.acca.com/survey/poll.php?sid=13).

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environment, lawmakers should embrace and foster the dual role of attorney-executives.

The attorney-client privilege is an exception to an evidentiary principle that discovery should be liberal and in search of the truth.[26] The rationale for this privilege is that it encourages full and frank communication between attorney and client, thereby resulting in more effective advocacy, which leads to more efficient administration of the law.[27] Similarly, the rationale behind the work-product doctrine is that advocacy is best served by forcing opponents to do their own work.[28] Better advocacy, reasons the work-product doctrine, results in more efficient administration of the laws.[29] While these policy reasons would presumably apply to other professions, thereby prescribing a similar privilege, courts and legislators have refused to extend an evidentiary privilege to nonlegal communications.[30] Thus, the test to determine whether a communication is privileged revolves around the legal nature of the communication.[31] This test is problematic because the very nature of a dual capacity practice blurs the line between business and legal advice.[32] In the context of the attorney-executive, courts have developed a test that allows privilege for mixed communications when the purpose of the communication is predominantly legal.[33] This "predominantly related" test is preferable from a policy standpoint because it embraces the attorney-executive in his dual capacity, while respecting evidentiary principles and the rationale for the attorney-client privilege.[34] But courts have not so favorably addressed mixed business and legal communications between the attorney-tax accountant and client.[35]

Historically, lawmakers have avoided the creation of an accountant-client privilege.[36] Presumably, these lawmakers feared the impact it would have on the system of taxation.[37] For example, in *United States v. Frederick*, the Seventh Circuit held that communications which contain both information for purposes of completing tax returns and for purposes of obtaining legal advice are not privileged, because tax preparation is accountant's work, no accountant-client privilege exists, and the mixing of privileged and

26. *See* discussion *infra* note 121 and accompanying text.

27. *See* discussion *infra* Part III.A (discussing in detail the rationale behind the attorney-client privilege).

28. *See* discussion *infra* Part III.A-B.

29. *See* discussion *infra* Part III.A.

30. *See* discussion *infra* notes 137-41 and accompanying text.

31. *See* discussion *infra* note 141 and accompanying text.

32. *See* discussion *infra* Part IV.

33. *See* discussion *infra* Part IV.A.2 (discussing the application of the attorney-client privilege to the attorney-executive).

34. *See* discussion *infra* Part IV.A.

35. *See* discussion *infra* Part IV.B.

36. *See* discussion *infra* Part IV.B.1.

37. *See* discussion *infra* Part IV.B.1.

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nonprivileged information renders the whole communication nonprivileged.[38] The result of this holding is that communications between dual capacity attorney-tax accountants and their clients lose privilege when legal advice is commingled with tax preparatory advice.[39] This standard undermines the very synergies that allow the attorney-tax accountant to provide a higher quality product at lower costs, particularly when such a standard is not necessary to further competing policies.[40] In addition, no precedent supports such a standard.[41]

This article challenges the uncategorical denial of the attorney-tax accountant-client privilege as an unnecessary restraint that prevents consumers from receiving a socially beneficial service.[42] Part II of this article demonstrates the benefits of and the demand for both the attorney-executive and the attorney-tax accountant.[43] Part III examines the history of and rationale for maintaining client confidences, including both the attorney-client and work-product privileges.[44] Part IV analyzes the implications that a dual capacity legal practice has on the attorney-client and work-product privileges.[45] After reviewing the flexible approach taken by courts in dealing with attorney-executive-client confidences, Part IV demonstrates the federal judiciary's uncategorical denial of an attorney-tax accountant-client privilege.[46] Part IV then analyzes the legal precedent, social policy, and reasoning underlying the uncategorical denial of an attorney-tax accountant-client privilege.[47] Finally, Part IV concludes that no justification can be found for an uncategorical denial of the attorney-tax accountant-client privilege and proposes alternative solutions to the Seventh Circuit's approach.[48] Part V recommends steps that can be taken by both attorney-executives and attorney-tax accountants to maintain client confidences in the face of current law.[49]

While the judicial standard to determine when attorney-executive-client communications are privileged is acceptably balanced, the analogous test addressing attorney-tax accountant-client communications cannot be supported. In fact, the reasoning employed by the Seventh Circuit in *Frederick* to uncategorically deny an accountant-client privilege is not supportable by legal precedent or by policy considerations. This outcome severely limits the social benefits of the dual capacity attorney-tax accountant.

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38. 182 F.3d 496, 500 (7th Cir. 1999).
39. *See id.*
40. *See* discussion *infra* Part IV.B.2.
41. *See* discussion *infra* Part IV.B.2.
42. *See* discussion *infra* Parts II-IV.
43. *See* discussion *infra* Part II.
44. *See* discussion *infra* Part III.
45. *See* discussion *infra* Part IV.
46. *See* discussion *infra* Part IV.
47. *See* discussion *infra* Part IV.
48. *See* discussion *infra* Part IV.
49. *See* discussion *infra* Part V.

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This outcome is not warranted.[50] By creating a broad attorney-tax accountant-client privilege and a limited tax accountant-client privilege, small businesses would fully realize the benefits of dual capacity attorney-accountants, while improving overall tax compliance, maintaining the rationale of the attorney-client and work-product privileges, and equitably dealing with all tax practitioners, thereby achieving an overall societal benefit.[51] In the alternative, courts should apply a predominantly related test (that test used in the context of the attorney-executive) to privilege issues surrounding the attorney-tax accountant.[52]

II. THE BENEFITS OF AND THE DEMAND FOR THE DUAL CAPACITY LEGAL PRACTITIONER

The growing need for multidisciplinary expertise coupled with a refocusing on bottom line finances has created a demand for the dual capacity attorney-practitioner.[53] In fact, both small and large businesses demand dual capacity practitioners to satisfy their need for professional services.[54] Part II.A defines the scope of dual capacity practice for purposes of this article and highlights the general benefits derived from a dual capacity legal practitioner.[55] Part II.B-C then demonstrates the demand for the attorney-executive and the attorney-tax accountant for purposes of illuminating the societal benefits these practitioners provide.[56]

A. *Scope and General Benefits of the Dual Capacity Practitioner*

For purposes of this article, a dual capacity practitioner is an attorney who is trained and practices in another professional discipline concurrent with his legal practice. While dual capacity practitioners come in all forms,[57] the scope of this article is limited to the attorney-executive and the attorney-accountant.[58] Employing a dual capacity practitioner provides benefits that two separate practitioners are not able to provide.[59] By combining two

50. *See* discussion *infra* Part VI.

51. *See* discussion *infra* Part IV.C.4.

52. *See* discussion *infra* Part IV.C.5.

53. *See* John S. Dzienkowski & Robert J. Peroni, *Multidisciplinary Practice and the American Legal Profession: An Approach to Regulating the Delivery of Legal Services in the Twenty-First Century*, 69 FORDHAM L. REV. 83, 117-27 (2000); discussion *infra* Part II.B-C.

54. *See* discussion *infra* Part II.C.

55. *See* discussion *infra* Part II.A.

56. *See* discussion *infra* Part II.B-C.

57. Dzienkowski & Peroni, *supra* note 53, at 123 (stating that multi-disciplinary practitioners are available in the form of environmental services firms, small business consulting, and family mediation clinics).

58. *See* discussion *infra* Part II.B-C.

59. Dzienkowski & Peroni, *supra* note 53, at 117-18.

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disciplines, dual capacity practitioners deliver a higher quality product at a lower cost to the consumer.[60]

Perhaps the greatest benefit of the dual capacity practitioner is the provision of a higher quality product.[61] This high level of service is the result of synergies that are inherent in the nature of a dual practice.[62] By definition, a dual capacity practitioner has expertise in two professional disciplines.[63] Because dual capacity practitioners are trained and have experience with considering the implications of two disciplines, they are better able to give complete advice than separate practitioners.[64] By way of example, consider a business contemplating a change in legal form. Not only will the attorney-tax accountant understand the substantive tax implications but will also be able to advise on the added return preparation costs, additional overhead associated with tracking information, implications to tort liability protection, and any evidentiary issues.[65] Similarly, the attorney-chief financial officer will not only be able to advise the corporation on the impact a course of action would have with respect to securities law but could also advise the corporation on the impact to the financial statements and what effect a change in the financial statements would have on stock ratings.[66] By contrast, in either of the two scenarios, separate specialists would not be able to competently give advice on the cross-disciplinary issues without consulting another individual.[67] In these cases, because separate practitioners are not privy to the same

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60. *Id.* at 117.

61. *Id.* at 117-18.

62. *Id.* at 117 (pointing out the synergy that develops as a result of having two practitioners of different disciplines in one multi-disciplinary practice and noting that these synergies are lost when two separate firms with a single discipline are employed). This same logic would presumably apply to the dual capacity practitioner. For example, greater synergies would presumably exist where one person performed all legal and nonlegal work as opposed to two separate firms or even two individuals within one firm, because of the absence of a need for two separate practitioners. *See generally* MICHAEL TREBILCOCK & LILLA CSORGO, AM. BAR ASS'N, MULTI-DISCIPLINARY PROFESSIONAL PRACTICES: A CONSUMER WELFARE PERSPECTIVE (Aug. 4, 1999), *at* http://www.abanet.org/cpr/canada.html (stating that the combination of legal and nonlegal expertise thrown at a given problem results in the "optimal problem solving approaches," allowing the client to benefit from "the resulting increase in quality in service").

63. LOUIS S. GOLDBERG, THE ATTORNEY—CPA, A PUBLICATION OF THE AMERICAN ASSOCIATION OF ATTORNEY-CERTIFIED PUBLIC ACCOUNTANTS, INC., HOW DID WE GET HERE? 2 (2003).

64. *Id.* In responding to a debate on the competency of the attorney-CPA, Mr. Goldberg argued that in areas where law and accounting mix, "the public's interest is best served . . . by the joint skills of the two professions when such skills are exercised by the lawyer-CPA." *Id.*; *see* Dzienkowski & Peroni, *supra* note 53, at 121 (concluding that "an [multi-disciplinary practitioner] MDP is more likely to identify both the legal and non-legal issues than would an entity comprised of personnel within the same professional specialty"). Again, the same logic applies to the dual capacity practitioner. For example, as with a firm that contains practitioners with differing disciplines, an attorney with nonlegal expertise would presumably be able to identify both legal and nonlegal issues. This would result in more complete advice and hence a higher quality of service. Dzienkowski & Peroni, *supra* note 53, at 121-22.

65. *See* discussion *infra* Part IV.

66. *See* Dzienkowski & Peroni, *supra* note 53, at 171.

67. *Id.* at 181-200.

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information, issues often fall between the cracks.[68] Thus, because the dual capacity practitioner is trained and experienced with cross-disciplinary issues, the dual capacity practitioner is able to give complete advice.[69] The result of this complete advice is a higher level of service in which issues are not dropped in transition between separate practitioners.[70]

In addition to providing a higher level of service than separate practitioners, dual capacity practitioners are able to deliver services more efficiently.[71] First, clients employing dual capacity practitioners incur fewer transaction costs.[72] For example, a client with a multidisciplinary problem who wants two separate practitioners will utilize double resources in "search[ing] out" the two separate practitioners.[73] In addition, once those practitioners are found, the client will have to oversee two contract negotiations.[74] And once the work begins, there are two practitioners to coordinate, two sets of bills to monitor and account for, and two sets of information providers to receive information from.[75]

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68. *Id.* at 188, 121-22. During my experience with professional services at three national accounting firms, issues were occasionally dropped in transition of work between the tax professionals and audit professionals. In my opinion, the issues were dropped as a result of practitioners from two separate disciplines not understanding cross disciplinary issues that were present in one problem.

69. *See id.*

70. *See id.* at 118-26.

71. *See id.* at 118-23.

72. TREBILCOCK & CSORGO, *supra* note 62, at Part II; *see* Dzienkowski & Peroni, *supra* note 53, at 118 n.186 (citing The Consumer Alliance, *Written Remarks to the ABA Commission on Multidisciplinary Practice* (Mar. 31, 1999), *available at* http://www.abanet.org/cpr/consumer.html ("advocating development of multidisciplinary services to offer consumers more choices and cost-effective solutions"); Daniel R. Fischel, *Multidisciplinary Practice*, 55 BUS. LAW. 951, 974 (2000)). Because employing a dual capacity attorney would involve transacting with one business entity, similar to the MDP, the client of a dual capacity attorney would realize these same efficiencies. *See* TREBILCOCK & CSORGO, *supra* note 62, at Part II.

73. TREBILCOCK & CSORGO, *supra* note 62, at Part II.A. "Search costs" are the costs of looking for professionals in each of the service areas and geographical locations in which professional services are needed to complete the consumer's project. *Id.*; Dzienkowski & Peroni, *supra* note 53, at 119 n.187 (citing JOHN QUINN, MULTIDISCIPLINARY LEGAL SERVICES AND PREVENTIVE REGULATION, IN LAWYERS AND THE CONSUMER INTEREST, at 329, 334, 342 (Robert G. Evans & Michael J. Trebilcock eds., 1982)).

74. TREBILCOCK & CSORGO, *supra* note 62, at Part II.A. "Contracting costs," which are the costs of contracting with each professional performing services that are needed on the project, will need to be incurred twice in obtaining separate representation. *Id.*

75. *See id.* These costs are referred to as "co-ordination costs," or the costs of coordinating the tasks performed by each of the professionals and relaying information between the professionals, and "monitoring costs," which are the costs of verifying the quality of tasks performed by each of the professionals on the project. *See id.*; Dzienkowski & Peroni, *supra* note 53, at 119 n.187 (arguing that "if one integrated MDP provides various professional services to the consumer, the consumer could . . . monitor the different services randomly and impute the verified quality to the MDP"). Again, because employing a dual capacity attorney would involve coordinating and monitoring with one business entity, similar to the MDP, the client of a dual capacity attorney would realize these same efficiencies. *See* Dzienkowski & Peroni, *supra* note 53, at 118-23.

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An additional cost to consider is the minimum engagement fee set by some firms.[76] Currently, many large and midsized professional services firms set a floor on the engagement fee required by each new client.[77] Unfortunately, in some locations, such firms may be the only firm in town with expertise in a certain area. Thus, in order to secure the expertise needed to solve a multidisciplinary problem, a consumer may have to employ two separate firms and guarantee them both a minimum fee. By contrast, employing a dual capacity practitioner will accomplish the goal of obtaining the expertise needed to solve the multidisciplinary problem, while incurring only one set of transaction costs and dealing with only one fee floor.[78]

Dual capacity practitioners also save consumers money in the form of production efficiencies.[79] These production efficiencies are typically grouped into economies of scope and economies of scale.[80] Economies of scope arise "when the total cost of producing a group of products or services is less when those products are produced by a single [practitioner] than when the same volume of those products or services are produced by a set of independent [practitioners]."[81] Because the dual capacity practitioner will not need to consult separate practitioners, time is not spent meeting and attempting to cover cross-disciplinary issues.[82] In addition, by employing only one practitioner, no duplication of work arises in areas where the disciplines cross.[83] Thus, dual capacity practitioners help clients realize economies of scope.[84]

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76. *See* Dzienkowski & Peroni, *supra* note 53, at 121, 121 n.201.

77. Interview with Erin Brooks, Controller, NetQos, Inc. (Oct. 15, 2003). Mrs. Brooks is the controller of a small network management software company in Austin, Texas. *Id.* She formerly spent time as an audit manager with a Big Four accounting firm. *Id.* Mrs. Brooks stated that over the last few years, Big Four accounting has mandated certain minimum profitability requirements for each engagement—somewhere in the $30,000 range. *Id.* Mrs. Brooks argued that these floors have forced start-up companies and other small businesses to choose between the expertise of a Big Four firm and paying costs that they cannot afford. *Id.* During my experience as a summer legal clerk for several national law firms, I noted that minimum-matter-fees were imposed as a threshold to accepting new clients. Most of these fee floors were around $25,000. Thus, for a small business who needed multi-disciplinary expertise and wanted large firm quality, the minimum price they could pay would be $50,000 to $70,000—considering both the fee floors of accounting and law firms.

78. TREBILCOCK & CSORGO, *supra* note 62, at Part II.

79. *Id.* at Part II.B.

