

PUBLICATION

CPAs and Privileged Communications [Ober|Kaler]

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Accountants may encounter issues regarding the privilege of client confidentiality in three general contexts. The first is codified in Sec. 7525, which covers tax advice between a taxpayer and a federally authorized tax practitioner. However, the Sec. 7525 privilege is limited by a number of important exceptions. For example, the privilege applies only in civil matters and may not be invoked in criminal cases.

The second context in which accountants may encounter privilege is when they prepare materials, such as reports, in preparation for litigation. These materials may be covered by a privilege referred to as the work-product doctrine. Here, too, the privilege has a narrow application. The doctrine generally applies only to the tangible materials produced in preparation for litigation, not to the communications or information contained in the materials. This means that a memo an accountant drafts in preparation for litigation may be protected by the work-product doctrine but not the communications the attorney had with the accountant regarding the project.

The third context is the attorney-client privilege. This privilege affords the most protection, as it applies in both civil and criminal cases. Furthermore, it protects communications and information, as well as prepared materials. While this privilege is generally limited to communications between attorneys and their clients, it may extend to accountants in limited circumstances. This third context is the focus of this item.

The attorney-client privilege has been called the bedrock of the legal profession. Originating in common law, it is the oldest doctrine protecting communications from being disclosed in court. As stated in *Upjohn Co.*, 449 U.S. 383, 388 (1981), the purpose of the attorney-client privilege is to encourage “full and frank communication between attorneys and their clients.” Even though the privilege was traditionally reserved for attorneys, as the world became more complex, the courts expanded privilege beyond attorneys to include accountants in certain situations.

Appreciating the details of how and when privilege applies to accountants will aid tax practitioners, as attorneys are increasingly turning to accountants for assistance. This item first provides a general background on how the attorney-client privilege applies to accountants, then discusses how to structure (1) the accountant's relationship with the attorney and the taxpayer and (2) the nature of the accountant's participation in the taxpayer's affairs, with a goal of ensuring that communications with the accountant are protected by the attorney-client privilege.

Background on the Attorney-Client Privilege and Its Application to Practitioners

Generally, attorney-client privilege protects only a communication that is (1) between a client and the attorney, (2) made in confidence, and (3) made for the purpose of securing legal advice. Communications between a taxpayer and a nonlawyer accountant acting alone are not covered by the attorney-client privilege. Therefore, if a taxpayer brings an accountant along to a meeting with the taxpayer's attorney to provide emotional support or advice, the conversations in the meeting are generally not privileged. The presence of the accountant (or any third person) is presumed to mean that the communications were not made in confidence.

Kovel, 296 F.2d 918 (2d Cir. 1961), extended the attorney-client privilege to accountants who are assisting attorneys. Louis Kovel, a nonattorney, was a former IRS agent who was employed at a law firm that specialized in tax law. In 1961, Kovel was subpoenaed before a grand jury investigating one of the law firm's clients. Kovel refused to testify about communications he had with the client and asserted that the communications were protected by the attorney-client privilege. The court held him in contempt and sentenced him to one year in jail. Kovel appealed the sentence to the Second Circuit. The appeals court sided with Kovel and held that the communications were indeed privileged.

The court analogized Kovel to an interpreter who is necessary for the attorney to communicate with a client who speaks a language the attorney does not understand. As the court noted, "Accounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases." Therefore, reasoned the court, "the presence of the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer." *Kovel* extended the attorney-client privilege to communications involving an accountant when the accountant is (1) "necessary" or "highly useful" for (2) the lawyer to provide the client with legal advice.

Determining if the accountant meets the elements of being necessary or highly useful for providing legal advice depends on the facts and circumstances of each case. The inquiry largely focuses on whether the accountant was assisting the attorney to provide legal advice to the taxpayer or instead was providing the taxpayer with accounting or tax advice. If the court determines that the accountant was providing the taxpayer with accounting or tax advice, the privilege does not apply. Courts examine the structure of the relationship between the accountant, attorney, and taxpayer and the nature of the accountant's work. As such, it may be harder to show that the accountant was necessary if the attorney is experienced and knowledgeable in the area the accountant is working on.

