

The Privilege Two-Step

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In this article, the authors urge the government to take consistent positions in matters regarding privilege in both administrative practice and in litigation in the federal courts.

In recent years the government has become far more aggressive in seeking, and often obtaining, documents from taxpayers for which there is a claim of nondisclosure under the attorney-client privilege or the work product doctrine. It is debatable whether these attempts are justified, as the IRS claims, by its efforts to combat perceived tax shelters. What cannot be debated, however, is that the government holds taxpayers' privilege claims to a higher standard than that by which it defends its own privilege claims. This double standard was on view again last month as a result of an opinion issued by the Court of Federal Claims in *Cencast Services LP v. United States*.¹

The taxpayer in *Cencast* provides payroll services to movie production companies to compensate their production workers. The tax issue before the court was whether the taxpayer should be treated as the workers' employer for FICA and FUTA purposes.² The subject of the court's February 2 opinion and order, however, was a dispute between the taxpayer and the government involving the adequacy of a privilege log provided by the government, claiming that 14 documents sought by the taxpayer were protected by the attorney-client privilege.

Fed. R. Civ. P. 26(b)(5)(A) provides that in order to perfect a privilege claim, a party must "describe the nature of the documents, communications, or tangible things not produced or disclosed — and do so in a manner that, without revealing information itself privileged or protected, will enable other parties to assess the claim."³

¹*Cencast Services, LP v. United States*, Nos. 02-1916T, 02-1917T, 02-1918T, 02-1919T, 02-1920T, 02-1921T, 02-1922T, 02-1923T, 02-1924T, 02-1925T, Doc 2009-24170, 2009 TNT 211-12.

²Doc 2010-2522, 2010 TNT 23-9.

³Rule 26(b)(5) of the Rules of the Court of Federal Claims is identical. Emphasis added.

The government's privilege log contained the following descriptions:

- "Handwritten notes of IRS personnel reflecting legal advice provided by Deborah Reale regarding issuance of 30-day letter."
- "Attorney notes regarding series of meetings involving IRS attorneys, including IRS attorney Neil Shepherd, for purposes of providing legal advice in context of audit."

None of those entries identified the author or the recipient of the document.

On February 2 the court ruled that the government's privilege log was "adequate to determine whether the elements of privilege have been established." While acknowledging that the privilege log at issue was "somewhat skeletal," the court concluded that the log "met the Government's minimum obligations" under Fed. R. Civ. P. 26(b)(5).

One lesson to be learned from *Cencast* is that taxpayers asserting a claim of privilege should consider requesting an in camera inspection of the documents in issue. In making its determination that the IRS's documents were properly privileged, the *Cencast* court relied partly on its in camera review.

The problem exposed by *Cencast* — in the view of these practitioners — is that the government freely maintains inconsistent positions in disputes regarding the attorney-client privilege and the work product doctrine, depending on the identity of the privilege claimant. Based on its conduct in tax audits and tax litigation in recent years, it is clear that the government would not accept from a taxpayer the "somewhat skeletal" privilege log that it produced in *Cencast*.

For example, the IRS Mandatory Tax Shelter Information Document Request demands that a claim of privilege be accompanied by the following:

- "The names, titles, and addresses of all recipients of the documents, including persons to whom the document was made available to [sic] some time after it was created (e.g., the taxpayer's independent auditor)."
- "The subject matter of the document."
- "For any opinion or memoranda . . . the conclusions reached in the opinion or memorandum."⁴

Moreover, before the U.S. District Court for the Middle District of Louisiana last year, the government argued successfully that the taxpayer's privilege log failed to provide sufficient detail for determining whether the documents were truly privileged because the log entries provided only that the documents contained legal advice

⁴Available at <http://www.irs.gov/businesses/corporations/article/0,,id=164592,00.html>.