80. *Id.*

81. *Id.*

82. *Id.*

83. *See generally* Dzienkowski & Peroni, *supra* note 53, at 118. For example, a consumer who hires an attorney-tax accountant will not need to spend time in two meetings informing the practitioner of pertinent facts. *Id.* In addition, in the event that the consumer needed an issue addressed that related to a tax return and an impending tax audit, the consumer would only need to pay to have the issue researched once. *See id.*

84. TREBILCOCK & CSORGO, *supra* note 62, at Part II.

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Economies of scale "arise when the average cost of producing a good decreases with increased production of the good."[85] Because a dual capacity practitioner will have repetitive experience handling cross-disciplinary problems, the practitioner would presumably become more efficient with each additional multidisciplinary problem faced.[86] These efficiencies would be passed on to the consumer.[87] In contrast, a separate practitioner with no cross-disciplinary experience would spend more time identifying the cross-disciplinary issues to pass on to another professional.[88]

By employing a dual capacity practitioner, the consumer would get the highest quality of service at the best possible price.[89] The ability of the dual capacity practitioner to understand multidisciplinary issues enables him to provide complete advice to the client and minimize the risk of dropping cross-disciplinary issues.[90] This synergy results in a higher quality of service to the client.[91] In addition, because the consumer is only employing one practitioner, transaction costs are reduced, economies of scope and scale are realized, and only one fee floor assessed.[92] Because dual capacity practitioners provide the highest quality of service at the lowest possible cost, dual capacity practitioners are in high demand.[93]

B. Demand for the Attorney-Executive

During the last ten years, corporate America has seen an unprecedented increase in the number of attorneys employed. For example, in 1991 the top ten Fortune 500 companies employed an average of 287 in-house attorneys. By 2000 that number had increased more than 47% to 407 in-house attorneys. Common reasons cited for employing attorneys in corporations include cost savings, familiarity with the business of the corporation, accessibility, and the working relationship with other executives.[94] But the most important reason cited by these companies for retaining in-house counsel was their ability to manage legal risks, particularly their ability to intervene early and prevent the company from being involved in litigation.[95]

85. *Id.*
86. *Id.*
87. *Id.*
88. *See id.*
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. Brown, *supra* note 21, at 93; AMERICAN CORPORATE COUNSEL ASSOCIATION, *supra* note 22, at 2-4.
95. AMERICAN CORPORATE COUNSEL ASSOCIATION, *supra* note 22, at 2-4.

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In addition to their legal duties, in-house counsel are increasingly being assigned dual roles.[96] Contemporary changes in SEC regulations as well as a changing business climate demand competent legal and business advice to be rendered immediately as emergencies arise.[97] In fact, a study performed by the American Corporate Counsel Association (ACCA) found that 8.7% of in-house counsel also serve as COO, 7.4% serve as CFO, 6.3% serve as CEO, 13.5% serve as the head of an operating business unit, 24.9% serve as the director of human resources, and 39.2% serve "other" business functions.[98] In light of corporate America's demand for the attorney-executive and considering the difficulty of finding persons with the requisite credentials, lawmakers should be hesitant to prevent those attorney-executives from functioning in their dual roles.[99]

C. Demand for the Attorney-Accountant

The majority of United States businesses consist of sole proprietorships and other entities with less than five hundred employees.[100] In fact, approximately 99.7% of United States corporations and partnerships have less than five hundred employees and 84% have fewer than one hundred employees.[101] This statistic does not include sole proprietorships, which comprise three-fourths of all United States businesses.[102] The United States Census reports that these entities bring in approximately $4.3 billion out of $18.5 billion (or 23%) of annual U.S. gross business receipts.[103] Unfortunately, two-thirds of these small businesses close their doors after the first two years, and one-half are out of business by their fourth year.[104]

While sole proprietorships, small corporations, and partnerships contribute 23% of United States business revenues, they are estimated to spend 60% more per employee on compliance with federal regulations than their large business counterparts.[105] In addition, small businesses are reported

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96. *See* Scott R. Flucke, *The Attorney Client Privilege in the Corporate Setting: Counsel's Dual Role as Attorney and Executive*, 62 UMKC L. REV. 549 (1994).

97. *See id.*

98. *See* Brown, *supra* note 21, at 101 (citing NONLEGAL FUNCTION OF GENERAL COUNSEL, ACCA ONLINE POLL (July 29-Sep. 28, 2002), *available at* http://www.acca.com/Surveys/accapoll.php).

99. *See id.*

100. U.S. Census Bureau, *supra* note 14.

101. *Id.*; Small Business Association Office of Advocacy, *Small Business by the Numbers-Answers to Frequently Asked Questions* (2002), *available at* http://www.sba.gov/advo/stats/sbfaq.pdf (last visited Apr. 4, 2004).

102. Small Business Association Office of Advocacy, *supra* note 101.

103. U.S. Census Bureau, *supra* note 14. In arriving at the total revenue for small businesses and sole proprietorships, I added the individual revenues for small corporations, partnerships and sole proprietorships as represented by this website. *See id.*

104. Small Business Association Office of Advocacy, *supra* note 101.

105. *Id.* (answering the question of how federal regulations effect small businesses through statistics, which show that "[v]ery small firms with fewer than 20 employees spend 60% more per employee than

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to spend twice as much as large businesses on tax advice.[106] Based on Internal Revenue Service (IRS) statistics, these expenditures appear warranted.[107] For example, the IRS claims that 51% of sole proprietors and small businesses make a mistake on their tax return compared to 83% of taxpayers at large.[108] As a result, small businesses are likely to be audited twice as much as other taxpayers.[109] In fact, the IRS anticipates that audits of small businesses will double over the next two years.[110]

In light of these statistics, small businesses need quality tax advice, tax preparation, and tax controversy representation at a price that will enable them to survive.[111] But the extreme costs of retaining both a tax accountant and a tax attorney prevent many small businesses from addressing these multidisciplinary problems.[112] Furthermore, in smaller economies without the dual capacity attorney-accountant, no service may be available if there is not

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larger firms to comply with federal regulations. Small firms spend twice as much on tax compliance as their larger counterparts.").

106. *Id.*

107. *See id.*

108. Joseph Anthony, *The IRS is eyeing your small business*, MICROSOFT B-CENTRAL, *at* http://www.bcentral.com/articles/anthony/147.asp (last visited Apr. 1, 2004) (stating that "[t]he government's own statistics indicate that about 83% of all taxpayers fully comply with the tax code when doing their returns"; but for small business owners, "that figure is more like 51%").

109. Kent Hoover, *Small Businesses Twice as Likely to Face Audits*, CHARLOTTE BUSINESS JOURNAL, http://www.bizjournals.com/charlotte/stories/1999/09/06/smallb6.html (Sept. 3, 1999) (stating that small businesses are twice as likely to be audited compared to other taxpayers given the amount of mistakes made in withholding payroll taxes and the amount of treasury revenues attributable to small businesses); Jacquelyn Lynn, *Audit Alert: Keeping good records from the start is the key to surviving an IRS audit*, ENTREPRENUER MAGAZINE, http://www.entrepreneur.com/mag/article/0,1539,269441,00.html (Apr. 2000). "Historically, small businesses have been audited by the IRS at double the rate of all filers." Lynn, *supra*.

110. *See* Anthony, *supra* note 108 (arguing that the IRS's "new Small Business/Self-Employed Operating Division is going to be able to focus on partnerships and sole proprietors with more than $100,000 in total gross revenues, and small corporations with less than $5 million on their balance sheets"). According to Mr. Anthony, the IRS's statistics reveal that the agency audited a little more than 63,000 of these type of small-business returns in 1999. *Id.* The IRS's initial goal strove to inflate that number by "50,000 during the 2001 fiscal year, and by *another* 50,000 in fiscal year 2002—an overall increase of 100,000 audits." *Id.* Based on these assertions, audits of small businesses will increase from 63,000 to about 150,000, or in effect double. *See id. See also*, Peg Monahan, *Good news/bad news from the IRS*, Buyerzone.com, *at* http://www.buyerzone.com/features/news_and_deals/tips080701-1.html (Aug. 7, 2001) (expecting a general increase in the audits of small business as a result of IRS restructuring).

111. *See supra* notes 105-10 and accompanying text.

112. *See* Dzienkowski & Peroni, *supra* note 53, at 126 (citing Letter from Michael H. Horner to Arthur Garwin, Staff Counsel to the ABA Commission on Multidisciplinary Practice, *available at* http://www.abanet.org/cpr/horner.html (Feb. 19, 1999) (discussing his need for multi-disciplinary services in a small business context); Letter from Scott Hart to Arthur Garwin, Staff Counsel to the ABA Commission on Multidisciplinary Practice, *available at* http://www.abanet.org/cpr/hart.html (Feb. 22, 1999) (discussing the benefits of obtaining legal services from his accounting firm in the business context)). Dzienkowski and Peroni conclude that "if the organized bar does not accommodate multidisciplinary services[, l]ow- and middle-income individuals and small businesses, who are excellent candidates for receiving multidisciplinary services, are likely not to obtain professional legal and non-legal services in the ordering of their personal and business matters." *Id.*

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enough pure legal or pure accounting work to satisfy two separate practices.[113] Because the attorney-accountant delivers higher quality services with greater efficiency than two separate practitioners, the attorney-accountant appears to be the provider of choice. Unfortunately, the American Association of Attorney-Certified Public Accountants estimates that of the 450,000 CPAs and 1,000,000 lawyers in the United States, only about 44,000 practitioners have dual qualifications.[114] Thus, policy makers should consider the demand for attorney-accountants in comparison to their limited supply before limiting the ability of these practitioners to serve in their dual capacity.

III. THE ATTORNEY-CLIENT AND WORK-PRODUCT PRIVILEGES: THE HISTORY OF AND RATIONALE FOR MAINTAINING CLIENT CONFIDENCES

A. Attorney-Client Privilege

The attorney-client privilege is among the oldest of the evidentiary privileges.[115] Courts and legal scholars recognize that it dates back to early Anglo-Saxon jurisprudence of the sixteenth century.[116] Since the creation of the attorney-client privilege, its rationale has changed.[117] For example, the initial privilege was to preserve the " 'oath and the honor of the attorney.' "[118] Because it was the attorney's "honor 'as a gentleman' " that was at stake, only

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113. Gary A. Munneke, *Dances With Nonlawyers: A New Perspective on Law Firm Diversification*, 61 FORDHAM L. REV. 559, 568 (1992) (making an argument in favor of permitting lawyers to engage in ancillary business activities by pointing out that "in smaller towns, there may not be sufficient demand for legal services to keep lawyers engaged full-time in a legal practice). Dzienkowski and Peroni also argue that "if lawyers are permitted to diversify and engage in other professional activities in addition to law practice . . . , they can make sufficient total profits to stay in business. This means that the clients in these smaller towns will have access to legal services that they might not have had otherwise." Dzienkowski & Peroni, *supra* note 53, at 126-27.

114. American Association of Attorney-Certified Public Accountants, *Membership*, (2003), *at* http://www.attorney-cpa.com/membership.html (last visited Apr. 4, 2004). I computed the number of dually qualified practitioners as: 3% of a total 1,450,000 practitioners (1,000,000 lawyers plus 450,000 CPAs) is 43,500. *Id.*

115. 8 JOHN H. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2290, at 542-43 (McNaughton rev. 1961) (estimating that the origin of the privilege dates to the 1600s). *See also* Max Radin, *The Privilege of Confidential Communications Between Lawyer and Client*, 16 CAL. L. REV. 487, 487-88 (1928) (estimating that the privilege has been in existence since Roman times).

116. 8 WIGMORE, *supra* note 115, at 542-43; Michael W. Loudenslager, *Cover Me: The Effects of Attorney-Accountant Multidisciplinary Practice on the Protections of the Attorney-Client Privilege*, 53 BAYLOR L. REV. 33, 57 n.105 (citing *In re* Six Grand Jury Witnesses, 979 F.2d 939, 943 (2d Cir. 1992) ("The attorney-client privilege[] is, according to Professor Wigmore, the oldest of the common law privileges dating back to the early 16th century, and has encouraged clients to confide in their attorneys fully and frankly, free from the apprehension of disclosure, for nearly 500 years.")).

117. 8 WIGMORE, *supra* note 115, at 542-43.

118. Andrea I. Mason, *Counsel as Tax Preparer, An Unprivileged Position:* United States v. Frederick, *182 F.3d 496 (7th Cir. 1999)*, 69 U. CIN. L. REV. 411, 413 (2000) (stating that the attorney-client privilege is one of the "oldest evidentiary privileges"); *see* Flucke, *supra* note 96, at 551 (summarizing the evolution of the attorney-client privilege); 8 WIGMORE, *supra* note 115, at 542-43.

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the attorney could waive the privilege.[119] But at the end of the eighteenth century, the "oath of honor" justification for the attorney-client privilege was discarded in favor of the policy that "full and frank communication" between attorneys and clients should be encouraged.[120]

The attorney-client privilege is an exception to a general policy underlying civil procedure that "broad and liberal" discovery should be allowed in furtherance of the truth.[121] The rationale underlying the attorney-client privilege is that "full and frank communication" between attorney and client will render the attorney a more effective advocate, which will better serve the public interest by improving the administration and efficiency of the law.[122] But clients will only engage in full and frank communication when such communication is "free from the consequences . . . of disclosure."[123] Thus, in order to elicit full and frank communication between attorney and client, thereby better serving the public interest, the attorney-client privilege protects confidences from disclosure.[124]

The Federal Rules of Civil Procedure codified the attorney-client privilege, which protects privileged information from discovery.[125] But those rules do not provide guidance on what information is privileged. Thus, courts historically use the rules of evidence to determine what information is privileged for discovery purposes.[126] The Federal Rules of Evidence define privileged information as that determined by "the principles of common law

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119. *See* Flucke, *supra* note 96, at 551; Mason, *supra* note 118, at 413; 8 WIGMORE, *supra* note 115, at 542-43.

120. Flucke, *supra* note 96, at 551.

121. 8 WIGMORE, *supra* note 115, at 554.

122. *Id.*; Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) (arguing that full and frank communication between client and attorney will result in the disclosure of the relevant facts to the attorney and thus allow the attorney to be a more effective legal advocate); *see* Fisher v. United States, 425 U.S. 391, 403 (1976) (stating that the policy behind the attorney client privilege is to "encourage clients to make full disclosure to their attorneys"); United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999) (citing Upjohn Co. v. United States for the proposition that "the attorney-client privilege is intended to encourage people who find themselves involved in actual or potential legal disputes to be candid with any lawyer they retain to advise them" and reasoning that "this will assist the lawyer in giving good advice [] which may head off litigation").

123. *Upjohn*, 449 U.S. at 389 (citing Hunt v. Blackburn, 128 U.S. 464, 470 (1888) (arguing that "privilege 'is founded upon the necessity, in the interest and administration of justice, of the aid of persons having knowledge of the law and skilled in its practice, which assistance can only be safely and readily availed of when free from the consequences of or the apprehension of disclosure' "); Loudenslager, *supra* note 116, at 57 ("Knowing that communications will remain confidential, even against court compelled disclosure, clients are encouraged to communicate frankly with their legal counsel."); Grace M. Giesel, *The Legal Advice Requirement of the Attorney-Client Privilege: A Special Problem for In-House Counsel and Outside Attorneys Representing Corporations*, 48 MERCER L. REV. 1169, 1186 (1997) ("If the privilege is to encourage disclosure, the client must be able to predict that the communicated disclosure will enjoy the privilege in any possible future legal proceeding."))

124. *See supra* notes 121-23 and accompanying text.

125. FED. R. CIV. P. 26(b)(1).

126. *See* discussion *infra* text accompanying notes 127-28.

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as they may be interpreted by the courts of the United States."[127] Thus, the test to determine whether information is privileged is largely a test developed by the courts.[128] Most courts apply the following rule to determine when information is privileged: "[when] legal advice of any kind is sought, from a professional legal adviser in his capacity as such, the communications relating to that purpose, made in confidence, by the client, are at his instance permanently protected, from disclosure by himself or by the legal advisor, except if the protection be waived."[129]

B. The Work-Product Privilege

Because an attorney creates work product following, and as a result of, the substance of communications that are privileged, protection for the underlying communications could be jeopardized if attorney work product were subject to discovery.[130] In response to this problem, the Court in *Hickman v. Taylor* created the work-product privilege, which protects certain items created by an attorney from a summons to discovery.[131]

Since *Hickman*, the work-product privilege has been codified in the Federal Rules of Civil Procedure, which identifies the following two types of protected work product: "fact work-product, or attorney work that develops factual information, and opinion work product, or the mental impressions, conclusions, opinions, or legal theories of the attorney."[132] In order to qualify as privileged work product, the product must have been prepared in "anticipation of litigation."[133] Historically, courts interpret the following as litigation: "governmental investigations, grand jury subpoenas, and arbitrations and negotiations, as well as judicial proceedings."[134] But in the event that the opposing party can show a substantial need for the material that they will not be able to replace without undue hardship, the attorney can

127. *See* FED. R. EVID. 501.

128. *See* Bruce Kayle, *The Tax Adviser's Privilege in Transactional Matters: A Synopsis and a Suggestion*, 54 TAX LAW. 509, 511 (2001) (citing WIGMORE JOHN HENRY, EVIDENCE IN TRIALS AT COMMON LAW § 2292, 558 (3d ed. 1940)); Louis F. Lobenhofer, *The New Tax Practitioners Privilege: Limited Privilege and Significant Disruption*, 26 OHIO N.U. L. REV. 243, 246 (citing United States v. United Mach. Corp., 89 F. Supp. 357, 358-59 (D. Mass. 1950) for a somewhat more detailed, but fundamentally identical test).

