

Adrift In a Sea of Uncertainty: Tax Accrual Workpapers Are Work-Product . . . But Showing Them to Your Auditor May Waive the Protection

By Jean A. Pawlow and Kevin Spencer

For more than 20 years, the Internal Revenue Service and corporate taxpayers have been embroiled in a battle over the disclosure of tax accrual workpapers. The prize sought by the IRS is a roadmap to the “soft spots” on the tax returns. Taxpayers have been fighting back with some success. In a recent case involving *Textron*, for example, both the trial court and the U.S. Court of Appeals for the First Circuit sustained the taxpayer’s claim of work product protection. The First Circuit’s recent opinion in *Textron*, however, asks as many questions as it answers. Most pointedly, the *Textron* decision begs the question: How do taxpayers best protect themselves against an IRS push for transparency?

First Out of the Gate: *United States v. Textron, Inc.*

Like most large corporations, *Textron, Inc.*’s returns were regularly audited by the IRS, and in seven of the eight previous audit cycles, *Textron* had administratively contested the IRS examiner’s proposed adjustments, with three of those disputes ending up in court. During its examination of *Textron*’s 1998-2001 tax years, the IRS discovered that *Textron* had executed nine sale-leaseback transactions. The IRS contended that the transactions were substantially similar to the “sale in, lease out” or “SILO” transactions that it had “listed” as abusive tax-shelter transactions,¹ and in accordance with its audit policy,² the IRS requested *all* of *Textron*’s “tax accrual workpapers.”³ One of the documents covered by the IRS’s request was a list of items that, in the opinion of *Textron*’s counsel, involved issues that might be challenged because the law was unclear, counsel percentage estimates of success in litigation, dollar amounts reserved per issue if *Textron* did not prevail, and backup workpapers including notes and memoranda written by in-house counsel.⁴ As part of its internal audit process, *Textron* permitted its independent auditor, Ernst & Young LLP, to examine its workpapers with the express understanding that they were to be kept confidential. When *Textron* refused to produce these documents, the IRS issued an administrative summons and the government brought suit to enforce the IRS summons.

1. The District Court Upholds Work-Product Protection

On August 29, 2007, the U.S. District Court for the District of Rhode Island ruled that the IRS could not force *Textron* to turn over its tax accrual workpapers on the ground they were protected under the attorney work product doctrine⁵ and disclosure to *Textron*’s outside auditors did not waive such protection.⁶ The work product privilege, the court explained, applies to material prepared and

gathered “in anticipation of litigation,” but it is a qualified privilege that can be overcome by a showing of “substantial need.”

The court acknowledged that two tests have been used to determine if a document was prepared “in anticipation of litigation.” A minority of courts apply the “primary purpose” test, which protects documents “as long as the primary motivating purpose behind the creation of a document was to aid in possible future litigation.”⁷ The majority of courts have adopted the more inclusive “because of” test, which asks whether the document was prepared or obtained “because of” the prospect of litigation.⁸

Noting that the U.S. Court of Appeals for the First Circuit had adopted the “because of” test,⁹ and that the work product doctrine does not apply if the materials were prepared in the ordinary course of business, the district court stated that it was clear that the workpapers “would not have been created at all ‘but for’ the fact that *Textron* anticipated the possibility of litigating with the IRS.” The court explained that, although the workpapers were useful in providing its auditor with justifications for reserve positions *Textron* took on its returns, the company’s creating the reserve at all was evidence that it anticipated litigation with the IRS. The court explained that *Textron*’s subjective belief was objectively reasonable based upon *Textron*’s litigious history with the IRS.

Moreover, disclosure to Ernst & Young did not waive protection since the purpose of the work product doctrine is “to prevent a potential adversary from gaining an unfair advantage over a party obtaining documents prepared by the party or its counsel in anticipation of litigation which might reveal the party’s strategy or the party’s own assessment of the strengths and weaknesses of its case.” Only disclosures inconsistent with “keeping the information from an adversary constituted a waiver of the work product privilege.”

Textron did not waive its work product privilege by sharing its tax accrual workpapers with Ernst & Young because the disclosure did “not substantially increase the opportunity for potential adversaries to obtain the information.” Under the AICPA Code of Professional Conduct, Ernst & Young had a professional obligation not to disclose client information without *Textron*’s consent, and Ernst & Young expressly agreed not to provide the information to any other party. In distinguishing prior case law, the *Textron* court underscored the point that “E&Y was a truly independent auditor that had no obligation to the IRS to determine whether *Textron*’s tax return was correct and no authority to challenge the return.”