— the same information the government itself provided in *Cencast*.⁵ By comparison, in response to a discovery request in a case before the U.S. District Court for the Eastern District of Michigan, the government *refused altogether* to produce a privilege log, claiming that doing so would be unduly burdensome.⁶ The IRS also refused to produce a privilege log in a recent case involving a Freedom of Information Act request.⁷

Finally, the government has maintained inconsistent positions regarding the application of work product privilege to documents that are prepared *because of the prospect of litigation* even though they were also prepared for a business purpose. In 2009, in *United States v. Textron*,⁸ the government filed a petition for rehearing asking the *en banc* First Circuit to reconsider the panel's holding that "dual purpose documents created because of the prospect of litigation are protected even though they were also prepared for a business purpose." On what basis did the panel reach this holding? The astute reader will already have guessed that the *Textron* panel followed a prior First Circuit decision in which the government had successfully defended its own work product claim on precisely those same grounds.⁹ Sadly, for those in favor of an even-handed application of the law to governmental agencies and private litigants alike, the *en banc* First Circuit sided with the government. *Textron's* petition for writ of certiorari is pending.¹⁰

The government's inconsistency leads to internal conflicts and, as *Textron* demonstrates, the development of conflicting case law governing privilege disputes. Accordingly, we urge the government to take consistent positions in matters relating to privilege in both administrative practice and in litigation in the federal courts.

⁵*Chemtech Royalty Associates v. United States*, 2009 U.S. Dist. LEXIS 27696 (M.D. La. Mar. 30, 2009), *Doc* 2009-8064, 2009 TNT 66-6.

⁶*Ford Motor Co. v. United States*, 2009 U.S. Dist. LEXIS 62318 (E.D. Mich. July 21, 2009), *Doc* 2009-18223, 2009 TNT 154-15. In that case, however, the court granted the taxpayer's motion to require the United States to supplement its discovery responses by producing an "adequately detailed privilege log," as required by Fed. R. Civ. P. 26(b)(5).

⁷*Batton v. United States*, No. 08-20724 (5th Cir., Feb. 24, 2010), *Doc* 2010-4091, 2010 TNT 38-9 (District Court upheld the IRS's refusal to produce a privilege log in response to a FOIA request; Fifth Circuit reversed).

⁸*United States v. Textron Inc.*, 577 F.3d 21 (*en banc*), petition for cert. filed (U.S. Dec. 24, 2009) (No. 09-750), *Doc* 2009-28371, 2009 TNT 247-9.

⁹*Maine v. United States Dep't of Interior*, 298 F.3d 60 (1st Cir. 2002). (First Circuit upheld government's claim that dual purpose documents created by the U.S. Department of the Interior and the U.S. Department of Commerce were protected by the work product doctrine because such could "be fairly said to have been prepared or obtained because of the prospect of litigation.")

¹⁰See *supra* note 8.

The Cultural Symbolism of the Deductible Skybox

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Because of the advent of scientifically targeted Internet ticket sales and the creation of so-called seat licenses, the deduction limitation in section 274(l)(2) for luxury skyboxes is no longer effective. This is evident by the ubiquity of skybox seating at professional sports arenas, which often reduces the availability of seats for ordinary fans. We recommend that Congress either eliminate the deduction for business entertainment expenses or, as a second-best alternative, place a dollar cap on their deductibility.

A few months ago, as a part of the Shelf Project, we published an article arguing that business expense deductions for entertainment expenses generally should be disallowed.¹ True to other Shelf Project contributions, that piece was designed to present an idea for raising additional tax revenue while improving the overall quality of the tax system.² However, our previous piece was also motivated by a sense that deductibility of business entertainment expenditures creates corrupting influences on the process of doing business and engenders resentment among taxpayers who are not executives or professionals and thus are rarely in a position to have their entertainment costs subsidized by other taxpayers.

This article focuses on one aspect of the business entertainment problem that is especially symbolic for ordinary taxpayers, namely, the ubiquity of luxury skyboxes in professional sports arenas.³ While the development of this phenomenon is attributable to many causes, we focus on the deductibility of luxury box seat purchases as a major contributing factor to their proliferation.

¹Richard Schmalbeck and Jay A. Soled, "Elimination of the Deduction for Business Entertainment Expenses," *Tax Notes*, May 11, 2009, p. 757, *Doc* 2009-8860, 2009 TNT 89-30.

²The Shelf Project, begun in 2007, is the brainchild of Calvin H. Johnson, professor at the University of Texas. See Calvin H. Johnson, "The Shelf Project: Revenue-Raising Projects That Defend the Tax Base," *Tax Notes*, Dec. 10, 2007, p. 1077, *Doc* 2007-22632, or 2007 TNT 238-37 (describing the project's goals and purposes).

³The focus of this article is primarily on the skybox phenomenon as it presents itself in the professional sports context. College sports are not immune to the skybox problem, but the use of luxury seating in college sports is largely designed to cultivate donors, which raises different policy questions.