129. Kayle, *supra* note 128, at 511.

130. *Id.*

131. *Id.* at 512; *see* Hickman v. Taylor, 329 U.S. 495, 511 (1947) (arguing that if "such materials [were] open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten").

132. Kayle, *supra* note 128, at 528.

133. FED. R. CIV. P. 26(b)(3).

134. Kayle, *supra* note 128, at 529.

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overcome the privilege for fact work product.[135] Overcoming the privilege for opinion work product is more difficult.[136]

IV. THE IMPLICATIONS OF A DUAL CAPACITY PRACTICE ON THE ATTORNEY-CLIENT AND WORK-PRODUCT PRIVILEGES

During legal disputes, attorneys call on courts to establish the parameters of the attorney-client and work-product privileges for instances in which the attorney acts in a dual role.[137] The discretionary nature of these proceedings—including the difficulty of addressing the attorney-client privilege in such contexts—has increased both legal dispute and scholarly debate.[138] The difficulty underlying the application of the attorney-client privilege in a dual capacity context is that the line between legal and business advice becomes blurred.[139] Because only legal advice is privileged and because the dual capacity practitioner often renders simultaneous legal and nonlegal advice, courts have struggled to determine what information is privileged.[140] The majority of courts resolve this problem by determining whether information is related to the rendition of legal advice, in camera, on a case-by-case basis.[141]

A. *Application of Evidentiary Privileges to the Attorney-Executive*

Typically, in-house corporate counsel serves a corporation beyond that of a legal advisor.[142] In an increasingly regulated world, in-house counsel

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135. *See id.* at 528, 528 n.120 (citing the Federal Rules of Civil Procedure for the assertion that the " 'substantial need' that must be demonstrated to summons factual work product requires a showing of (1) importance, (2) a lack of availability, and (3) a lack of substantial equivalent").

136. *Id.* at 528, 529 n.122 (stating that while the Federal Rules of Civil Procedure do not list an exception to the opinion work product rule, cases have allowed summonses only where the attorney work product itself was at issue, for instance in a malpractice case).

137. Mason, *supra* note 118, at 413; Flucke, *supra* note 96, at 549 (noting that much attention has been recently given to the attorney-client privilege in the context of the attorney-executive/director).

138. Mason, *supra* note 118, at 413 (stating that the frequency in which courts have had to address the attorney-client privilege in dual capacity relationships has made "the attorney-client privilege a fertile source of litigation and debate").

139. *Id.*

140. *See* United States v. Frederick, 182 F.3d 496, 501-02 (7th Cir. 1999) (recognizing the difficulty of determining whether information related to an IRS audit was accounting work and not privileged, or legal work and privileged).

141. *See* Flucke, *supra* note 96, at 581 (citing Hercules Inc. v. Exxon Corp., 434 F. Supp. 136, 144 (D. Del. 1977) for the proposition that contemporary courts perform a case-by-case in camera inspection to determine whether documents are privileged); *Frederick*, 182 F.3d at 499 (recanting the district courts efforts to examine the communications in camera).

142. JOHN K. VILLA, THE ATTORNEY-CLIENT PRIVILEGE AND IN-HOUSE CORPORATE COUNSEL ANALYSIS, 1 CORP. COUNSEL GUIDELINES § 1.16, 1-64 n.1 (2002 ed.) (noting surveys showing "better than 80% of corporate attorneys, with the title General Counsel were also officers of the corporation at the rank of Vice President, Executive Vice President, or Senior Vice President"). *See also* Vincent C. Alexander, *The Corporate Attorney-Client Privilege: A Study of the Participants*, 63 ST. JOHN'S L. REV. 191, 279 (Winter 1989) (noting the overlap between in-house attorney and other business roles).

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must be closely enmeshed with the business dealings of a corporation in order to render immediate business and legal advice.[143] But the provision of such dual capacity service often blurs the distinction between legal and nonlegal advice, which in turn jeopardizes the attorney-client privilege.[144] Because the attorney-client privilege only applies to legal advice rendered to the corporation, any business communication between counsel and the corporation will not be protected.[145]

1. Upjohn v. United States *and Subsequent Developments*

In 1981, the United States Supreme Court addressed the corporate attorney-client privilege in *Upjohn Co. v. United States.*[146] In *Upjohn*, a drug manufacturer's in-house general counsel and vice president was engaged in soliciting information from various employees (some who were not among top executives) as part of an internal investigation of possible illegal payments made to foreign governments.[147] The IRS, while conducting a tax investigation, sought to compel the in-house counsel to produce interview notes and questionnaires taken during the internal investigation.[148] The in-house counsel refused, arguing that the information was protected by the attorney-client privilege.[149] The United States Court of Appeals for the Sixth Circuit held that the information was not privileged because not being among the corporation's "control group," the employees could not be considered the client.[150]

In overruling the Sixth Circuit, the Supreme Court stated that the attorney-client privilege should not be narrowed such that it makes "it difficult for corporate attorneys to formulate sound advice when their client is faced with a specific legal problem[, or] threatens to limit . . . efforts of corporate counsel to ensure their client's compliance with the law."[151] Because "[t]he communications [between attorney and employees] concerned matters within the scope of the employees' corporate duties, and the employees themselves

143. VILLA, *supra* note 142, at 1-64 (citing AMERICAN BAR ASSOCIATION, TORTS AND INSURANCE PRACTICE SECTION, ATTORNEY-CLIENT PRIVILEGE IN CIVIL LITIGATION 308 (Vincent Walkowiak ed., 2d ed. 1997) ("As we move away from that traditional model, does it make sense to apply rules developed when that traditional model prevailed almost exclusively? More importantly, is it ever meaningful to distinguish 'law' and business' in a regulated industry?")); Flucke, *supra* note 96, at 550 (stating that the ever-changing world of regulated business requires competent business and legal advice as immediate emergencies arise).

144. Mason, *supra* note 118, at 431.

145. *See id.* at 432-33.

146. 449 U.S. 383 (1981).

147. *Id.* at 386-87.

148. *Id.* at 387.

149. *Id.* at 388.

150. *Id.*

151. *Id.* at 392.

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were sufficiently aware that they were being questioned in order that the corporation could obtain legal advice," the court held that the communications were privileged.[152] Subsequent courts and commentators cite *Upjohn* for the proposition that dual capacity communications are protected only to the extent that they were made " 'to secure legal advice from counsel.' "[153]

After *Upjohn*, a determining factor in establishing the attorney-client privilege in the context of a dual capacity practice is what distinguishes business from legal advice?[154] This process can be "extremely onerous for both corporations and attorneys."[155] On one hand, it is common for in-house counsel to receive "communications clearly made with the sole purpose of seeking and obtaining legal advice."[156] Legal tasks are considered to be those in which the attorney "appl[ies] law to a set of facts; review[s] client conduct based upon the effective law or regulations; or advis[es] the client about status or trends in the law."[157] If the sole purpose of a communication is related to the provision of legal advice, the communication is protected, even if such advice may "ultimately affect business decision-making."[158] Documents are also protected, to the extent that the document was created for the purpose of

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152. *Id.* at 394.

153. *Id.* at 414 n.28 (quoting Sedco Int'l, S.A. v. Cory, 683 F.2d 1201, 1205 (8th Cir. 1981) (arguing that the "attorney-client privilege does not protect ordinary business advice," thereby implying that *Upjohn* protects attorney-client communications intended to secure legal advice from counsel)).

154. *See id.* at 414.

155. Flucke, *supra* note 96, at 557. FTC v. Shaffner, 626 F.2d 32, 37 (7th Cir. 1980) (arguing that a blanket assertion of the privilege is unacceptable). These cases set an onerous burden for the client and their counsel to differentiate business from legal advice. Flucke, *supra* note 96, at 557 n.59.

156. VILLA, *supra* note 142, at 1-66. In discussing the range of possible communications between attorney-executive and corporate clients, Villa notes that it is entirely common for pure legal consultations to transpire. *Id.* These communications, he states, are of course privileged. *Id.*

157. *Id.* at 67; *see, e.g.*, Leibel v. Gen. Motors Corp., 646 N.W.2d 179, 185 (Mich. Ct. App. 2002) (arguing that while in-house counsel's memo contained certain factual statements, "the overriding basis for and content of the memorandum concerns legal advice for seatback safety and potential litigation").

158. *See* Satcom Int'l Group, P.L.C. v. Orbcomm Int'l Partners, L.P., 1999 WL 76847, at *2 (S.D.N.Y. Dec. 15, 1999) (applying Virginia law) (holding that merely because a legal decision to terminate licensing agreements, which was made at a meeting of the executive committee, had commercial ramifications did not the alter conclusion that all communications at the meeting were privileged, where the sole purpose of the meeting was to make a legal decision on this issue, counsel was present at the meeting to render legal advice on this issue, and all communications related to this issue); *In re* Federated Dep't Stores, Inc., 170 B.R. 331, 354 (S.D. Ohio 1994) (holding that merely because business considerations are weighed in the rendering of legal advice does not vitiate the attorney-client privilege); *Leibel*, 646 N.W.2d at 189 (holding that a memorandum whose overriding basis and content concerns legal advice is privileged); VILLA, *supra* note 142, at 1-67 (citing *In re* Ford Motor Co., 110 F.3d 954, 966 (3d Cir. 1997) (holding that

> Certainly, the ultimate decision reached by the [corporate committee] could be characterized as a business decision, but the Committee reached its decision only after examining the legal implications of doing so. Even if the decision was driven, as the district court seemed to assume, principally by profit and loss, economics, marketing, public relations, or the like, it was also infused with legal concerns, and was reached only after securing legal advice.).

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giving legal advice.[159] Additionally, a record of a meeting is protected if the purpose of the meeting was for the provision of legal advice.[160]

At the other end of the spectrum, in-house counsel is often required to engage in purely business activities. In such instances, courts have held that the mere involvement of an attorney or that merely giving documents to the company's in-house counsel does not invoke the privilege.[161] For example, in-house counsel's "mere presence at a meeting" does not invoke the privilege.[162] In addition, when in-house counsel negotiates business deals, acts as a business agent, prepares tax returns, lobbies, performs public relations work, or acts as an agent with the press, the privilege does not apply.[163] And business correspondence, interoffice reports, file memoranda, and minutes of business meetings ordinarily do not qualify for the privilege.[164]

While certain communications made by an attorney-executive are easily categorized into legal and nonlegal activity, some are more difficult to sort. By way of example, consider a corporate board committee meeting called for the purposes of discussing a significant asset acquisition. In this meeting, the

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159. Great Plains Mut. Ins. Co. v. Mut. Reinsurance Bureau, 150 F.R.D. 193, 197 (D. Kan. 1993). In deciding whether memorialized advice in a meeting, where mixed business and legal advice was given, was discoverable business advice, the court held that

> [w]hile it is possible that the advice rendered by Great Plains' attorney could conceivably affect Great Plains' success (or failure) as an ongoing entity, this possibility does not convert the legal advice rendered by its attorney into discoverable "business advice"—such a construction of the attorney-client privilege would eviscerate the privilege and essentially render it a nullity in this factual context.

Id.

160. VILLA, *supra* note 142, at 1-70 (citing *Great Plains Mut. Ins. Co.*, 150 F.R.D. at 197 (holding that board meeting minutes are privileged when the meeting is devoted to giving and discussing legal advice)).

161. *See* discussion *infra* notes 162-63.

162. VILLA, *supra* note 142, at 1-68 (citing Neuder v. Battelle Pac. Northwest Nat'l Lab., 194 F.R.D. 289 (D.D.C. 2000)).

163. United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999) (denying privilege to the client of an attorney-tax accountant because the business nature of the relationship tainted all information sought to be privileged); Georgia-Pacific Corp. v. GAF Roofing Mfg. Corp., 1996 WL 29392 at *4 (S.D.N.Y. Jan. 25, 1996) (holding that when negotiating a contract the attorney acted in a business capacity); Mass. Sch. of Law at Andover, Inc. v. Am. Bar Ass'n, 895 F. Supp. 88, 91 (E.D. Pa. 1995) (holding that the way in which the attorney referred to himself and the nature of his work, the way the client characterized him as an accreditation consultant, and the attorney's prior legal experience (none) establish that when he performed work and drafted a report, he was providing business services and not rendering legal advice); United States v. Willis, 565 F. Supp. 1186, 1189-91 (S.D. Iowa 1983) (holding that tax return preparation by attorney is not privileged, however, tax planning is privileged); Montebello Rose Co. v. Agric. Labor Relations Bd., 173 Cal. Rptr. 856 (Ct. App. 1981) (holding that communications with a lawyer acting as negotiator for labor contracts were not privileged, despite that some communications involved strategy which may have had legal significance); *In re* Bekins Record Storage Co., 465 N.E.2d 345 (N.Y. 1984) (holding that communications to an attorney acting as a commercial consultant are not privileged).

164. Oil Chem. and Atomic Workers Int'l Union v. Am. Home Prods., 790 F. Supp. 39, 41 (D.P.R. 1992); Foseco Int'l Ltd. v. Fireline, Inc., 546 F. Supp. 22, 24 (N.D. Ohio 1982) ("Communications made in the routine course of business, however, such as transmittal letters or acknowledgment of receipt letters, which disclose no privileged matters and which are devoid of legal advice or requests for such advice are not protected."); VILLA, *supra* note 142, at 1-68, 1-69.

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company's chief financial officer, who is also in-house counsel, gives and receives information related to several proposed structures for the transaction. These communications are pertinent to the impact each proposed structure would have on the company's federal taxes, debt covenants, GAAP earnings, and operating cash flow. If the minutes for that meeting are subsequently summonsed, will they be protected under the attorney client privilege? This would seemingly depend on whether the communications to and from the attorney-CFO were for the purpose of rendering legal advice.[165] If the facts communicated back and forth were equally applicable to legal problems (federal tax and debt covenant analysis) as well as nonlegal problems (GAAP earnings and cash flow), is the communication for the purpose of rendering legal advice? These are the issues that courts continue to struggle with.[166]

The majority of courts determine whether the attorney-client privilege applies to mixed business and legal communication by addressing each communication *in camera*, on a case-by-case basis.[167] But when inspecting each mixed communication, courts apply different standards to determine if the privilege applies.[168] For example, some courts distinguish protected information by looking to see whether the communication was primarily concerned with the provision of legal advice.[169] In *In re Spalding Sports Worldwide, Inc.*, the United States Court of Appeals for the Federal Circuit held that information sent by inventors to Spalding's patent attorneys was protected by the attorney-client privilege because the communication was primarily related to legal advice.[170] In so holding, the court reasoned that the presence of nonlegal information in the communication does not preclude the privilege so long as the "overall tenor of the document" relates to "legal advice or services."[171]

The Restatement (Third) of the Law Governing Lawyers takes a somewhat more liberal approach to the attorney-client privilege in the face of mixed business and legal communications.[172] For example, the Restatement provides that a privilege applies when the communication is made to a lawyer who consults "for the purposes of obtaining legal assistance and not predominantly for another purpose."[173] As stated in the commentary, this language is intended by the drafters of the Restatement to be an expansion of

165. *See* discussion *infra* notes 167-76 and accompanying text.

166. *See* discussion *infra* notes 167-76 and accompanying text.

167. Flucke, *supra* note 96, at 557.

168. *See id.*

169. *Id.*

170. 203 F.3d 800, 805-06 (Fed. Cir. 2000).

171. *Id.* at 806. The court rejected the lower court's holding that "documents relating to the prosecution of patent applications are nonprivileged, based on the rationale that the attorney is acting as a mere 'conduit' between his client and the Patent and Trademark Office" and are "not binding on this court." *Id.* at 806 n.3.

172. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 72 (2000).

173. *Id.* § 72 cmt. c.