The IRS appealed the district court’s decision to the U.S. Court of Appeals for the First Circuit.

Following on Textron's Coat-Tails

Before the First Circuit could rule in Textron's case, a district court in *Regions Financial Corp. v. United States*, 2008 U.S. Dist. LEXIS 41940 (N.D. Al. May 8, 2008), was asked to decide a substantially similar issue. The court in *Regions* granted work product protection to tax accrual workpapers following much of *Textron's* legal reasoning.

During its examination of *Regions's* 2002 and 2003 tax years, the IRS discovered that *Regions* had executed two sale lease-back transactions. The IRS served a summons on *Regions's* independent auditor seeking information about the transactions. *Regions's* auditor produced approximately 260,000 pages of documents, but at *Regions's* request, withheld 20 documents that were prepared by *Regions's* outside counsel and tax advisers, asserting work product protection. The court conducted an *in camera* review of the withheld documents.

The issue presented to the court was which test ("because of" or "primary purpose") the Eleventh Circuit would apply in determining whether the putatively protected documents were created "in anticipation of litigation." The district court held that if the Eleventh Circuit was forced to decide, it would choose the broader "because of" test. Nonetheless, the court ruled that applying either test would lead to the same result — the documents were protected work product because they were created in anticipation of litigation. The court explained that the critical question was "the purpose for which the documents were created."

The IRS argued that it should succeed even if the court employed the more expansive "because of" test since the tax accrual workpapers were prepared for business reasons; that is to say, they "would have been prepared, even in the absence of the prospect of litigation, to comply with *Regions's* public reporting requirement." The court disagreed and found that "[w]ere it not for anticipated litigation, *Regions* would not have to worry about contingent liabilities and would have no need to elicit opinions regarding the likely results of litigation." The court reasoned that even under the "primary motivating purpose" test the documents would be protected. The court found that the fact that *Regions* "undertook the time and expense of consulting outside firms to assess its potential liabilities shows that it believed litigation to be likely."

Primary to the court's decision was its holding that there was no need to show that the withheld documents were prepared solely for litigation and for no other reason. The court held that documents subject to work product protection can have uses other than solely analyzing the litigation issues. Furthermore, there was no waiver of work product protection when *Regions* disclosed the workpapers since the auditor was not an adversary. The court found that "[t]here is simply no conceivable scenario in which [the outside auditor] would file a lawsuit against *Regions* because of something [the outside auditor] learned from *Regions's* disclosures." The outside auditor was neither an adversary nor a conduit to an adversary.

The IRS appealed the *Regions* decision to the Eleventh Circuit, but on December 22, 2008, *Regions* announced that the case had been settled. As such, the appeal was mooted and dismissed.

The First Circuit Affirms *Textron* But Remands Regarding Waiver

About a month after *Regions* settled with the IRS, the First Circuit

issued its opinion upholding the district court's decision that *Textron's* tax accrual workpapers are protected from disclosure under the work-product doctrine.¹⁰ But the court remanded the case for the district court to determine whether *Textron* had waived the protection by allowing the information to be reflected in Ernst & Young's own workpapers and whether *Textron* had "control" of Ernst & Young's workpapers.

As a preliminary matter, the First Circuit ruled that the "resolution of disputes through adversary administrative processes, including before the IRS Appeal Board, meets the definition of litigation," and as such documents sought during the administrative process could be subject to work-product protection. The First Circuit next turned its attention to whether *Textron's* tax accrual workpapers were created in anticipation of litigation. The court rejected the IRS's "contention that the mere presence of a business or regulatory purpose defeats work-product protection," explaining that "dual purpose" documents created because of the prospect of litigation are protected even though they were also prepared for a business purpose."¹¹ The court found that "the business purpose derives from and is inextricably related to anticipating litigation. That the anticipation of such disputes (and corresponding potential litigation) also triggered certain business and accounting obligations does not bar the protection of the work-product doctrine."