It is noteworthy, however, that there are no uniform rules for making the determination. Courts in different jurisdictions consider different criteria for determining when an accountant is necessary to facilitate communications between lawyers and clients. The courts also have different methods for determining whether an accountant is assisting the lawyer or the taxpayer. Even within the same jurisdiction there can be different standards. This lack of uniformity makes it difficult to predict how a court will rule in a given case and act accordingly. However, practitioners and attorneys can take certain precautions to increase the likelihood that a court will extend the attorney-client privilege to the accountant.

Practical Steps for Protecting Taxpayers' Communications

To ensure that all communications between a taxpayer and an accountant are privileged, the attorney and the accountant should carefully structure their relationship. Preferably, the taxpayer should not meet with the accountant before retaining the attorney, as communications between the taxpayer and the accountant that occur before the taxpayer retains an attorney will likely not be protected by the attorney-client privilege. This is true even if the taxpayer subsequently consults an attorney about the same matters after consulting with the accountant.

Once the taxpayer retains an attorney, it is important to clearly establish that the accountant's role is to assist the attorney in providing legal advice to the taxpayer. A prudent attorney may take the precaution of hiring the accountant directly, instead of having the taxpayer hire the accountant. This helps to ensure that the relationship is between the attorney and the accountant and that the purpose is to assist the attorney, not the taxpayer. It is also prudent to ensure that this relationship is well-documented. The accountant's formal retention letter, as well as any invoices for services rendered, should clearly stipulate that the attorney is the

accountant's client and the accountant is being retained to assist the attorney. Ideally, to further substantiate this relationship, the accountant should bill the attorney directly and not bill the client.

A prudent attorney may take an added precaution of establishing a history of working with one accounting firm. While this is certainly not required, a history of using the same accountant or accounting firm to provide advice regarding different taxpayers indicates that the accountant's work is to assist the attorney. A prudent attorney may also prefer to hire an accountant who has not previously worked for the taxpayer, because when an accountant has a history of assisting the taxpayer, courts may infer that the accountant is currently assisting the taxpayer rather than the attorney. This is especially true if the accountant is providing accounting or tax assistance to the taxpayer at the same time that the accountant is assisting the attorney.

A history of assisting the taxpayer with accounting work does not automatically prevent privilege from extending to the accountant. However, hiring a new accountant who has no history with the taxpayer does not guarantee that privilege will extend to the accountant. It is only one of several factors that courts may look to.

The attorney and the accountant should also pay careful attention to the nature of the work the accountant is performing. Once the accountant has been hired, it is important to limit the accountant's work to assisting the attorney in providing legal advice. An illustration of this is found in *Gurtner*, 474 F.2d 297 (9th Cir. 1973), in which an attorney sent a taxpayer to an accountant to prepare the taxpayer's returns.

The taxpayer asserted that his communications with the accountant were privileged. The Ninth Circuit noted that privilege extends to the accountant only if the accountant is assisting the attorney in providing legal advice. The Ninth Circuit held that preparing tax returns was not legal advice and, therefore, the communications with the accountant were not privileged and were allowed to be used against the taxpayer in court. However, in another instance, an accountant prepared a net-worth statement at an attorney's request, and this was considered privileged because it was necessary for the attorney to provide legal advice to the taxpayer (*Judson*, 322 F.2d 460 (9th Cir. 1963)).

Conclusion

Privilege can prevent communications between taxpayers and attorneys, and in some cases accountants, from being disclosed. Privilege can be important to taxpayers, and knowing that communications are privileged may encourage taxpayers to fully and frankly communicate with their attorneys and accountants. For attorney-client privilege to extend to an accountant, it is necessary to demonstrate that the accountant was assisting the attorney giving legal advice to the taxpayer and that the accountant's assistance was necessary. Practitioners and attorneys can take a number of important precautions to ensure that their clients are well-protected.