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the attorney-client privilege.[174] The Restatement test is based upon factual circumstances, including the extent to which the person performs legal and nonlegal work, the nature of the communications in question, and whether the person had previously provided legal assistance on the same matter.[175] "So long as the client consults to gain advantage from the 'lawyer's legal skills and training,' the communication is privileged, even if the client may expect to gain other benefits, such as business advice."[176]

Despite the more liberal tests applied by the Federal Circuit and the Restatement, some courts require that communications be motivated solely by the provision of legal services to be protected by the attorney-client privilege.[177] For example, the United States Court of Appeals for the Second Circuit held in *In re John Doe Corp.* that the "*Upjohn* privilege is clearly limited to communications made to attorneys solely for the purpose of the corporation seeking legal advice and its counsel rendering it."[178] Although this case espouses the minority view, this approach has been followed by some courts.[179]

2. *Discussion of the Law Governing Privileged Information in the Context of the Attorney-Executive*

By allowing the invocation of the attorney-client privilege when a corporate communication predominantly relates to the provision of legal services, courts are striking a desirable balance between eliciting full and frank attorney-client communication, providing for liberal discovery, and satisfying corporate demand for the dual capacity attorney-executive.[180] For example, the predominantly related test recognizes the inherent intermingling of facts in the dual capacity context and encourages that relationship.[181] At the same time, by putting a more-legal-than-not standard on dual capacity

174. *See id.* § 72 cmt. b, c. "The evidence codes commonly limit the privilege to client consultations for the purpose of obtaining legal assistance from a lawyer." *Id.* § 72 REP.'S NOTE cmt. b. But

> [c]ourts no longer follow an early doctrine that limited the privilege to confidences given in aid of litigation and in the very litigation to which they pertained . . . .
>
> In general, American decisions agree that the privilege applies if one of the significant purposes of a client in communicating with a lawyer is that of obtaining legal assistance. That position is reflected in [this restatement].

Id. § 72 REP.'S NOTE cmt. b, c. Thus, the Restatement view is similar to "the English view, differently stating a 'predominant purpose' test as a requirement for application of the privilege, but rejecting a sole purpose test." *Id.* § 72 REP.'S NOTE cmt. c.

175. *See id.* § 72 cmt. b, c.

176. *See* VILLA, *supra* note 142, at 1-71.

177. *See id.*

178. 675 F.2d 483, 488 (2d Cir. 1982).

179. VILLA, *supra* note 142, at 1-71 (citing Hardy v. N.Y. News, Inc., 114 F.R.D. 633, 643 (S.D.N.Y. 1987)).

180. *See* discussion *infra* Part IV.A.1.

181. *See* Mason, *supra* note 118, at 415; Flucke, *supra* note 96, at 566.

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communications, the test prevents the application of the attorney-client cloak merely by association with an attorney.[182] Thus, while no uniform standard exists to determine whether a communication between a corporate client and a dual capacity attorney-executive is related to legal or business advice, the majority of courts employ an ad-hoc test with preferential policy balances.[183] As this article later addresses, courts have not exercised such sound policy judgment in applying the attorney-client privilege to other dual capacity practitioners.[184]

B. The Attorney-Client Privilege and the Attorney-Tax Accountant

Distinguishing legal advice from nonlegal advice can be problematic when law and other disciplines overlap.[185] This is especially true in the context of the attorney-tax accountant.[186] Similar to the application of privilege to attorney-executive communications, courts determine whether attorney-tax accountant communications are privileged on an ad-hoc basis.[187] But unlike cases that address the attorney-executive, courts addressing an attorney-tax accountant-client privilege apply a standard that is neither grounded in legal precedent nor sound in social policy.[188] In order to fully address privilege issues that arise under the scope of the dual capacity attorney-tax accountant, Part IV.B reviews the history of a general accountant-client privilege.[189] Part IV.C then discusses the current state of the law as it addresses privileges in the context of the attorney-tax accountant.[190] Parts V-VI conclude with an analysis of the current state of the law followed by suggestions on how the law could be improved.[191]

1. No Common-Law Privilege for Accountants

Currently, courts do not recognize a common-law accountant-client privilege.[192] The *Frederick* court cites to the United States Supreme Court decisions in *Couch v. United States*[193] and *United States v. Arthur Young & Co.*[194] to establish that "[t]here is no common law accountant's or tax

182. *See* Mason, *supra* note 118, at 426-27; Flucke, *supra* note 96, at 566.
183. *See* Flucke, *supra* note 96, at 554.
184. *See* discussion *infra* Part IV.C.3.
185. *See* VILLA, *supra* note 142, at 1-64 through1-74.
186. *See* discussion *supra* Part II.C.
187. *See* Flucke, *supra* note 96, at 554.
188. *See id.*
189. *See* discussion *infra* Part IV.B.1-3.
190. *See* discussion *infra* Part IV.C.1-3.
191. *See* discussion *infra* Parts V-VI.
192. United States v. Frederick, 182 F.3d 494, 500 (7th Cir. 1999).
193. 409 U.S. 322, 325 (1973).
194. 465 U.S. 805, 817 (1984).

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preparer's privilege."[195] In *Arthur Young*, a CPA firm engaged as the auditor of a corporation refused to turn over the corporation's tax accrual work papers to the IRS.[196] The United States Court of Appeals for the Second Circuit determined that a privilege should apply to the tax accrual and fashioned an accountant work-product privilege.[197] The court reasoned that such a privilege would promote the public interest because it would promote full disclosure to public accountants, which would ensure the integrity of the securities market.[198]

In reversing the decision of the Second Circuit, the Supreme Court held that "workpapers prepared by an independent auditor . . . [reviewing] . . . corporate financial statements" are not privileged because of the nature of an auditor's role compared with an attorney's.[199] An attorney's role, reasoned the Court, is that of a "confidential adviser and advocate, a loyal representative whose duty it is to present the client's case in the most favorable possible light."[200] By contrast, in "certifying the public reports that depict a corporation's financial status, the independent auditor assumes a *public* responsibility" that trumps any relationship with the client.[201]

The Supreme Court also rejected the Second Circuit's argument that an accountant's privilege was necessary as a procedural safeguard for corporate disclosure.[202] The Supreme Court reasoned that such a privilege was not necessary because a procedural safeguard already existed to prevent corporations from withholding information from auditors (for fear that such information would be accessible to the IRS).[203] By way of example, the Court noted that an auditor has a duty to determine the sufficiency of the tax accrual reserves based on whether the corporation has adequately provided for its contingent tax liabilities.[204] If an auditor thought a corporation was withholding information, reasoned the Court, the auditor could not give an unqualified opinion regarding the accuracy of the corporation's financial statements.[205] In fact, in such an instance an accountant is required to give a

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195. *Frederick*, 182 F.3d at 500.

196. *Arthur Young*, 465 U.S. at 808-09. Tax accrual workpapers are documents relating to the evaluation of reserves for contingent tax liabilites. *Id.* at 808.

197. *Id.* at 810 (citing United States v. Arthur Young & Co., 677 F.2d 211, 219-21 (2d Cir. 1982) (holding that "[a] work-product privilege, similar to the privilege fashioned in *Hickman*, seems to us appropriate")).

198. *See id.*

199. *Id.* at 815-18.

200. *Id.* at 817.

201. *Id.*

202. *Id.* at 818.

203. *Id.*

204. *Id.*

205. *Id.* The Court described the different types of audit opinions:

> An *unqualified opinion*, the most favorable report an auditor may give, represents the auditor's finding that the company's financial statements fairly present the financial position of the company, the results of its operations, and the changes in its financial position for the period

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qualified opinion, indicating potential problems with the corporation's accounting records to the investing market.[206] Thus, because no corporate officer would risk receiving a qualified opinion, the Court reasoned that the integrity of the securities market is protected, and no need existed for an accountant-client privilege.[207]

In addition to the Supreme Court's logic in *Arthur Young*, opponents to an accountant-client privilege provide many other reasons for its disallowance.[208] First, principles of evidence disfavor privileges because privileges prevent the use of highly relevant evidence.[209] According to this rationale, testimonial privileges are only tolerable when they are "within the narrowest limits required by principle."[210] Thus, reasons Professor Wigmore, "there must be good reason, plainly shown, for their existence."[211] Opponents of the accountant-client privilege argue that the differing roles of attorney and accountant are a sufficient reason for prohibiting an accountant-client privilege.[212] For example, unlike an accountant, an attorney is a confidential advisor with a duty of undivided loyalty to his client.[213] The attorney-client privilege aids the attorney in this role because it gives the client the assurance that the attorney will not repeat information relayed to him by the client.[214]

> under audit, in conformity with consistently applied generally accepted accounting principles. See 1 AICPA, Statement on Auditing Standards §§ 510, 511.01 (1973). Alternatively, the auditor may give a *qualified opinion*, which states that the financial statements are fairly presented except for, or subject to, a departure from generally accepted accounting principles, a change in accounting principles, or a material uncertainty. *Id.*, § 512. An *adverse opinion* is a reflection of the auditor's determination that the corporation's financial statements do not fairly present the financial position, results of operations, or changes in financial position of the company in conformity with generally accepted accounting principles; an adverse opinion is issued when the auditor determines that the corporation has materially misstated certain items on its financial statements. *Id.*, § 513. Finally, a *disclaimer of opinion* expresses the auditor's inability to draw a conclusion as to the accuracy of the corporate financial records. A disclaimer of opinion is generally issued when the auditor lacks sufficient information about the financial records to issue an overall opinion. *Id.*, § 514.

Id. at 818-19 n.13.

206. *Id.* at 818.

207. *See id.* at 819.

208. *See* discussion *infra* notes 209-22 and accompanying text.

209. 8 WIGMORE, *supra* note 115, at 73; Flucke, *supra* note 96, at 551 (citing Weil Ceramics & Glass, Inc. v. Work, 110 F.R.D. 500, 504 (E.D.N.Y. 1986)). *See also* Cuno, Inc. v. Pall Corp., 121 F.R.D. 198, 200 (E.D.N.Y. 1988) (asserting that the privilege is "an obstacle to the investigation of truth"); Emily Jones, *Keeping Client Confidences: Attorney-Client Privilege and Work-Product Doctrine in Light of* United States v. Adlman, 18 PACE L. REV. 419, 429 (1998) (arguing that a reason for denying an attorney-accountant-client privilege is a general disfavor of privileges since they "prevent the use of highly relevant evidence").

210. 8 WIGMORE, *supra* note 115, at 73.

211. Jones, *supra* note 209, at 429 (citing 8 WIGMORE, *supra* note 115, at 73).

212. *Id.* (citing *Arthur Young*, 465 U.S. at 816-18).

213. *See Arthur Young*, 465 U.S. at 817. "[A]n attorney's role as the client's confidential adviser and advocate, a loyal representative whose duty it is to present the client's case in the most favorable possible light. An independent certified public accountant performs a different role." *Id.*

214. Upjohn Co. v. United States, 449 U.S. 383, 388 (1981).

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The attorney-client privilege also encourages full disclosure from client to attorney, which allows for more effective advocacy, leading to the efficient administration of justice.[215]

An accountant, it is argued, owes a duty of loyalty to his client, government agencies regulating the client's industry, the client's creditors, and the client's investors.[216] Because of these duties, the *Couch* court held that the accountant-client relationship was not of such a confidential nature as to create an expectation of privacy that would invoke the right against self-incrimination under the Fifth and Fourteenth Amendments.[217] The Court reasoned that "there can be little expectation of privacy where records are handed to an accountant, knowing that mandatory disclosure of much of the information therein is required in an income tax return."[218] Furthermore, reasoned the Court, because an accountant can be criminally prosecuted for preparing a false return, the accountant has great incentive to disclose any information given to him by the client.[219] This ability of an accountant to disclose client confidences, reasoned the Court, precludes a client from claiming any expectation of privacy.[220] Finally, unlike an attorney, a typical role of an accountant is to provide public compliance services, which disclose client financial information to both government agencies and the public.[221] This role is not consistent with that of a confidential adviser.[222]

In spite of the Supreme Court's holding in *Couch*, proponents of the accountant-client privilege continue to argue for a common-law accountant-client privilege.[223] One argument in support of the privilege is that it

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215. *Id.* at 389 (stating that the purpose of the attorney client privilege is to "encourage full and frank communication between attorneys and their clients and thereby promote the broader public interests in the observance of law and the administration of justice").

216. *See Arthur Young*, 465 U.S. at 817 (contrasting the role of the attorney from that of the independent auditor).

217. Couch v. United States, 409 U.S. 322, 325 (1973).

218. *Id.* (distinguishing the facts in *Boyd v. United States*, 116 U.S. 616, 630 (1886) (holding that "any forcible compulsory extortion of a man's own . . . private papers to be used as evidence to convict him of crime" violated the Fifth and Fourteenth Amendments on the grounds that there is little expectation of privacy because of the disclosure to an accountant (emphasis omitted))).

219. *Id.* (citing I.R.C. § 7206(2) (2000)).

220. *Id.*

221. *Arthur Young*, 465 U.S. at 817; *see Couch*, 409 U.S. at 325 (arguing that there can be little expectation of privacy when handing documents to an accountant for filing in a tax return). Opponents to an accountant-client privilege cite the language in *Couch* regarding an expectation of privacy cannot exist when documents are given to an accountant when filing a tax return because all accountants have a public fiduciary role that supercedes the relationship between the accountant and client. *See Couch*, 409 U.S. at 325.

222. *See Arthur Young*, 465 U.S. at 817 (holding that differing roles of auditors and attorneys precludes the extension of a privilege to a client of any accountant). Opponents of an accountant-client privilege cite this section of the opinion for the proposition that the differing roles of auditors and attorneys precludes the extension of a privilege to a client of any accountant. *See id.*

223. Jones, *supra* note 209, at 430 (citing Ronald E. Friedman & Dan L. Mendelson, *The Need for CPA-Client Privilege in Federal Tax Matters*, 1996 TAX ADVISER 154, 155).

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conserves resources.[224] For example, in order to protect certain tax-related communications, a taxpayer is better off not disclosing such information to their tax preparer, thereby requiring the taxpayer to retain separate counsel.[225] This can be duplicative, time consuming, and expensive, especially for small business taxpayers.[226] The lack of privilege also reduces a client's choice of adviser.[227] For example, if the client wants to ensure that the communication is privileged, he must choose a lawyer[228] for advice instead of, or in addition to, an accountant.[229] Third, proponents of an accountant-client privilege argue that because accountants are treated like attorneys for purposes of representing clients before the IRS, all information communicated to the accountants by their clients (in the context of a tax dispute) should be privileged in the federal courts.[230]

Despite continued support for an accountant-client privilege, courts continue to cite *Couch* and *Arthur Young* for the proposition that no common-law accountant-client privilege exists.[231] But in 1998, Congress responded to the lobbying of various accounting interests by enacting Internal Revenue Code (IRC) Section 7525, which creates a statutory accountant-client privilege.[232] While Section 7525 purports to create an accountant-client privilege, its reach is narrow and does not benefit the dual capacity attorney-tax accountant.[233]

2. *Statutory Accountant-Client Privilege*

IRC Section 7525 grants a limited common law protection of confidentiality, similar to that applicable to attorney-client communications, to those communications between a client and a "federally authorized tax practitioner" (FATP).[234] FATPs include certified public accountants, enrolled agents, enrolled actuaries, and attorneys that are authorized to practice before

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224. Friedman & Mendelson, *supra* note 223, at 156.

225. *Id.*

226. *See* discussion *supra* Part II.A (explaining how the utilization of a dual capacity practitioner can cut down on transaction costs—particularly with respect to "search" and "monitoring" costs); Friedman & Mendelson, *supra* note 223, at 156.

227. *See* discussion *infra* Part IV.B.2.

228. *See* Friedman & Mendelson, *supra* note 223, at 156. Or the client could choose a federally authorized tax practitioner (FATP) under IRC § 7525. *See* discussion *infra* Part IV.B.2. In any event, because communications to tax preparers are not privileged, the client would have to seek separate counsel. *See* Friedman & Mendelson, *supra* note 223, at 156.

229. *See* Friedman & Mendelson, *supra* note 223, at 156.

230. *Id.*

231. *See* United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984); Couch v. United States, 409 U.S. 322, 335 (1973).

232. I.R.C. § 7525 (2000).

233. *See id.*

234. *See id.* § 7525(a).

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the Internal Revenue Service (IRS).[235] Under Section 7525, communications between a client and an FATP are privileged "to the extent [that] the communication would be considered a privileged communication if it were between a taxpayer and an attorney."[236] The privilege applies only to communications "with respect to tax advice."[237] The privilege extends to "noncriminal" tax proceedings before the IRS and to civil tax proceedings in federal court "by or against the United States."[238] But the privilege does not apply to "written communication[s] between" a tax advisor and a representative of a corporation "in connection with the promotion" of tax shelters.[239]

While the public's perception of Section 7275 is that it affords a broad privilege between accountants and their clients, the benefits are actually much narrower.[240] Because the privilege applies only to tax matters, nonlawyer FATPs could be required to disclose information revealed in confidential tax planning interviews to other federal agencies.[241] Likewise, a party (other than the United States) opposing a FATP's client could force the FATP to disclose client confidences.[242] Thus, if a client discloses information to a nonlawyer FATP and the information becomes pertinent to any criminal investigation; or the client's civil-tax-matter becomes a criminal matter; or the client becomes involved in any civil matter against another party (other than the United States), the disclosure would not be privileged.[243] Finally, the FATP privilege does not apply in proceedings before state courts or state or local government agencies.[244]

The Section 7525 privilege applies only when the FATP is rendering "tax advice," meaning "advice given by an individual with respect to a matter that is within the scope of the individual's authority to practice" before the

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235. *See id.* § 7525(a)(3)(A) (stating "[t]he 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."); Kayle, *supra* note 128, at 513 (stating that FATPs include CPAs and enrolled agents); PETER H. BLESSING, PRACTICING LAW INSTITUTE, TAX LAW AND ESTATE PLANNING COURSE HANDBOOK SERIES, TAX AND LAW PRACTICE, PRIVILEGED COMMUNICATIONS IN THE CONTEXT OF U.S. TAX PRACTICE 25 (2003).