The IRS argued that granting protection runs afoul the decision of the Supreme Court of the *United States* in *United States v. Arthur Young & Co.*¹² In *Arthur Young* the Supreme Court declined to recognize an accountant's work-product privilege, and held that tax accrual workpapers prepared by a taxpayer's independent auditors were not protected from disclosure. The First Circuit in *Textron* distinguished *Arthur Young* explaining it answered a different question — to wit, whether to recognize a new privilege for accountants and, as such, was not controlling.

The First Circuit elaborated on its holding granting protection to *Textron's* documents stating that *Textron's* not having specific litigation in mind when creating the tax accrual workpapers does not bar protection. The court explained "[t]hat *Textron* might ultimately decide not to dispute a specific position does not contradict the conclusion that when it estimated its litigation success, it was anticipating specific litigation." The court found that *Textron* had a subjective belief that litigation was a real possibility and that belief was objectively reasonable. In this context, the court found that *Textron's* history of litigation with the IRS should not be the deciding factor. The court reasoned that, regardless of a taxpayer's history with the IRS, it is the "possibility of a dispute [that] compels them to anticipate litigation so as to prepare and assess their tax reserve funds." A contrary conclusion "would essentially be offering protection only to the cantankerous and combative taxpayer who intends to thoroughly litigate every position."

The IRS also argued that *Textron* waived work-product protection when it disclosed its tax accrual workpapers to Ernst & Young. The court recognized that work product protects disclosure of materials to adversaries (real or potential), so disclosing it "in a way inconsistent with keeping it from an adversary waives work product protection."¹³ The court acknowledged that a number of courts have concluded that disclosure to independent auditors does not waive

work-product protection. The IRS argued that, although it was undisputed that Textron and Ernst & Young were not actual adversaries; they were *potential* adversaries. The court disagreed stating:

While it is possible to imagine circumstances where E&Y's professional obligations could cause E&Y and Textron to come into conflict on some legal question, the IRS can point to no "conceivable scenario in which E&Y would file a lawsuit against [Textron] because of something E&Y learned from [Textron's] disclosures."

In contrast, "disclosure to a conduit to a potential adversary can also waive work-product protection," which "occurs upon disclosure to a third party that 'substantially increased the opportunities for potential adversaries to obtain the information.'"¹⁴

Although Ernst & Young might have a professional obligation to keep Textron's documents and information confidential, the IRS argued that the accounting firm may be required to turn over documents to the SEC, disclose information to protect Textron's stockholders, and disclose the information in response to a valid IRS subpoena. In responding to the IRS's argument, the court acknowledged that Ernst & Young did not retain a copy of Textron's workpapers. There was evidence, however, that the accounting firm used the putatively protected documents, "together with its own expertise, in preparing its own assessment of Textron's reserve tax liability." Thus, "the only remaining documents which could be subjected to a risk of discovery are E&Y's own assessment, which incorporate Textron's analysis." Since Ernst & Young's documents may be discoverable, whether such disclosure would substantially increase the risk that the contents of Textron's workpapers would be disclosed to an adversary may weigh on whether Textron's workpapers are protected. As such, the court remanded the case to the district court to determine to what extent the disclosure of E&Y's workpapers "would effectively constitute disclosure of Textron's own assessment."

The IRS's subpoena for documents also sought tax accrual workpapers prepared by Ernst & Young within the "possession, custody, or control of Textron or its accountants." Because the district court failed to rule on their discoverability, the First Circuit remanded the issue to the lower court. In sending the issue back, the First Circuit addressed Textron's argument that it cannot produce documents over which it does not have "possession, custody, or control." In responding to Textron's argument, the court explained that "so long as the party has the legal right or ability to obtain the documents from another source upon demand, that party is deemed to have control."¹⁵ The court remanded the issue "to determine the factual question of whether Textron can obtain E&Y's workpapers."^{15A}

Textron's Waiver Holding Undermines Work-Product Protection

At first blush, the First Circuit's decision seems like a substantial taxpayer victory. But the court's discussion on waiver may in fact significantly undermine its affirmation of the district court's holding that tax accrual workpapers are protected by the work product doctrine.