236. I.R.C. § 7525(a)(1); *see* BLESSING, *supra* note 235, at 25 (citing *Frederick* for the proposition that because section 7525 limits the privilege to those same communications between attorney and client, "tax return preparation as opposed to 'lawyers work' is not covered").

237. I.R.C. § 7525(a)(2)(A)-(B).

238. *Id.*

239. *Id.* § 7525(b).

240. *See* discussion *infra* text accompanying notes 241-43.

241. Lobenhofer, *supra* note 128, at 256.

242. *Id.* (citing Dan L. Mendelson, et. al, *The New CPA-Client Privilege*, TAX ADVISER 676, 679 (Oct. 1998)).

243. *Id.*

244. *Id.* ("In state courts and before state agencies, evidentiary privileges are a matter of state law."). While some states have enacted accountant-client privileges, the privilege afforded by § 7525 is inapplicable. *Id.*

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IRS.[245] "Representation before the Internal Revenue Service focuses on 'presentations to and communications with' the Service, not rendering tax advice."[246] Thus, one could argue that giving tax advice is not covered by the new privilege.[247] While most commentators suggest that this argument is a stretch (it has not yet been used by the IRS), it is still a point to be considered.[248]

Assuming that tax advice is covered by section 7525, trying to determine when an nonlawyer FATP is providing "tax advice," and thus qualifies for the privilege, will be difficult.[249] Generally, neither business advice nor "accountant's work" is considered tax advice protected by the attorney-client privilege.[250] Distinguishing tax advice from business advice is a difficult process that courts address in an ad hoc fashion.[251] Because law firms are in the business of providing legal and tax advice, courts begin an analysis to distinguish tax from business advice (provided by law firms) with the presumption that an attorney's practice and the client's expectation is related to legal advice.[252]

Unlike law firms, accounting firms provide mostly business and nonprivileged accounting services to clients, including business consulting, examination and attestation of financial statements (i.e., auditing), business valuation, and tax preparatory services.[253] Thus, when determining whether a FATP in an accounting firm provided privileged tax advice or nonprivileged business advice, courts will begin with the presumption that the advice is business related.[254] With a presumption of no privilege, the burden would then be on the client to demonstrate to the court in camera that the privilege applies.[255] During this in camera examination, the court would presumably

245. I.R.C. § 7525 (a)(2)-(3)(B).

246. Lobenhofer, *supra* note 128, at 257. *See also* BLESSING, *supra* note 235, at 715 (citing IRS Circular 230, § 10.2(a)) ("Practice before the IRS includes all matters relating to a client's rights, privileges, or liabilities connected with a presentation before the IRS, including preparing and filing necessary documents, corresponding and communicating with the IRS, and representing a client at conferences, hearings, and meetings.").

247. Lobenhofer, *supra* note 128, at 257.

248. *Id.*

249. *Id.*

250. *See* I.R.C. § 7525(a)(1) (stating that tax advice is only privileged "to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney"); United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999) (holding that because accountant's work is not considered legal advice protected by the attorney-client privilege, any overlap between accountant's work and tax advice does not fall under the § 7525 privilege).

251. *See Frederick*, 182 F.3d at 499; *supra* Part III (demonstrating the court's use of ad hoc in camera investigation to determine whether documents relate to business or legal advice).

252. United States v. Chen, 99 F.3d 1496, 1501 (9th Cir. 1996).

253. *See* Lobenhofer, *supra* note 128, at 257.

254. *Id.*

255. *Id.* at 257-58 (citing United States v. Baucus, 377 F. Supp. 468 (D. Mont. 1974); *see id.* at 268 n.82 ("A privilege log, which identifies each document and the grounds for claiming that it is privileged, may take the place of document by document review.").

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exercise increased scrutiny to identify tax advice, which is a smaller, less distinguishable category than either legal or business advice.[256] Because of this increased court scrutiny, a greater possibility exists that documents will be disclosed. Thus, the impact that the new privilege would have on FATPs working in an accounting firm would be that very little information is privileged.[257]

While section 7525 appears to provide an accountant-client privilege by way of statute, it does little work from a practical standpoint.[258] At most, the new privilege protects the tax advice given by a FATP when his client is involved in a noncriminal matter against the IRS in Tax Court or in federal court.[259] Because the privilege is limited to information that would be protected by the attorney-client privilege, information related to tax preparation is not protected.[260] In fact, because courts presume that a tax preparer-FATP primarily performs nonprivileged services, information sent to the tax preparer-FATP would be subjected to greater scrutiny.[261] This would result in very little information being privileged. If given its literal (but possibly absurd) meaning, section 7525 could be interpreted to not apply to tax advice at all.[262] In summary, section 7525 only provides meaningful benefit to the clients of nontax preparer FATPs.[263] Unfortunately, section 7525 does nothing to address the evidentiary privilege problem in the context of a dual capacity attorney-tax accountant.[264]

3. United States v. Frederick: *Dual Capacity Communications and Documents are Not Privileged*

In *United States v. Frederick*, the United States Court of Appeals for the Seventh Circuit reviewed a district court ruling denying the application of the attorney-client and work-product privileges to certain documents possessed by Richard Frederick, an accountant and lawyer, who provided tax preparation and legal services to two individuals (the "taxpayers"), and to their

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256. *See id.* at 258.

> A court doing a similar review for items protected by the new privilege would seek only documents involving tax advice. Because tax advice is a smaller category than legal advice, the review would have to be more exacting, with a greater possibility of documents being disclosed because they involved unprivileged advice.

Id.

257. *See id.* at 257.
258. *Id.* at 255.
259. I.R.C. § 7525(a)(2)(A)-(B) (2000).
260. *Id.* § 7525(a).
261. *See supra* notes 254-55 and accompanying text.
262. Lobenhofer, *supra* note 128, at 257.
263. *See supra* notes 234-62 and accompanying text.
264. *See supra* notes 234-62 and accompanying text.

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company.[265] The court addressed both information sent by the taxpayers to Frederick and documents prepared by Frederick during the course of his dual capacity representation.[266] The documents included "drafts of the returns (including schedules), worksheets containing the financial data, computations required to fill in the returns, and correspondence [between Frederick and the taxpayers] relating to the tax returns."[267]

The court began its analysis by citing *Couch* and *Arthur Young* for the proposition that "[t]here is no common law accountant's or tax preparer's privilege."[268] The court reasoned that because no accountant-client privilege exists, a taxpayer may not receive more protection from a government investigation by hiring a lawyer to do the work that an accountant, another tax preparer, or the taxpayer himself could have done.[269] As policy support for this position, the court explained the reasons underlying both the attorney-client and the work-product privileges and listed how the well-established policies would be compromised by their extension into accounting documents created by attorneys.[270]

The court stated that the purpose of the attorney-client privilege is to encourage people to be candid with counsel when involved in legal disputes.[271] Such candidness, reasoned the court, better enables the attorney to "head off litigation, bring the client's conduct into conformity with the law, or dispel legal concerns that are causing the client unnecessary anxiety."[272] The court stated that "[t]he work-product privilege is intended to prevent a litigant from taking a free ride on the research and thinking of his opponent's lawyer," thereby ensuring that lawyers are not deterred from committing their thoughts to paper.[273] Thus, reasoned the court, because granting a privilege to the accounting documents either prepared or sent to Frederick (a lawyer) would "impede tax investigations, reward lawyers for doing nonlawyers' work, and create a privileged position for lawyers in competition with other tax preparers . . . without promoting the legitimate aims of the attorney-client and work-product privileges," the documents were not privileged.[274]

Separately, the court addressed both the communications made by the taxpayers to Frederick and documents prepared by Frederick in connection

265. United States v. Frederick, 182 F.3d 496, 496 (7th Cir. 1999).

266. *Id.* at 499.

267. *Id.* Some of the communications were for purposes of completing tax returns, and some of the communications were for preparation in connection with an IRS audit. *Id.*

268. *Id.* (citing Couch v. United States, 409 U.S. 322, 335 (1973); United States v. Arthur Young & Co., 465 U.S. 805, 817-19 (1984)).

269. Mason, *supra* note 118, at 423.

270. *Id.*

271. *Id.*

272. *Frederick*, 182 F.3d at 500.

273. *Id.* (citing United States v. Nobles, 422 U.S. 225, 236-39 (1975); Hickman v. Taylor, 329 U.S. 495, 510-11 (1947) (Jackson, J., concurring)).

274. *Id.* (citing Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

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with his services.[275] The court held that communications are not privileged when they do not reflect the legal thinking of the lawyer or are not made for purposes of obtaining legal assistance.[276] Thus, reasoned the court, because tax return preparation is not legal work and because the information sent by the taxpayers was for the purpose of completing their tax return, that information was not privileged.[277]

Although the court ultimately sided with the Service in deciding that privileged status should not be extended to the documents at issue, two of the government's arguments were explicitly rejected.[278] First, the court rejected the argument that information sent to Frederick was not privileged under any circumstances merely "because the information was transmitted to a tax preparer with the exception of its being relayed to a third party, namely the IRS.[279] The court reasoned that because Frederick was both tax preparer and lawyer "it cannot be assumed that everything transmitted to him by the taxpayer was intended to assist him in his tax-preparation function . . . rather than in his legal representation-function."[280] The court also rejected the government's argument that numerical information never falls "within the attorney-client or work-product privilege."[281] The court stated that instances of privileged numbers were rare but imaginable.[282] But the court affirmed the district court statement that " '[i]t cannot be argued that numbers in the hands of the accountant are different from numbers in the hands of a lawyer.' "[283]

Next, the court addressed the application of the work-product privilege to documents prepared by Frederick.[284] Citing *United States v. Arthur Young & Co.*, the court held that "accountants' worksheets" are not privileged.[285] The court then acknowledged the tension created by the fact that Frederick's legal thinking "infected" his accounting worksheets.[286] The court reasoned that by using Frederick for a tax preparer, the taxpayers ran the risk that Frederick's legal thinking would infect any accounting related worksheets, thereby rendering such legal thinking discoverable.[287] Accordingly, the court concluded that a dual purpose document—a document prepared for use in preparing tax returns and for use in litigation—is not privileged because people contemplating litigation would be able to invoke an accountant's

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275. *See id.* at 501-02.
276. *Id.* at 500.
277. *Id.*
278. Mason, *supra* note 118, at 423 (citing *Frederick*, 182 F.3d at 500-01).
279. *Frederick*, 182 F.3d at 500.
280. *Id.* at 501 (citations omitted).
281. Mason, *supra* note 118, at 424.
282. *Id.*
283. *Frederick*, 182 F.3d at 501.
284. *Id.*
285. *See id.* (citing United States v. Arthur Young & Co., 465 U.S. 805, 817-19 (1984)).
286. *See id.*
287. *See id.*

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privilege provided that their attorney completed their tax return.[288] Chief Judge Richard Posner's analysis concluded that the taxpayers' loss of evidentiary privilege was simply the cost of having their tax lawyer complete their tax return; the loss of privilege was simply the "bad" to be taken with the "good."[289] The court concluded this portion of the analysis by extending its reasoning to all privileged communications (in addition to attorney work product).[290] By way of example, the court stated that numbers "bandied about" in a meeting with an attorney-accountant for purposes of obtaining both litigation and tax preparation advice would not enjoy privilege.[291]

After disposing of the broader privilege issues, the Seventh Circuit found that an even more difficult question existed: whether the documents Frederick prepared solely in connection with IRS audits were covered by the privilege?[292] The court "stated that an audit was unique as a possible antechamber to litigation as well as a stage in determining tax liability."[293] But the court noted that taxpayers are usually represented by accountants in audits.[294] Thus, the court reasoned that documents and communications related to audit representation were unprivileged "accountants work," even if the "person rendering the assistance [was] a lawyer rather than an accountant."[295] As policy support for its reasoning, the court claimed that finding otherwise would "create an accountant's privilege only usable by lawyers."[296] In the context of an IRS audit, the court held that a privilege would only apply when the taxpayer was accompanied by a lawyer who was engaged to "deal with issues of statutory interpretation or caselaw."[297] Apparently, Frederick's work did not comport with this requirement, leading the court to conclude that the documents at issue were not privileged.[298]

Finally, the court considered the implications of IRC section 7525 on the documents at issue.[299] The court noted that section 7525 was intended to "protect communications between a taxpayer and a federally authorized tax practitioner 'to the extent the communication would be considered privileged if it were between a taxpayer and an attorney.' "[300] But the court reasoned that "[n]othing in the new statute suggests that these nonlawyer practitioners are

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288. *Id.*
289. *Id.*
290. *See id.*
291. *Id.*
292. Mason, *supra* note 118, at 424.
293. *Id.*
294. *Id.*
295. *Frederick*, 182 F.3d at 502.
296. *Id.*
297. *Id.*
298. *Id.*
299. *Id.*
300. *Id.*

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entitled to privilege when doing other than lawyer's work."[301] Thus, the court implicitly reasoned that because audit representation was "accountant's work" rather than "lawyer's work," section 7525 would not extend a privilege to Frederick's documents.[302] The court concluded its opinion by stating that the district court had made no errors in denying privilege to the "dual-purpose documents."[303]

C. Discussion of the Law Governing Privileged Information in the Context of the Attorney-Tax Accountant

By uncategorically refusing to create a meaningful tax accountant-client privilege, Congress and the federal judiciary have limited the societal benefits that attorney-tax accountants could otherwise provide.[304] For example, while Congress purportedly enacted an accountant-client privilege in IRC section 7525, the privilege is so narrow that it is of no benefit to the dual capacity practitioner.[305] In fact, the section 7525 privilege is limited to tax advice provided during noncriminal litigation against the IRS and then only when such information would also fall under the attorney-client privilege.[306] In addition to congressional denial, the judiciary also continues to uncategorically deny an accountant-client privilege, citing both *Couch v. United States* and *Arthur Young*.[307]

Following the general disapproval of an accountant-client privilege, the Court of Appeals for the Seventh Circuit in *Frederick* denied the attorney-client privilege to a dual capacity attorney-tax accountant, except when the information for which the privilege sought was solely related to the provision of legal services.[308] The resulting policy implications of *Frederick* are that many small businesses will either spend valuable resources to retain both an accountant and an attorney, will risk discovery of sensitive information because they cannot afford both an accountant and an attorney, or will not employ the needed level of professional service.[309] This outcome is not

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301. *Id.*
302. *Id.*
303. *Id.*
304. *See* discussion *supra* Part IV.B.2.
305. *See* discussion *supra* Part IV.B.2.
306. *See* I.R.C. § 7525(a) (2000).
307. *See Frederick*, 182 F.3d at 500.
308. *Id.* at 500-01.
309. *See* TREBILCOCK & CSORGO, *supra* note 62, at Part II.A. Small and medium sized businesses that rarely engage in activities requiring professional services are more likely to resort to an integrated provider of professional services. *See id.* (showing that these types of consumers typically will not pay to assemble a team of separate service providers and incur the resulting higher transaction and monitoring costs). Thus, because of the holding in *Frederick* and because consumers will not pay to assemble a team of separate practitioners, the consumer could be left with the choice of either no representation or sacrificing their evidentiary privileges. *See id.*

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warranted. Contrary to the opinion of Chief Judge Posner, dual capacity tax and legal services should not cost consumers their evidentiary privileges.

The denial of privilege to communications with, and to the work product of, an attorney-tax accountant is not supportable by legal precedent. In addition, this analysis concludes that relevant policy considerations favor an attorney-tax accountant-client privilege.[310] Because no precedent denies attorney-tax accountant-client privileges and because policy considerations favor them, this article proposes that an attorney-tax accountant-client privilege be created.[311] To narrow the inequities that an attorney-tax accountant-client privilege would create between attorney-tax accountants and other tax practitioners, this article proposes that a limited tax accountant-client privilege be created for accredited tax practitioners.[312] Similar to IRC section 7525, this privilege would be limited to noncriminal tax matters against the IRS.[313]

1. Legal Precedent Does Not Support the Denial of an Attorney-Tax Accountant-Client Privilege

In *Frederick*, the court held that because no common-law accountant-client privilege exists, a lawyer doing accountant's work is not entitled to the privilege.[314] As support for that proposition, the Seventh Circuit cited *Arthur Young* and *Couch*.[315] But using these cases to support the proposition that there is and should be no tax accountant-client privilege is questionable. The logic employed in *Arthur Young*, which addressed the accountant-client privilege in the context of an independent auditor, is not applicable to the tax accountant in *Frederick*. In addition, this article shows that the reasons stated by the court for not granting a privilege to a tax accountant in *Couch* have not been properly construed by *Frederick* or by other circuit courts.[316] The conclusion drawn from this portion of the analysis is that no legal precedent exists supporting the uncategorical denial of a common-law tax accountant-client privilege.[317] Because no legal precedent denies a tax accountant-client privilege, the Seventh Circuit's reasoning for denying an attorney-tax accountant-client privilege should not stand.

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310. *See* discussion *infra* Part IV.C.1.
311. *See* discussion *infra* Part IV.C.3-4.
312. *See* discussion *infra* Part IV.C.4.
313. *See* discussion *infra* Part IV.C.4-5.
314. United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999).
315. *Id.*
316. *See* discussion *infra* Part IV.C.1.a.
317. *See* discussion *infra* Part IV.C.1.a.

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a. Arthur Young *and* Couch *Do Not Uncategorically Deny an Accountant-Client Privilege*

In *Arthur Young*, the United States Supreme Court held that workpapers prepared by an independent auditor reviewing corporate financial statements are not privileged because of the nature of an auditor's role compared with an attorney.[318] An attorney's role, reasoned the court, is that of a "confidential adviser and advocate, a loyal representative whose duty it is to present the client's case in the most favorable possible light."[319] By contrast, in "certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility" that trumps any relationship with the client.[320] Under this reasoning, the dual purpose information (i.e., tax accounting and legal advice) in *Frederick* should not have been denied privilege.

The role of the tax accountant, like that of an attorney, is to be a confidential advisor who presents the client's information in the most advantageous manner.[321] Unlike the auditor, who owes a duty to the investing public, the tax accountant does not assume a public responsibility that would supercede his relationship with his client.[322] Thus, because the attorney in

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318. United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984).

319. *Id.*

320. *Id.*

321. A governing principle in tax law is that "[t]axpayers are generally free to structure transactions as they please, even if motivated by tax-avoidance considerations." Estate of Strangi v. Commissioner, 115 T.C. 478, 484 (2000), *rev'd*, 293 F.3d 279 (5th Cir. 2002). Accordingly, the American Institute of Certified Public Accountants (AICPA) states that member tax accountants have a duty to ensure that their clients pay no more taxes than they actually owe. Tax Executive Committee, *Statements on Standards for Tax Services*, 1 AM. INST. OF CERTIFIED PUB. ACCT. 10 (2000) [hereinafter *Statements on Standards for Tax Services*], *available at* http://www.aicpa.org/download/tax/SSTSfinal.pdf. In fact, the AICPA requires that the tax accountant act as an "advocate" for tax positions recommended to the taxpayer. *Id.* In addition, general standards applicable to all accountants require that an accountant "in public practice shall not disclose any confidential client information without the specific consent of the client." AM. INST. OF CERTIFIED PUB. ACCTS., CODE OF PROFESSIONAL CONDUCT 301.01 (1992) [hereinafter CODE OF PROFESSIONAL CONDUCT], *available at* http://www.aicpa.org/about/code/et301.htm. While this requirement of confidentiality will not withstand an "enforceable subpoena" or the "violation of any law," it should be noted that attorneys must also disclose client confidences when "final orders of a court . . . requir[e] the lawyer to give information about the client," when it is necessary to prevent a fraud on the court, and when it is necessary to prevent the perpetration of a fraud on another. *Id.*; MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. 19, 3.3(a)(2), 4.1(b) (2001) (amended 2002). Thus, because a tax accountant has a duty to place his client in the best tax position possible and to maintain confidences commensurate with those of an attorney, the tax accountant's role is more like that of an attorney than an auditor.

322. *See Arthur Young*, 465 U.S. at 817; *Statements on Standards for Tax Services*, *supra* note 321. While the AICPA states that tax preparers owe a duty to the client as well as to the "tax system," an attorney has a similar duty to the tribunal. *Statements on Standards for Tax Services*, *supra* note 321; MODEL RULES OF PROF'L CONDUCT R. 3.3 (2002). These duties are not comparable to the auditor's duty to the investing public. *See* PAUL MUNTER & THOMAS A. RATCLIFFE, APPLYING GAAP AND GAAS § 25.02 (Matthew Bender ed., 2004). For example, the tax accountant and the attorney have a duty of advocacy to their client, which is limited only by a duty to abide by the law within which they operate. *Statements on Standards for Tax Services*, *supra* note 321 (stating that tax accountants owe a duty to the tax system,

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Frederick was practicing as a tax accountant (rather than as an auditor) and because tax accountants, like attorneys, owe duties of loyalty to clients (rather than to the public), *Arthur Young* does not supply a basis for denying privilege in *Frederick*.[323] Furthermore, the policy reason given in *Arthur Young* for not adopting the accountant-client privilege would seem equally inapplicable to *Frederick*.[324] In *Arthur Young*, the court held that the accountant-client privilege was not needed to ensure full disclosure to an auditor in order to better comply with the SEC.[325] The Court reasoned that because of the testing and investigation required of an auditor, less than full disclosure would result in the auditor rendering a qualified audit report, which would have negative effects on company stock.[326] Because management of the company would not risk getting a qualified opinion, full disclosure to the auditors was assured.[327]

This logic employed by the *Arthur Young* Court does not apply to *Frederick*.[328] For example, tax accountants, unlike auditors, are not required to exercise investigative skepticism when dealing with the assertions of their clients.[329] Tax accountants take information from their clients at face value and arrange that information (within the rules of tax law) to the benefit of their client.[330] Auditors, on the other hand, are independent "public watchdogs" who are required to test client assertions in order to opine about whether the assertions are materially correct.[331] In addition, while the auditor produces a red-flag-type report that alerts the investing public regarding whether a client is properly accounting, the tax accountant issues no comparable report to the IRS.[332] Because the tax accountant does not provide a watchdog function,

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but the client is obligated to pay only the taxes that are legally owed; and, as an advocate of his client, the tax accountant has a duty to make sure the client does not pay more taxes than the client legally owes); MODEL RULES OF PROF'L CONDUCT R. 3.3 (2002). By contrast, the independent auditor does not have any duty to advocate a more favorable position for his client. MUNTER & RATCLIFFE, *supra* (quoting Tax Executive Committee, *Statements on Auditing Standards*, 1 AM. INST. OF CERTIFIED PUB. ACCT. § 220.02 (1972) ("[I]n all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.")). The duty of the independent auditor is only to objectively opine on the material accuracy of the company's financial statements for use by the investing public. *Arthur Young*, 465 U.S. at 817-18.

323. *See Arthur Young*, 465 U.S. at 817-18; United States v. Frederick, 182 F.3d 496, 500-01 (7th Cir. 1999).

324. *See* discussion *infra* notes 325-34 and accompanying text.

325. *Arthur Young*, 465 U.S. at 818-19.

326. *Id.*; *see supra* note 109 (discussing the various types of audit opinions that may be given by an independent auditor).

327. *Arthur Young*, 465 U.S. at 818.

328. *See* discussion *infra* notes 329-49 and accompanying text.

329. *Statements on Standards for Tax Services*, *supra* note 321. In preparing a tax return, an accountant may "in good faith rely, without verification, on information [obtained from the client or from] third parties." *Id.* Only if information appears to be "incorrect, incomplete, or inconsistent" is a tax preparer required to investigate further. *Id.* at 22.

330. *Id.*

331. *Arthur Young*, 465 U.S. at 818.

332. *Id.* In the context of the audit, the auditor issues a report to the investing public that is either unqualified—meaning free of accounting problems or qualified—meaning containing accounting problems.

with accompanying consequences, any incentive for the client to disclose information to a tax accountant is not comparable to that between client and auditor.[333] Thus, because the incentive for disclosure that displaced the accountant-client privilege in *Arthur Young* is not present in *Frederick*, it cannot logically be used to refuse the privilege in *Frederick*.[334]

In addition to *Arthur Young*, the *Frederick* court cited *Couch* for the proposition that there is uncategorically no tax accountant-client privilege.[335] After a close reading of *Couch*, it appears that such a proposition may be overly broad. In *Couch*, a taxpayer argued that the "confidential nature of the accountant-client relationship" resulted in an "expectation of privacy" that under the Fifth and Fourteenth Amendments protected certain documents sought by the IRS.[336] The Supreme Court held that it did not.[337] First, the Supreme Court noted that "although not . . . controlling," no accountant-client privilege had been previously recognized at common law.[338] The Court then stated that there was no "justification for such a privilege where records relevant to income tax returns are involved in . . . criminal investigations."[339] Then, the Court refocused on the constitutional issue, reasoning that "little expectation of privacy" exists because the records were handed to an accountant knowing that much of the information would be disclosed on the tax return.[340] Because no expectation of privacy existed, concluded the Court, no violation of the constitutional prohibition against self-incrimination was present.[341]

Several aspects of *Couch* make its broad application problematic.[342] First, the Court does not address whether an accountant-client privilege exists.[343] In fact, the issue in *Couch* was purely constitutional.[344] The *Couch*

Id. at 819. *See also supra* note 109 (discussing the various types of audit opinions). Thus, by means of the audit report, the auditor can alert investors to problems within a corporation's accounting function. *Arthur Young*, 465 U.S. at 819. The tax preparer however, does not have the means to discover nor send the IRS a notice of a taxpayer who did not report all of their income or who has accounting with material errors. *See generally Statements on Standards for Tax Services*, *supra* note 321 (mentioning no analogous red-flag report to be sent to the IRS).

333. *Arthur Young*, 465 U.S. at 818-19.

334. *See id.*

335. United States v. Frederick, 183 F.3d 496, 500 (7th Cir. 1999).

336. Couch v. United States, 409 U.S. 322, 335-36 (1973).

337. *Id.* (citing Falsone v. United States, 205 F.2d 734 (5th Cir. 1953); Gariepy v. United States, 189 F.2d 459, 463-64 (6th Cir. 1951); Himmelfarb v. United States, 175 F.2d 924, 939 (9th Cir. 1949); Olender v. United States, 210 F.2d 795, 806 (9th Cir. 1954)).

338. *Id.* at 335 (citing Boyd v. United States, 116 U.S. 617, 630 (1886)).

339. *Id.*

340. *Id.*

341. *Id.*

342. *See* discussion *infra* notes 343-49 and accompanying text.

343. *See Couch*, 409 U.S. at 335-36 (stating that there is no justification for privileging documents used to prepare an income tax return when those documents are expected to be included in a communication to the IRS—not that there is never an accountant-client privilege).

344. *Id.*

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holding states only that a taxpayer's right against self-incrimination was not violated by requiring his tax accountant to comply with IRS summonses, because no expectation exists that tax information would remain private.[345] The Court does not explicitly state that no accountant-client privilege exists.[346] In fact, the Court implies that an accountant-client privilege could be justified.[347] For example, the Court first recognizes that the absence of an accountant-client privilege is "not in itself controlling."[348] Then, by stating that no "justification" exists for an accountant-client privilege in the context of a "criminal investigation," the Court implies that justification could exist for an accountant-client privilege in other areas (such as civil litigation or government regulations).[349] Thus, because *Couch* addressed the constitutional right to not self-incriminate, rather than the existence of an accountant-client privilege and because the Court implied that situations arise in which an accountant-client privilege could be justified, the Seventh Circuit should not have cited *Couch* for the broad proposition that no tax accountant-client privilege exists.

b. Attorney-Tax Accountant-Client Communication Should Enjoy Privilege, Despite Its Use in Preparing Tax Returns

Many opponents of an attorney-tax accountant-client privilege argue that because information sent to a tax preparer ultimately finds its way into a tax return and because the tax return is disclosed to a third party, the IRS, the privilege is waived.[350] This argument was used by the *Frederick* court to deny privilege to any dual-capacity communication that contained information related to the taxpayer's return sent from the taxpayers to Frederick.[351] But after reviewing the precedent cited in *Frederick* and analogous case law, one could argue that a privilege applies to client and attorney-tax accountant communications even when the communications contain tax return support if that information is not actually disclosed in the return.[352]

Frederick cites *United States v. Lawless* for the proposition that the transmission of information to possibly be used in a tax return destroys the privilege for all the information.[353] In *Lawless*, an attorney-tax preparer argued that the information transmitted to him, but which was not disclosed

345. *Id.*
346. *Id.*
347. *See id.*
348. *Id.*
349. *Id.*
350. *Id.*; United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999).
351. *Frederick*, 182 F.3d at 500.
352. *See id.* at 496-504.
353. *Id.* at 500 (citing United States v. Lawless, 709 F.2d 485, 487 (7th Cir. 1983)).

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on the return, was protected by the attorney-client privilege.[354] But the Seventh Circuit held that "[i]f the client transmitted the information so that it might be used on the tax return, such a transmission destroys any expectation of confidentiality" for all of the transmitted information.[355] While the *Lawless* holding is explicitly clear, it appears to misconstrue the case cited for its reasoning, *Colton v. United States*.[356]

In *Colton v. United States*, the Second Circuit was faced with the similar problem of determining whether information sent to an attorney-tax preparer was privileged.[357] The court held that a "good deal" of the information sent to the attorney, especially information for "inclusion in the tax return," was not privileged.[358] Because the court limited the loss of privilege to information "includ[ed] in the tax return," information sent to the attorney-tax preparer but not included in the return would presumably remain privileged.[359] Thus, one could argue that the Seventh Circuit misinterpreted *Colton* in *Lawless*, and subsequently in *Frederick*, to mean that no information supporting a tax return enjoys privilege, when actually only that information "included" in the return loses privilege.[360] This conclusion is corroborated by the application of the *Colton* proposition in other areas of the law.

This *Colton* proposition—that only information actually disclosed to the public loses privilege—is utilized in the context of patent work.[361] For example, in *In re Spalding Sports Worldwide, Inc.*, a party to a civil action motioned to compel discovery of documents used by a patent attorney in creating a patent application.[362] The issue was whether documents sent from an inventor to a patent attorney retained privilege.[363] The documents were used by the attorney to create a patent application, which was subsequently disclosed to a third party, the U.S. patent office.[364] In holding that the privilege still applied to the documents, the United States Court of Appeals for the Federal Circuit reasoned that "an attorney cannot evaluate patentability or prepare a competent patent application without . . . obtaining relevant technical information from the inventors."[365] Additionally, "[t]he fact that

354. 709 F.2d at 487.

355. *Id.*

356. *Compare id.* at 485-88 (holding all transmitted information not privileged), *with* Colton v. United States, 306 F.2d 633 (2d Cir. 1962) (holding information included in the tax return not privileged).

357. *Colton*, 306 F.2d at 633-40.

358. *Id.* at 638.

359. *Id.*

360. *Compare id.* (holding information in the tax return not privileged), *with Lawless*, 709 F.2d at 496-504, *and* United States v. Frederick, 182 F.3d 496 (7th Cir. 1999) (holding all information transmitted for purpose of preparing tax return not privileged).

361. *See Colton*, 306 F.2d at 633-40.

362. 203 F.3d 800, 802 (Fed. Cir. 2000).

363. *Id.*

364. *Id.*

365. *Id.* at 806.

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much of the technical information in one form or another finds its way into the patent application, to be made public when the patent issues, should not preclude the assertion of the privilege over the communication in which that information was disclosed to the attorney."[366] In so holding, the Federal Circuit appears to say that documents sent from client to attorney do not lose their privileged status, even when some of the information contained on those documents is ultimately disclosed to a third party.[367]

Based on the Seventh Circuit's apparent misconstruction of the holding in *Colton* and the reasoning in *In re Spalding*, one could argue that a document or communication between client and attorney-tax preparer does not lose its privilege, even though some of the information ends up on the tax return.[368] While *In re Spalding* concededly deals with patent applications rather than tax returns, the two areas do share common policy concerns with respect to client confidentiality.[369] For example, it surely is equally as important for our federal tax compliance system to be administered as efficiently as our system of patent registration.[370] Would this desire for efficient administration in the tax system not call for the same full and frank discussion between attorney and client? The answer would appear to be yes. But opponents of any accountant-client privilege argue, among other things, that this privilege would be an unbearable impediment to tax investigations.[371]

2. *Arguments Against an Accountant-Client Privilege and an Attorney-Tax Accountant-Client Privilege*

Opponents to an attorney-tax accountant or tax accountant-client privilege cite Professor Wigmore for the proposition that evidentiary privileges should only be allowed when there is "good reason, plainly shown, for their existence."[372] Opponents argue that no good reason exists for creating a privilege for the clients of a tax accountant or an attorney-tax accountant.[373] First, opponents argue that the fundamental difference between accountants and attorneys precludes the application of an evidentiary privilege to their clients.[374] For example, accountants, unlike attorneys, do not have a duty of undivided loyalty to their clients given that accountants have a duty to the

366. *Id.* (quoting Knogo Corp. v. United States, 1980 U.S. Ct. Cl. Lexis 1262 (Ct. Cl. Trial Div. 1980) and proposing that denying privilege to information communicated to a patent attorney that ultimately finds its way into a patent application would undermine the system of patent registration, by preventing patent seekers from filing the application).