The First Circuit's ruling intimates that if any of the protected information is reflected in documents contained in Ernst & Young's

files, there is waiver in respect of Textron's workpapers. This is an unworkable standard and arguably raises more questions than it answers. For instance, what amount of taxpayer information must be found in the accounting firm's documents to trigger a waiver? Must the accounting firm's workpapers contain the taxpayer's information verbatim to constitute a waiver? Or is it sufficient that, looking at the documents side-by-side, a reasonable person could proclaim that the substance of the protected material has found its way into the auditor's files and thus the protection is waived?

The First Circuit fails to give taxpayers (and the trial court) any guidance on how much information spillage is too much. This *ad hoc* approach to determining whether work product protection has been waived is likely to lead to inconsistent results as trial courts and magistrates struggle to determine when the scale is tipped in favor of waiver. The First Circuit's formulation continues to obscure what should otherwise be a bright line test, and will require an *in camera* inspection of the auditor's and taxpayer's workpapers in each case where work-product protection is asserted.

The First Circuit's ruling also incorrectly presumes that E&Y would not be able to claim privilege on selective portions of its audit workpapers that might possibly reflect Textron's work product. In a typical case where an independent auditor is summoned by the IRS to disclose its workpapers,¹⁶ section 7609 of the Internal Revenue Code requires that the IRS give the taxpayer notice of such summons. Section 7609(b) also gives the taxpayer standing to intervene and to move to quash the summons to preserve any and all privileges (such as work product) it may have over such documents.¹⁷ Although the auditor might be required to turn over its documents, typically the auditor and taxpayer will work together to ensure that any privileged material is redacted prior to disclosure and that the appropriate privileges are timely asserted.

Furthermore, the First Circuit's remand to weigh the amount of information spillage lies on shaky and questionable legal grounds. For support of its position, the First Circuit relied on the district court decision in *In re Raytheon*.¹⁸ In that case, the plaintiff moved to compel Raytheon to disclose audit opinion letters and other documents prepared by its attorneys and provided to its independent auditor. The magistrate held that work-product protection had not been waived by disclosure.

In reviewing the magistrate's findings, the district court in *Raytheon* stated that "the pivotal question is whether disclosure of documents protected by the work product doctrine to an independent auditor substantially increases the opportunities for potential adversaries to obtain the information." The court, quoting *Arthur Young*, described the role of an independent auditor as:

By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.

The court rejected the plaintiff's argument that any disclosure to an independent auditor constituted a waiver. Since the record failed to show "the scope of the litigation information an independent auditor or audited company can reasonably be expected to disclose in public financial reports," however, the court in *Raytheon* ordered the production of the documents for an *in camera* review of the documents.

The cases cited by the *Raytheon* court underscore the confused state of the law in the application of the waiver doctrine as it applies to documents disclosed and used by a taxpayer's independent auditor. For example, in *In re Pfizer, Inc. Securities Litigation*,¹⁹ a discovery dispute arose over whether work product protection was waived by the disclosure of workpapers, among other documents, developed by in-house counsel showing the amount of reserves retained by the corporation in connection with certain product liability litigation, and which were shown to Pfizer's independent auditor. After an *in camera* review, the court determined that the primary motivating purpose behind the creation of the workpapers was for the preparation for litigation. In finding that work product protection had not been waived, the court held that Pfizer and its independent auditor "obviously shared common interests in the information, and [the independent auditor] is not reasonably viewed as a conduit to a potential adversary" despite the auditors use of the information for "public reporting."

In contrast is the decision of *Samuels v. Mitchell*²⁰ cited in *Raytheon*. In *Samuels*, documents prepared by the plaintiff or its outside counsel in connection with a private arbitration proceeding were disclosed to its accounting firm, Ernst & Young. The defendant sought discovery of the documents and the plaintiff asserted they were protected by the work product doctrine. The court in *Samuels* wrestled with the question whether the disclosure to Ernst & Young waived work product protection. Citing *Arthur Young*, the court acknowledged that the role of the public accountant to which the document was disclosed weighs heavily on whether there is a waiver. Finding that the accounting firm was "not acting as [the plaintiff's] public accountant during the arbitration, but as a consultant," the court held the documents were protected from disclosure.

The most careful analysis of waiver in the context of disclosure to an independent auditor is articulated in *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*²¹ In that case, Merrill Lynch disclosed two internal investigation reports to its independent auditor to "identify any potential internal control, accounting or audit issues." A third party sued Merrill Lynch and sought copies of the internal reports. Merrill Lynch resisted, arguing that the documents were protected by the work product doctrine. The primary issue presented to the court was whether Merrill Lynch had waived work product protection by disclosing the reports to its auditor.