367. *See supra* notes 362-66 and accompanying text.

368. *See Spalding*, 203 F.3d at 802-08; Colton v. United States, 306 F.2d 638 (2d Cir. 1962).

369. *See Spalding*, 203 F.3d at 805-08.

370. *See id.*

371. *See* discussion *infra* Part IV.C.2.

372. Jones, *supra* note 209, at 429-30 (citing 8 WIGMORE, *supra* note 115, at 73).

373. *See* discussion *infra* text accompanying notes 374-85 and accompanying text.

374. Jones, *supra* note 209, at 458-60.

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investing public and a duty to file accurate tax returns.[375] Secondly, opponents argue, because communications between client and tax accountant will be ultimately used to complete tax returns, no expectation of privacy exists.[376] Without an expectation of privacy, no privilege can attach. Third, it is argued that the creation of a tax accountant-client or attorney-tax accountant-client privilege would be an impediment to tax investigations, thereby injuring the tax base.[377] Furthermore, it would be unfair to extend a privilege only to the clients of attorney-tax accountants, rather than tax accountants at large, because it would "create a privileged position for lawyers in competition with other tax preparers."[378] In fact, it was because of this inequity between tax practitioners that IRC section 7525 was enacted.[379] But as previously mentioned, this section only creates a privilege for nontax preparatory advice.[380]

Finally, opponents of an accountant-client or attorney-tax accountant-client privilege argue that the privilege would not further any of the policy reasons underlying the attorney-client or work-product privileges.[381] For example, it is argued that the rationale for the attorney client privilege is to elicit "full and frank communication" between attorney and client.[382] Such full and frank communication will assist the lawyer in giving good advice, "which may 'head off litigation, bring the clients' conduct into conformity with law, or dispel legal concerns that are causing the client unnecessary anxiety or inhibiting him" from being productive.[383] In addition, the attorney-client privilege will prevent an attorney from being subpoenaed to testify against his client.[384] The work-product doctrine is argued to create the desired effect of preventing litigants from taking a free ride off of the opposition's mental impressions.[385]

3. Public Policy Supports Both Attorney-Tax Accountant-Client and Tax Accountant-Client Privileges

Opponents to attorney-tax accountant-client and work-product privileges base their argument on the fact that accountants' work, which is unprivileged,

375. United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984); Couch v. United States, 409 U.S. 322, 335-36 (1973); Jones, *supra* note 209, at 429-30.

376. *Couch*, 409 U.S. at 335-36; Jones, *supra* note 209, at 429-30.

377. United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999).

378. *Id.*

379. Lobenhofer, *supra* note 128, at 244.

380. *See* discussion *supra* Part IV.B.2.

381. *See* discussion *infra* text accompanying notes 382-85.

382. Upjohn Co. v. United States, 449 U.S. 383, 389 (1980).

383. *Frederick*, 182 F.3d at 500.

384. *Id.*

385. *Id.* (citing Hickman v. Taylor, 329 U.S. 495, 510-11 (1947); United States v. Nobles, 422 U.S. 225, 236-39 (1975)).

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taints all privileged information.[386] The basis for denying the tax accountant privilege lies in alleged differences between accountants' duties and attorneys' duties and because all communications to accountants are expected to be disclosed to the IRS.[387] In addition, opponents contend that these privileges would "impede tax investigations . . . and create a privileged position for lawyers in competition with other tax preparers," all "without promoting the legitimate aims of the attorney-client and work-product privileges."[388]

To the contrary, because of the similarities between the duties of tax accountants and attorneys, providing the clients of dual capacity attorney-tax accountants with an evidentiary privilege would be entirely consistent with the spirit of the attorney-client privilege.[389] In addition, that privilege would provide great benefits to the business community, while increasing tax compliance.[390] For example, small businesses, which make up a substantial portion of the U.S. economy, spend a disproportionate amount on tax compliance because they commit a disproportionate amount of tax mistakes.[391] Unfortunately, many of these businesses cannot afford the benefits of both accountant and attorney.[392] Because a dual capacity attorney-tax accountant can provide a higher level of service at lower costs, the practitioner would greatly benefit a large portion of the business community.[393] One downside to be managed, however, is the inequitable effect that an attorney-tax accountant-client privilege would have on other nonattorney tax practitioners.[394] Thus, a limited tax accountant-client privilege should also be created, similar in scope to IRC section 7525.[395]

a. Tax Accountants, Unlike Auditors and Like Attorneys, Owe an Undivided Duty of Loyalty to Their Clients

Opponents of an attorney-tax accountant-client privilege argue that because accountants are public fiduciaries, unlike attorneys who have an undivided loyalty to their clients, any form of accountant-client evidentiary

386. *See id.* at 501 ("[A] dual-purpose document—a document prepared for use in preparing tax returns *and* for use in litigation—is not privileged . . . .").

387. *Id.* at 500 (citing Couch v. United States, 409 U.S. 322, 335 (1973); United States v. Arthur Young & Co., 465 U.S. 805, 817-19 (1984); United States v. Lawless, 709 F.2d 485, 487 (1983)).

388. *Id.*

389. *See* discussion *infra* Part IV.C.3.a (arguing that the similarities in duties between the tax accountant and attorney justify an accountant-client privilege).

390. *See* discussion *supra* Part II.C.

391. *See* discussion *supra* Part II.C.

392. *See* discussion *supra* Part II.A.

393. *See* discussion *supra* Part II.A.

394. *See* United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999) (arguing against granting clients of dual capacity tax accountant-attorneys a privilege because it would place other accountants at a disadvantage).

395. *See generally* I.R.C. § 7525 (2000).

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privilege is inapplicable.[396] The flaw in this argument is that it ignores the difference between accountants who provide attest work and tax accountants.[397] As previously noted, auditors are independent public watchdogs that are required to test client assertions in opining on the material accuracy of these assertions.[398] Auditors have a fiduciary duty to the investing public, above their client, and report on the accuracy of their client's accounting to the investing public.[399] In addition, the tax accountant does not assume a broad public responsibility that would supercede his relationship with his client.[400] In fact, the tax accountant's duty of loyalty and confidentiality to the client is similar to that of the attorney in that the tax accountant's duty is limited only by a duty to the arena in which he operates.[401] For example, while the attorney has a duty of candor to the tribunal that supercedes any duty to his client, the tax accountant has a duty to the tax system that supercedes any duty to his client.[402] Because of ethical concerns related to the differing duties of auditor and tax accountant, many large accounting firms have divested their nonattest services.[403] In summary, the duty of the tax accountant—like that of an attorney—is to be a confidential advisor who advocates his client's position; therefore, a practitioner-client privilege is applicable to the clients of both tax accountants and attorneys.[404]

b. Clients of Tax Accountants Should Expect that Information Not Disclosed on Tax Returns Will Remain Confidential

Clients of tax accountants send information to their practitioner with the expectation that the information will be used in some fashion to produce a tax return or to make tax decisions.[405] But should the use of information to prepare third party documents, namely tax returns, waive all privilege with respect to that information, even when the underlying information is not explicitly included in the document? While the Seventh Circuit has held that any information sent to a tax accountant for purposes of preparing returns is

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396. *See* discussion *supra* Part IV.C.2.
397. *See* discussion *supra* Part IV.C.1.a-b.
398. *See* discussion *supra* Part IV.C.1.a.
399. *See* discussion *supra* Part IV.C.1.a.
400. *See supra* note 386 and accompanying text.
401. *See supra* note 386 and accompanying text.
402. *See supra* note 386 and accompanying text.
403. *See* John Goff, *They Might Be Giants*, CFO MAGAZINE, Jan. 1 2004, *available at* http://www.cfo.com/Article?article=11639 (stating that "45 percent of Big [Four accounting firm] revenues (not profits) came from professional management services, according to the General Accounting Office. In 2002, that slice was closer to 10%"). This is evidence of the Big Four accounting firms divesting their non-attest services because of the inherent conflict between the duties related to the attest function, consulting, and tax advocacy. *Id.*
404. *See* discussion *supra* Part IV.C.3.a.
405. *See In re* J.K. Lasser & Co., 448 F. Supp. 103, 105-06 (D.C.N.Y. 1978).

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not privileged,[406] this article demonstrates that the Seventh Circuit's reasoning is not based on a correct interpretation of legal precedent.[407] In addition, other areas of law addressing the attorney-client privilege hold that only the information actually included in the third-party document loses privilege.[408] Therefore, only the information actually included in the tax return should lose privilege.[409] All supporting calculations and worksheets should remain privileged.[410]

c. An Attorney-Tax Accountant or Tax Accountant-Client Privilege Would Impede Tax Investigations but Would Improve Overall Tax Compliance

An attorney-tax accountant-client privilege would not compromise the integrity of the tax system.[411] For example, in *Arthur Young*, the Court stated that the system of federal taxation "demands that all taxpayers be forthright in the disclosure of relevant information to the taxing authorities," to ensure that the tax burden is "fairly and equitably distributed."[412] In light of the statistics reflecting compliance errors committed by small businesses as well as the disproportionate audits of small businesses, one has to wonder how forthright small businesses currently are.[413] Presumably, most small businesses engage some form of tax preparer to complete their returns. Perhaps if those businesses were assured that their communications were protected from discovery, they would be more forthcoming in providing tax preparers with complete information. Thus, it is plausible that an attorney-tax accountant-client privilege would lead to greater disclosure, greater compliance, and a more fairly distributed tax burden. While such a privilege would concededly impede tax investigations, greater compliance through disclosure will lead to increased treasury revenues, which will outweigh any impediment to tax investigations.

406. *See* United States v. Frederick, 182 F.3d 496, 501 (7th Cir. 1999).

407. *See* discussion *supra* Part IV.C.1.b.

408. *See In re* Spalding Sports Worldwide, Inc., 203 F.3d 800, 806 (Fed. Cir. 2000) (holding that information sent to a patent attorney for purposes of completing and filing a patent application was privileged despite the fact that much of the information made its way into the patent application, which was subsequently made public).

409. *See* discussion *infra* Part IV.C.4.

410. *See* discussion *infra* Part IV.C.4.

411. *See infra* notes 412-13 and accompanying text.

412. United States v. Arthur Young & Co., 465 U.S. 805, 816 (1984).

413. *See* discussion *supra* Part II.C (demonstrating the disproportionate amount of tax mistakes made by small businesses, the higher audit rate of small businesses, and the higher cost of tax compliance spent by these companies).

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d. An Attorney-Tax Accountant-Client Privilege Would be Unfair to Other Tax Practitioners

Concededly, granting an attorney-tax accountant privilege beyond that of other tax accountants would give the attorney a competitive advantage over nonattorney tax practitioners.[414] In fact, it is the fulcrum of this article's argument that clients would prefer dual capacity attorney-tax accountants over sole tax accountants.[415] It is easily foreseeable that clients would prefer a practitioner that could also protect confidences in the face of summonses.[416] In light of this concern, some evidentiary privilege should be extended to all tax accountants.[417]

e. A Tax Accountant-Client Privilege Would Further the Policies of the Attorney Client and Work-Product Privileges

A tax accountant-client privilege would promote the legitimate aims of the attorney-client privilege.[418] The rationale behind the attorney-client privilege is to elicit full and frank communication between attorney and client, ensuring that the attorney will be a more effective advocate, resulting in greater compliance with the law.[419] The *Frederick* court expounded on these reasons, stating that such full and frank communication enables the attorney to "head off litigation, bring the client's conduct into conformity with the law," and "dispel legal concerns that are causing the client unnecessary anxiety."[420] The creation of a tax accountant-client privilege would serve all of these interests. For example, statistics show that small businesses commit a disproportionate share of tax return mistakes and are audited twice as much as other taxpayers.[421] Presumably, this disproportionate share of tax noncompliance is due to insufficient disclosure between clients and tax accountants.[422] But if a tax accountant-client privilege is created, small business taxpayers will likely disclose more to their tax accountant because the disclosures are privileged.[423] With complete disclosure, the tax accountant

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414. *See infra* notes 415-17 and accompanying text.
415. *See* discussion *supra* Part II.
416. *See* discussion *supra* Part IV.C.3.b.
417. *See* discussion *infra* Part IV.C.4.
418. *See infra* notes 419-29 and accompanying text.
419. *See* discussion *supra* Part III.A.
420. United States v. Frederick, 182 F.3d 496, 500 (7th Cir. 1999).
421. *See* discussion *supra* Part II.C.
422. *See* discussion *supra* Part II.C.
423. *See Frederick*, 182 F.3d at 500 (holding that "[t]he attorney-client privilege is intended to encourage people who find themselves involved in actual or potential legal disputes to be candid with [their] lawyer"). Thus, it reasons that taxpayers will likely disclose more information to their tax accountant if the communication is privileged. *Id.*

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will be able to ensure that small businesses comply with the law.[424] Thus, by creating a tax accountant-client privilege, more small businesses will be brought into "conformity with the [tax] law," which will "head off litigation" and "dispel legal concerns that are causing [those businesses] unnecessary anxiety."[425] By improving tax compliance and heading off potential litigation, the tax accountant-client privilege will promote the policies underlying the attorney-client privilege.[426]

In addition to a tax accountant-client privilege, a tax accountant work-product privilege is also supported by policy.[427] The policy behind work-product privileges is to protect mental impressions of attorneys and prevent opposing counsel from riding on the coattails of their opponents.[428] In this context, the work-product doctrine would seem equally applicable. For example, our system of advocacy would be no less served by preventing an IRS attorney from learning of the mental impressions of an attorney-tax accountant than it would by preventing any other litigant from obtaining his opponent's mental impressions.[429]

4. Solution: A Broad Attorney-Tax Accountant-Client Privilege and a Limited Tax Accountant-Client Privilege for Accredited Practitioners

By creating a privilege for the clients of accredited tax practitioners, lawmakers will achieve an overall societal benefit by allowing small businesses to utilize dual capacity practitioners, while (1) furthering the policies of the attorney-client privilege, (2) creating a level playing field for all tax practitioners, and (3) improving the tax compliance system.[430] As previously noted, dual capacity attorney-tax accountants provide enormous benefits to a substantial portion of the United States economy.[431] But because of the historical reluctance to create an accountant-client evidentiary privilege and because courts consider a mixing of accounting and legal communications to render all of the communication unprivileged, the attorney-tax accountant cannot be fully utilized.[432]

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424. *See* discussion *supra* Part IV.C.3.c.

425. *Frederick*, 182 F.3d at 500. Specifically, encouraging full disclosure to the tax accountant would increase compliance and prevent tax controversy litigation, while at the same time allowing the client to engage in a more socially beneficial activity. *Id.*

426. *See* discussion *supra* Part IV.B.3.

427. *See* discussion *supra* Part IV.C.3.

428. *Frederick*, 182 F.3d at 500 (citing Hickman v. Taylor, 329 U.S. 495, 510-11 (1947)).

429. *See generally id.* (considering the extension of the attorney-client privilege to federally authorized tax practitioners).

430. *See* discussion *supra* Part IV.C.3.

431. *See* discussion *supra* Part II.C.

432. *Frederick*, 182 F.3d at 501. The dual capacity attorney-tax accountant cannot be fully utilized to prepare tax returns, engage in tax planning, and be an effective legal advocate because privilege is denied to any commingled communication between practitioner and client and work-product of the practitioner.

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After further investigation, the reasons given by courts and opponents for not extending an evidentiary privilege to an attorney-tax accountant or to a tax accountant are not supportable.[433] This article has demonstrated the fundamental similarities between a tax accountant and an attorney.[434] It has also shown how the tax accountant's duties differ from that of an auditor.[435] Because the tax accountant, unlike the auditor, is an advocate for his client with a duty of confidentiality, the argument that a client of ANY accountant should not enjoy privilege has no force.[436] In addition, concerns by courts and opponents that extending a privilege to clients of tax accountants or attorney-tax accountants will not further the policy of the attorney-client privilege are not warranted.[437] For example, a tax accountant privilege would further the policy of the attorney-client privilege by eliciting full and frank communication between tax accountant and client, thereby resulting in greater administration of the tax compliance system, quelling client concerns, and heading off possible IRS audits.[438] And while a tax accountant or attorney-tax accountant-client privilege would concededly impede tax investigations, the impediments would be offset by placing small businesses in greater compliance with the tax law.[439] Therefore, both attorney-tax accountant-client and tax accountant-client privileges would improve compliance with the tax system, while furthering the policies of the attorney-client privilege, simply by recognizing similarities between attorneys and tax accountants.[440] In order to recognize the fundamental inconsistency between an auditor and an evidentiary privilege, this article suggests only extending the privilege to accountants that do not provide attest services.[441] Given the current trend in large accounting firms of divesting nonattest service lines, this policy would not appear to present an inequity in significant market segments.[442]

Opponents of an attorney-tax accountant-client privilege also argue that such a privilege would create inequity between attorney and nonattorney tax practitioners.[443] Because clients would surely rather employ a practitioner that would be able to protect their confidences, this argument has force.[444] As a

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Id.