The court recognized that courts are split on whether disclosure of information to an independent auditor automatically waives work product protection. In finding no waiver, many courts have noted that "where the disclosing party and the third party share a common interest, there is no waiver of the work product privilege."²² Other courts have looked at the role of an independent auditor as determinative of whether protection has been waived.²³

After surveying the relevant case law, the court in *Merrill Lynch* concluded that the inquiry whether work product protection has

been waived "must not end with the mere fact of a disclosure to the independent auditors."²⁴ The court pointed out that the crucial inquiry is whether the auditor "should be conceived as an adversary or a conduit to a potential adversary."²⁵ The court acknowledged an auditor's "important public function to independently ensure the accuracy of a company's financial reports." But to waive work product protection, a "tangible adversarial relationship" is required to be shown.²⁶ In holding that Merrill Lynch had not waived work product protection, the court highlighted that the auditor was under ethical and professional obligations to maintain the information received from its client as confidential. The court explained that to create "a blanket rule of waiver . . . could very well discourage corporations from conducting a critical self-analysis." Instead, "the aim should be for corporations to share information with their auditor's to facilitate a meaningful review and, ultimately, the availability of more accurate information for the investing public."

In *Textron*, there was no evidence that Ernst & Young was an adversary or a conduit to an adversary. The possibility that E&Y might (hypothetically) have to disclose the substance of Textron's workpapers is not sufficient to support waiver. As explained by the court in *Merrill Lynch*, "[t]he only public revelation [from disclosure of the protected documents was] a general statement [from the auditors] regarding its inability to accurately evaluate Merrill Lynch's financial statements due to internal control deficiencies." From the evidence provided to the lower court, Textron and Ernst & Young shared a common interest in keeping the workpapers private. In fact, the accounting firm was under express and implicit duties to do so. That the IRS could have subpoenaed Ernst & Young's workpapers does not acknowledge Textron's statutory right to seek the non-disclosure of those documents.

What About FIN 48 Documents After Textron?

On July 13, 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*.²⁷ FIN 48 requires a two-step process. First, the taxpayer must determine whether a tax position will more likely than not be sustained upon examination based on the technical merits of the position and assuming that the IRS has complete knowledge of the facts. The second step is to measure the uncertain tax position. For any tax position that clears the first hurdle (*i.e.*, it will more likely than not be sustained), the position is valued as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

Many accounting firms require their clients to disclose the documents prepared by them and their advisers to comply with FIN 48. The IRS treats FIN 48 workpapers as tax accrual workpapers, thereby making them open to disclosure.²⁸ Arguably, FIN 48 tax accrual workpapers serve a "dual purpose" and should be protected under the First Circuit's *Textron* decision even though the FIN 48 analysis is required. Given the First Circuit's holding on waiver, it is unclear whether disclosing a FIN 48 opinion to your independent auditors will waive the work product privilege.

State Tax Development

On March 3, 2009, the Massachusetts Supreme Court ruled that the

work product doctrine protected from disclosure communications between an in-house corporate counsel and outside tax accountants consulted by him regarding the structuring of a sale of stock transaction.²⁹ The in-house counsel sought the accountants' assistance to help him "interpret Massachusetts law" to assess the risks of and exposure to litigation for any various forms of a stock sale. The accountants prepared memoranda discussing the "pros and cons of the various planning opportunities and the attendant litigation risks." The Massachusetts Commissioner of Revenue sought the documents as part of a state excise tax case against Comcast.

The court held that the accountants' memoranda were protected by the work product doctrine. Applying the "because of" test, the court held that the accountants' memoranda would not have been prepared "irrespective of the prospect of litigation." As such, the documents were protected from disclosure.