433. *See* discussion *supra* Part IV.C.1.

434. *See* discussion *supra* Part IV.C.3.a.

435. *See* discussion *supra* Part IV.C.3.a.

436. *See* discussion *supra* Part IV.C.3.a.

437. *See* discussion *supra* Part IV.C.3.

438. *See* discussion *supra* Part IV.C.3.e.

439. *See* discussion *supra* Part IV.C.3.c.

440. *See* discussion *supra* Part IV.C.3.c.

441. Recognizing the fundamental inconsistency between an auditor and an evidentiary privilege reflects the holding in *United States v. Arthur Young & Co.*, 496 U.S. 805, 817 (1984).

442. *See supra* note 403 and accompanying text (demonstrating the divestment of nonattest services from Big Four accounting). As a result of recent corporate scandals and the ineffectiveness of audits, regulatory bodies will force large audit firms to divest all consulting (including tax consulting) services.

443. *See* United States v. Frederick, 182 F.3d 496, 500-01 (7th Cir. 1999).

444. *See id.* at 500.

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solution, this article proposes that a privilege be extended to both attorney and nonattorney accredited tax practitioners. Accreditation should be required for two reasons. First, by attaining accreditation (for example CPA), the practitioner is under the supervision of a governing body which can ensure that the practitioner understands how to use the privilege and can be disciplined for misuse of the privilege.[445] In addition, requiring accreditation to invoke the privilege will eliminate many preparers serving lower income markets, whose clients will rarely need to invoke the privilege.[446] The nonattorney tax practitioner privilege, similar to IRC section 7525, would only apply to noncriminal tax matters in which the IRS is the opposing party.[447] This would achieve a desirable balance between leveling the playing for all tax practitioners and limiting the extension of the evidentiary privilege beyond the area of taxation. The attorney-tax accountant privilege, similar to the relationship between current tax attorneys and FATPs, would extend beyond civil tax matters to criminal and nontax matters against any opponent.[448]

5. Courts Should Adopt a Predominantly Related Test to Determine if Communications are Privileged

The majority of courts in the United States determine whether privilege applies to attorney-executive-client communications by applying a predominantly related test.[449] This is also the approach taken by the Restatement (Third) of Law Governing Lawyers.[450] Under the predominantly related test,

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445. *See* discussion *supra* Part IV.C.3 (demonstrating that CPAs are governed by codified standards and subjected to state monitoring and disciplinary functions).

446. Jodie T. Allen, *Is the IRS Persecuting the Poor?*, (Apr. 21, 2000), *at* http://slate.msn.com/id/1005162/ (While low income tax payers are audited as much as higher income tax payers (both around 1.5% audit rate), the low income taxpayers are more likely to "face a 'letter exam,' asking for documentation of their claims." These lower income letter exams are in the place of "the time-intensive, face-to-face audit that higher-income filers are subjected to . . . ."). Presumably, these time intensive audits of higher income tax payers are more likely to invoke litigation and a need for privileged information compared to the short, mechanical, and less adversarial letter exam. *See id.*

447. I.R.C. § 7525(a) (2000).

448. *See* discussion *supra* Part IV.B.2.

449. *See* discussion *supra* Part IV.A.1.

450. RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 72, cmt c. (2000) (taking the position that a narrow definition of legal advice is antiquated and should be discarded in favor of allowing attorneys to perform perfunctory services without sacrificing the privilege). The Restatement says,

> Some tasks commonly performed by lawyers require no distinctly legal skill. Some courts in an earlier era determined that the lawyer was then a mere "scrivener" and that communications relating to such tasks were not privileged. The older decisions reflected a culture in which many clients were illiterate and lawyers were employed because they could read and write rather than because of their legal skills or knowledge. But in contemporary practice it will be unusual for a lawyer to prepare a document without communication with the client to determine, at a minimum, the client's objectives. Except in unusual circumstances clearly indicating otherwise, no distinction under this section should be drawn between situations where the lawyer performs perfunctory services and those involving greater complexity or moment.

Id.

courts hold that a mixed legal and nonlegal communication is privileged so long as the communication is predominantly related to the provision of legal services.[451] This test strikes a desirable balance between encouraging dual capacity services, the need for liberal discovery, and the policy reasons underlying the attorney-client privilege. For example, unlike the all-or-nothing test employed by the Seventh Circuit, the predominantly related test allows the dual capacity practitioner to perform some nonlegal services without destroying client privileges.[452] But because the court must find that the predominant reason for the communication was legal, clients are prevented from shielding nonlegal communications simply by funneling them through an attorney.[453] And as previously demonstrated by this article, extending an evidentiary privilege to the clients of an attorney-tax accountant would further the policy underlying the attorney-client privilege.[454]

In the event that courts do not adopt an attorney-tax accountant-client or work-product privilege, courts should adopt the predominantly related test.[455] By employing the predominantly related test, the *Frederick* court would have ensured the integrity of the attorney-client privilege while allowing consumers to reap the benefits of a dual capacity attorney-tax accountant.[456] Such an outcome is socially optimal. Because the predominantly related test would require that communications be more for legal representation than for tax preparation, a taxpayer would not be able to gain a benefit merely by having an attorney fill out their return.[457] In addition, those people who wished to retain dual capacity representation would not lose the benefit of the privilege merely because some of the information in a communication could be related to tax preparation.[458] Finally, contrary to the opinion of the *Frederick* court,

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As an illustration of a perfunctory service that would not preclude the attorney-client privilege, the Restatement includes the following example:

> Client frequently has consulted Lawyer about legal matters relating to Client's growing business. Lawyer drafts documents and provides other legal assistance relating to a complicated transaction having important tax implications that Client and Lawyer identify and discuss. Client later asks Lawyer to prepare Client's federal income-tax return for the tax year in which the transaction occurs. The circumstances indicate that Lawyer is providing legal services in preparing the tax return.

Id. § 72, cmt. c, illus. 3; *cf.* United States v. Frederick, 182 F.3d 496, 499-500 (7th Cir. 1999) (This hypothetical almost mirrors the facts in *Frederick* (but for the impending audit).). If policy makers do not adopt this article's first solution, this predominantly related approach should be considered.

451. *See* discussion *supra* Part IV.A.2.

452. *See supra* notes 172-77 and accompanying text.

453. *See* United States v. Frederick, 182 F.3d 496, 501 (7th Cir. 1999).

454. *See* discussion *supra* Part IV.C.3.e.

455. *See supra* notes 172-77 and accompanying notes.

456. *See Frederick*, 182 F.3d at 500-02; discussion *supra* Part IV.B.3.

457. *See Frederick*, 182 F.3d at 500 (arguing that clients of an attorney-tax accountant should not get a privilege because it would encourage clients to use attorneys to shield otherwise unprivileged tax information).

458. *See id.* at 501 (stating that a dual capacity communication, one that contains legal and tax advice, taints the whole communication rendering none of it privileged).

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extending a privilege to the clients of an attorney-tax accountant would further the policy behind evidentiary privileges.[459] Thus, as an alternative to the solution presented by this article, courts should consider adopting the predominantly related test over the all-or-nothing test.[460]

V. PROTECTING DUAL CAPACITY ATTORNEY-CLIENT COMMUNICATIONS UNDER CONTEMPORARY LAW

A. *Attorney-Executive*

Despite the policy benefits of the predominantly related test, no uniform standard has been employed by the courts to determine what is legal versus nonlegal advice.[461] Thus, counsel should be cautious. By taking the proper steps, dual capacity attorney-executives should be able to provide both business and legal advice while maintaining the full protection of the attorney-client privilege.[462] First, professional legal independence should be achieved by restricting the existence and content of legal assignments to those employees who are required to have knowledge.[463] Restricting legal information to necessary parties can best be accomplished by "routing all legal matters through counsel."[464] This practice of funneling information through legal counsel also minimizes the risk of accidentally disclosing the information to anyone who should not be privy to the legal issues.[465] By preventing the widespread disclosure of legal information, the attorney-executive can head off waiver problems that arise as a result of third parties learning of otherwise confidential communications.[466]

Furthermore, to strengthen the appearance of legality, "the corporation should use legal titles for legal personnel such as Law Department, General Counsel, Attorney at Law, or even Esquire."[467] But if the corporate counsel merely bears a secondary nonlegal title such as "vice-president" this fact should not automatically negate the attorney-client privilege.[468] In addition to maintenance of title, counsel should demonstrate that they are acting in a legal capacity for the corporation through the use of stationary and letterhead that

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459. *See* discussion *supra* Part IV.C.3.e.

460. *See supra* notes 172-77 and accompanying text.

461. Flucke, *supra* note 96, at 549-50.

462. *See* discussion *infra* notes 463-83 and accompanying text.

463. Flucke, *supra* note 96, at 576 n.203 (noting that James T. Haight, *Keeping Privilege Inside the Corporation*, 18 BUS. LAW 551, 556-61 (1963), has "an excellent discussion of some of the procedures attorneys can employ to protect information from unwanted disclosure").

464. *Id.*

465. *Id.*

466. *Id.* at 579.

467. *Id.* at 576.

468. *Id.*

demonstrates this legal capacity.[469] For example, "Legal Department, Office of Corporate Counsel, General Counsel, or Counsel for ABC, Inc. will usually suffice."[470] Also, a case for preserving privilege can be strengthened by stamping documents with language such as "privileged communication," "counsel's work papers" or "for counsel's use only."[471] While courts are not overly influenced by counsel's superficial labeling, the labeling is further evidence of the assertion by the corporation that the legal communications are of a legal nature.[472]

Attorneys should distinguish legal theories and conclusions from general business advice when business and legal communications are commingled.[473] In other words, the nature and purpose of all communications with corporate agents should be documented by attorneys with multipurpose responsibilities.[474] These demarcations should declare that counsel "is acting as an attorney and providing legal advice."[475] For instance, "from the legal standpoint . . ." or "our legal opinion is . . ." will differentiate legal advice from business advice.[476]

Counsel should also "create separate billings for the legal communications compared to those which are more business related."[477] While such extensive documentation regarding the nature of legal advice may present time and money constraint issues, "such defense procedures can only bolster a case."[478] Thus, in determining the amount of time to spend on detailing billings, counsel should consider the cost benefit analysis involved in protecting each item of information.[479]

Finally, the corporation should develop policies for preserving the confidentiality of legal communications.[480] To begin with, all legal files should be kept separate from the company's general corporate files.[481] The corporation should maintain the legal files in a special room or in the counsel's office.[482] File cabinets containing legal documents should be kept locked at all times and only those privy to their contents should have access.[483]

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469. *Id.* at 577.
470. *Id.*
471. *Id.*
472. *Id.*
473. *Id.* at 578.
474. *Id.*
475. *Id.*
476. *Id.*
477. *Id.*
478. *Id.*
479. *See id.*
480. *Id.* at 579.
481. *Id.*
482. *Id.*
483. *Id.*

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To ensure that only privied parties can access the files, the number of people given access to the legal files should be limited.[484]

B. Attorney-Tax Accountant

Until either Congress or the courts address the attorney-tax accountant dual capacity problem, dual practitioners must take extreme care to preserve client evidentiary privileges. Currently, the only way to preserve these privileges is through "careful planning and documentation."[485] For example, when an attorney-tax accountant is retained by a client for tax preparation or legal services, the practitioner should discuss with the client, and confirm in writing, the nature of the services to be performed.[486] More importantly, the dual capacity practitioner should ensure that his legal thinking does not infect any nonlegal documents.[487] For example, practitioners should make sure that documents prepared for dual capacity clients (those that are being represented in both litigation and tax preparation) are segregated.[488] In addition, practitioners need to make sure that meetings with clients are clearly segregated between giving business advice and legal advice.[489] One aid in keeping the meeting bifurcated is agreeing to discuss business related issues, taking a break, and then discussing litigation related issues.[490] "Additionally, dual practitioners should bill the clients separately, when appropriate, for pure tax preparation services as compared to those services more closely related to the provision of legal advice."[491] Because the burden of proving the legal nature of a communication falls on the dual practitioner and his client, these strategies will aid in establishing the attachment of the attorney-client privilege in similar situations to those addressed in *Frederick*.[492]

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484. *Id.*

485. Mason, *supra* note 118, at 431 (citing Flucke, *supra* note 96, at 576-80, for a discussion of various strategies that may be used by the dual practitioner in the corporate context). Mason extrapolates this advice and applies it to the context of the attorney-tax accountant. *See id.*

486. *See id.* (citing Flucke, *supra* note 96, at 576-77, for the proposition that when outside counsel is retained by a corporation, the dual capacity in-house lawyer-executive should confirm in writing whether the representation is for business or legal advice).

487. United States v. Frederick, 182 F.3d 496, 500-01 (7th Cir. 1999) (stating that where legal thinking infects a business document, the legal thinking becomes discoverable by virtue of being commingled with nonprivileged business advice).

488. *See id.*

489. *See id.* at 501. By holding that numbers "bandied about" in a dual purpose meeting would lose privilege, the court applied its tainting theory, which states that commingled legal and business advice renders nothing privileged, to meetings as well as written communication. *See id.* at 501-02.

490. Mason, *supra* note 118, at 432.

491. *Id.*

492. *Id.*

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VI. CONCLUSION

Today's consumer of professional services demands the expertise and efficiency of a dual capacity legal practitioner. Consumers expect those practitioners to maintain client confidences. But courts and legislators have historically opposed extending evidentiary privileges in favor of liberal discovery rules.[493] Currently, no privilege has been extended to communications or documents that do not relate to the provision of legal advice.[494] This creates a problem for courts, practitioners, and clients when mixed business and legal communications between dual capacity attorneys and their clients are summonsed.

In the context of the attorney-executive, courts have developed a test that allows privilege for mixed communications when the purpose of the communication is predominantly legal.[495] This test is preferable from a policy standpoint because it embraces the attorney-executive in his dual capacity, while respecting evidentiary principles and the rationale for the attorney-client privilege.[496] In contrast, courts have not so favorably addressed mixed business and legal communications between the attorney-tax accountant and client.[497]

Historically, lawmakers have avoided the creation of an accountant-client privilege.[498] Presumably, these lawmakers feared the impact it would have on the system of taxation. This fear manifested itself in a recent opinion by the United States Court of Appeals for the Seventh Circuit, which held that communications containing both information for purposes of completing tax returns and for purposes of obtaining legal advice are not privileged because tax preparation is accountant's work, no accountant-client privilege exists, and the mixing of privileged and nonprivileged information taints the whole document.[499] The result of this holding is that the clients of dual capacity attorney-tax accountants lose privilege if any communication or document mixes legal advice with tax preparatory advice.[500] According to the court, loss of evidentiary privileges is simply the cost of dual capacity accounting and legal representation.[501] This result undermines the very synergies that allow the attorney-tax accountant to provide a higher quality product at lower costs.

While the law regarding privilege in the context of the attorney-executive is tolerably balanced; but the law addressing the attorney-tax accountant-client

493. *See* discussion *supra* Part III.A.
494. *See* discussion *supra* Part III.A.
495. *See* discussion *supra* Part IV.A.
496. *See* discussion *supra* Part IV.A.2.
497. *See* discussion *supra* Part IV.B.1.
498. *See* discussion *supra* Part IV.B.2.
499. *See* discussion *supra* Part IV.B.3.
500. *See* discussion *supra* Part IV.B.3.
501. *See* discussion *supra* Part IV.B.3.

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privilege is not.[502] In fact, the Seventh Circuit's rationale for denying an attorney-tax accountant-client privilege cannot be supported by legal precedent or by policy considerations.[503] By creating a broad attorney-tax accountant-client privilege and a limited tax accountant-client privilege, small businesses would fully realize the benefits of dual capacity attorney-tax accountants, while improving overall tax compliance, maintaining the rationale of the attorney-client and work-product privileges, and equitably dealing with all tax practitioners.[504] This type of scheme would achieve an overall societal benefit.[505] In the alternative, courts should apply the predominantly related test (used in the context of the attorney-executive) to privileged issues surrounding the attorney-tax accountant.[506] In the event that no change in the law occurs, dual capacity attorney-executives and attorney-tax accountants should take care to maintain client privileges in the face of current law.[507]

502. *See* discussion *supra* Part IV.
503. *See* discussion *supra* Part IV.C.1-3.
504. *See* discussion *supra* Part IV.C.3.
505. *See* discussion *supra* Part IV.C.4.
506. *See* discussion *supra* Part IV.C.5.
507. *See* discussion *supra* Part V.

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