Expect and Be Prepared For a Summons

Although the First Circuit's *Textron* decision has created substantial uncertainty regarding the risk of waiver resulting from disclosing tax accrual workpapers to the company's independent auditor, the following are a few guidelines that may assist taxpayers in successfully asserting work-product protection:

1. Although work product protection does not require the presence or participation of an attorney, nonetheless it may strengthen the taxpayer's case if an attorney has prepared them. Involving the company's General Counsel or in-house tax counsel in creating or reviewing the workpapers will go a long way to establishing that the documents were prepared in "anticipation of litigation."
2. Similarly, involving outside counsel in determining the company's tax exposure is a good indication that there is a genuine concern that litigation might ensue.
3. Ideally, tax accrual workpapers should only consist of counsel memorandum and opinion and hazards of litigation analyses, and not business and transactional records.
4. Store business and transactional records separate and apart from tax accrual workpapers. Furthermore, tax accrual workpapers should be conspicuously labeled and treated as confidential and privileged. Limit access to the workpapers, including electronic access. This could include password protecting confidential electronic documents and email communications.
5. Do not allow the independent auditor to retain a copy of the company's tax accrual workpapers.
6. If tax accrual workpapers are shared with the company's outside auditor, make sure to enter into a written confidentiality agreement in which the auditor promises to keep the substance of the documents confidential and will not disclose the documents without the prior, express consent of the company. The agreement should also indicate that the auditor will not copy or make reference to the contents of the workpapers in the preparation of its audit workpapers.
7. Review the outside auditor's document retention policies. The engagement letter should specify that taxpayer's rights regarding access and control over any files.

8. Cooperate with the IRS by furnishing to it all non-privileged information and documentation in a timely manner.

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1. See IRS Notice 2005-13, 2005-9 I.R.B. 630.
2. For tax returns filed on or after July 1, 2002, the IRS will routinely seek tax accrual workpapers that pertain only to the listed transaction for the year under examination if the taxpayer properly disclosed the transaction on its tax return. If the taxpayer did not properly disclose the listed transaction, or if the taxpayer claimed tax benefits from multiple listed transactions, the IRS has discretion to request all tax accrual workpapers for all years under examination. See Announcement 2002-63, 2002-2 C.B. 72; I.R.M. 4.10.20.3.2.3 (1/15/2005).
3. There is no "immutable definition" of the term tax accrual workpapers, so they will differ from corporation to corporation and case to case. The IRS defines the term in the Internal Revenue Manual as:
[T]hose audit workpapers, whether prepared by the taxpayer, the taxpayer's accountant, or the independent auditor, that relate to the tax reserve for current, deferred and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to footnotes disclosing those tax reserves on audited financial statements. These workpapers reflect an estimate of a company's tax liabilities and may also be referred to as the tax pool analysis, tax liability contingency analysis, tax cushion analysis, or tax contingency reserve analysis.
I.R.M. 4.10.20.2 (7/12/2004).
4. "The first step in preparing the workpapers is that *Textron's* accountants circulate to *Textron's* attorneys a copy of the previous year's tax accrual workpapers together with recommendations regarding their proposed changes and/or additions for the current year. *Textron's* attorneys review those materials, propose further changes to the spreadsheets and hazard litigation percentages which are returned to the accountants who compile the information and perform the mathematical calculations necessary to compute the tax reserve amounts. The attorneys and accountants, then, meet to give their approval so that the accountants may finalize the workpapers." *Textron, Inc. v. United States*, 507 F. Supp.2d 138, 143 (D.R.I. 2007).

5. See Fed. R. Civ. P. 26(b)(3).
6. The court also held that the workpapers were privileged under the attorney-client privilege and the so-called tax practitioner-client privilege, but that Textron had knowingly waived both privileges when it provided the documents to Ernst & Young.
7. See *United States v. El Paso Co.*, 682 F.2d 530, 542 (5th Cir. 1982).
8. See *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998).
9. See *Maine v. Department of the Interior*, 298 F.3d 60, 68 (1st Cir. 2002).
10. *United States v. Textron, Inc.*, 2009 U.S. App. LEXIS 1538 (1st Cir. 2009). In a partly dissenting opinion, Judge Boudin argued that “tax accrual work papers are not protected because they are prepared for reasons independent of the need to prepare for or conduct litigation.”
11. Cf. *Valero Energy Corp. v. United States*, 100 AFTR2d 6473 (N.D. Ill. 2007) (an *in camera* review of documents summoned from independent auditor were not entitled to work product protection since they were not created “because of” the possibility of litigation; instead they were prepared in the ordinary course of a transaction in which the parties needed to quantify their risk and exposure with respect to involvement in certain tax shelter transactions). The case is currently on appeal to the Seventh Circuit to address the limited issue of the application of the tax practitioner privilege.
12. 465 U.S. 805 (1984).
13. See, e.g., *Regions Financial Corp. v. United States*, 2008 U.S. Dist. LEXIS 41940, at *27-28 (N.D. Ala. May 8, 2008); *Lawrence E. Jaffe Pension Plan v. Household International, Inc.*, 237 F.R.D. 176, 183 (N.D. Ill. 2006); *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 448 (S.D.N.Y. 2004), *aff’d and rev’d in part*, 500 F.3d 171 (2d Cir. 2007). But see *Medinol v. Boston Scientific Corp.*, 214 F.R.D. 113, 116-17 (S.D.N.Y. 2002).
14. Citing *In re Raytheon Securities Litigation*, 218 F.R.D. 354 (D. Mass. 2003).
15. Taxpayers should take particular note of the holding because the IRS routinely asks in IDRs for documents that are in the taxpayer’s “possession, custody, or control.” Such documents might include not only documents in the accountant’s files, but also documents in the files of other professionals, like law firms and investment bankers.
- 15A. On February 23, 2009, Textron sought a rehearing in the First Circuit on the grounds its decision “is inconsistent with the definition of conduit and with the protections” that the court afforded to Textron, and on March 6, the government filed its own request for reconsideration of the decision on the ground that the workpapers were protected by the work product privilege.
16. See I.R.C. § 7602.
17. See, e.g., *Zugerese Trading, LLC v. United States*, 102 AFTR 2d 5658 (E.D. La. 2008).
18. 218 F.R.D. 354 (D. Mass. 2003).
19. 1993 U.S. Dist. LEXIS 18215 (S.D.N.Y. 1993). See also *Gutter v. E.I. DuPont de Nemours & Co.*, 1998 U.S. Dist. LEXIS 23207 (S.D. Fla. May 18, 1998) (“Disclosure to outside accountants waives the attorney-client privilege, but not the work-product privilege, since the accountants are not considered a conduit to a potential adversary.”)
20. 155 F.R.D. 195 (N.D. Cal. 1994).
21. 229 F.R.D. 441 (S.D.N.Y. 2004), *aff’d and rev’d in part*, 500 F.3d 171 (2d Cir. 2007).
22. *In re Pfizer, Inc. Securities Litigation*, 1993 U.S. Dist. LEXIS 18215 (S.D.N.Y. 1993); *Gutter v. E.I. DuPont de Nemours & Co.*, 1998 U.S. Dist. LEXIS 232207 (S.D. Fla. May 18, 1998); *Gramm v. Horsehead Industries, Inc.*, 1990 U.S. Dist. LEXIS 773 (S.D.N.Y. Jan. 25, 1990).
23. *Samuels v. Mitchell*, 155 F.R.D. 195, 201 (N.D. Cal. 1994) (deciding that disclosure did not constitute waiver of the work product doctrine because the accounting firm was acting as a consultant, not a “public accountant”); *Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113, 116 (S.D.N.Y. 2002) (finding waiver of work product protection because independent auditors “must not share common interest with the company they audit.”).
24. See also *In re Steinhardt Partners*, 9 F.3d 230, 236 (2d Cir. 1993) (declining to adopt *per se* rule regarding disclosures to auditors).
25. “Under the so-called ‘conduit theory,’ communications made to an attorney with the understanding that the information will be conveyed to third parties is not protected by the attorney-client privilege.” *United States v. Edison*, 2008 U.S. Dist. LEXIS 6825, *6 (N.D. Cal. 2008), citing *United States v. Tellier*, 255 F.2d 441, 447 (2d Cir. 1958).
26. Cf. *United States v. Massachusetts Institute of Technology*, 129 F.3d 681 (1st Cir. 1997).
27. FIN 48 is an interpretation of FASB Statement No. 109 and relates to how financial reserves are calculated and disclosed for uncertain tax positions. For tax years beginning after December 15, 2006, all enterprises subject to GAAP must perform a special evaluation for uncertain tax positions.
28. See *FIN 48 and Tax Accrual Workpaper (TAW) Policy Update LMSB Commissioner Memorandum*, LMSB-04-0507-044 (May 10, 2007).
29. *Massachusetts Commissioner of Revenue v. Comcast Corp.*, No. SJC-10209 (Mass. Mar. 3, 2009).