Title
Protecting Abusive Tax Avoidance

Journal
UC Davis Legal Studies Research Paper

Author
Ventry, Dennis J

Publication Date
2008-07-29

Peer reviewed

Protecting Abusive Tax Avoidance

By Dennis J. Ventry Jr.

Dennis J. Ventry Jr. is an acting professor of law at University of California Davis School of Law and a visiting professor of law at American University Washington College of Law. The author thanks Michelle Kane, Susan Morse, Andrew Pike, and Paul Rice.

In August 2007 a federal court in Rhode Island denied the government's petition to enforce an IRS summons seeking tax accrual workpapers for a taxpayer's investment in abusive tax shelters. The court held in *United States v. Textron* that the documents at issue were protected under the work product doctrine, which immunizes from discovery documents prepared in anticipation of litigation as long as the prospect of litigation was "objectively reasonable" and the documents would not have been prepared in substantially the same manner regardless of the anticipated litigation. The government has appealed the decision.

Ventry argues that tax accrual workpapers never deserve work product protection because they are prepared for regulatory purposes rather than for litigation. He also argues that in preparing tax accrual workpapers, it is not objectively reasonable for a taxpayer to anticipate litigation because the nexus between the two events — that is, preparation of the documents and actual litigation — is so attenuated and fraught with contingencies that one leads to the other only a fraction of the time.

If affirmed, *Textron* threatens effective tax enforcement. It expands the work product doctrine beyond its historical role of protecting the adversarial process, and it swallows the attorney-client privilege, effectively cloaking from discovery not just all legal advice but all advice regarding potential litigation, no matter how unlikely. Also, the decision protects precisely the kind of abusive tax avoidance that Congress and the Treasury Department have fought to root out and punish. In the end, the decision substantially erodes the IRS summons power, prevents the IRS from performing its regulatory function of verifying a taxpayer's self-assessed liability, undermines recent antishelter efforts, and protects abusive tax avoidance.

Table of Contents

Introduction

All my students know the answer to the question, "What is the worst tax decision *ever*?" "*Murphy*!" they shout, referring to the D.C. Circuit's August 2006 decision in *Marrita Murphy v. IRS*.[1] Although other court decisions can challenge for the title,[2] *Murphy* was pretty

[1]*See* 460 F.3d 79 (D.C. Cir. 2006), *Doc 2006-15916, 2006 TNT 163-6*, *rev'd*, 493 F.2d 170 (2007), *cert. denied*, 128 S. Ct. 2050 (2008). In *Murphy*, a three-judge panel declared unconstitutional section 104(a)(2), which excludes from income damage awards for physical injuries but not damage awards for emotional injuries and punitive damages. In its opinion, authored by Chief Judge Ginsburg, the circuit court held that section 104(a)(2) violated the 16th Amendment because damages for emotional injury, like those for physical injury, do not constitute income as "commonly understood." *Murphy*, 460 F.3d at 89 (quoting *Merchants' Loan & Trust Co. v. Smietanka*, 255 U.S. 509, 519 (1921)). While the court was undoubtedly wrong on the law, it was arguably right on the tax policy issue, as Profs. Stephen Cohen and Laura Sager have argued, in the sense that emotional damages should not constitute taxable income because they make victims whole in the same way that tax-free compensatory damages for physical injuries make victims whole. *See* Cohen and Sager, "Discrimination for Damages Against Unlawful Discrimination," 35 *Harv. J. on Legis*. 447 (1998).

[2]For a sampling of these decisions, see, e.g., *Clintwood Elkhorn Mining Co. et al. v. United States*, 473 F.3d 1373 (Fed. Cir. 2007), *Doc 2007-1738, 2007 TNT 15-19* (ordering the government to pay refunds on untimely filed claims), *rev'd*, 128 S. Ct. 1511 (2008); *Estate of McCoy v. Commissioner*, 809 F.2d 333 (6th Cir. 1987) (unpublished order holding that interest and penalties should be forgiven "in order to achieve a fair and just result"), *rev'd*, 484 U.S. 3 (1987); *Asphalt Prod. Co. v. Commissioner*, 796 F.2d 843 (6th Cir. 1986) (holding that the negligence penalty could be applied only to that portion of the deficiency attributable to the disallowed deduction), *rev'd*, 482 U.S. 117 (1987); *Tufts v. Commissioner*, 651 F.2d 1058 (5th Cir. 1981), *rev'd*, 461 U.S. 300 (1983) (holding that fair market value of property limited the extent to which debt could be included in the amount realized on sale); *Five Star Mfg. Co. v. Commissioner*, 355 F.2d 724 (5th Cir. 1966)

(Footnote continued on next page.)

bad.[3] Not only was the opinion punctuated with a quotation from renowned tax lawyer Albert Einstein,[4] it declared unconstitutional a federal income tax statute without examining the full extent of Congress's taxing power under the Constitution.[5] Moreover, it failed to accomplish what it set out to do, that is, exempt Murphy's emotional damages award from taxation. By invalidating an exclusionary provision of the Internal Revenue Code (which *excludes* income without *including* anything), the court left undisturbed what caused Murphy's damages to be taxed in the first place, namely the code's catchall income provision (section 61), the 16th Amendment, and Article I, section 8, clause 1 of the Constitution.

Murphy has been worthy of the distinction ''worst tax decision *ever*.'' However, a challenger has emerged. Move over *Murphy*, say hello to *Textron*.[6]

***

In August 2007 the U.S. District Court for the District of Rhode Island denied the government's petition to enforce an IRS summons on Textron Inc. and its subsidiaries. As part of a routine audit to determine Textron's corporate income tax liability for 1998-2001, the IRS learned that one of Textron's subsidiaries entered into nine sale-in, lease-out transactions during 2001.[7] While the audit was still open, the Service designated SILOs as listed transactions,[8] at which point, and under published guidance,[9] the government requested all of Textron's tax accrual workpapers for 2001 so that it could sufficiently evaluate the abusive transactions.[10] Textron refused, and the government issued an administrative summons for the workpapers.[11] Again, Textron refused to comply, claiming that its tax accrual workpapers were protected

---

(applying the ''primary purpose'' test to determine the characterization of an asset, thereby permitting a corporate taxpayer to deduct as an ordinary and necessary expense the cost of redeeming stock from a 50 percent shareholder on the grounds that the redemption was essential to the corporation's survival) (decision effectively overturned over a 30-year period, see *Chrysler Corp. v. Commissioner*, T.C. Memo. 2001-244, *Doc 2001-24148*, *2001 TNT 182-5*, with reversal codified as 26 U.S.C. section 162(k)); and, finally, one supremely egregious trial court case, *Coltec Indus., Inc. v. United States*, 62 Fed. Cl. 716 (2004), *Doc 2004-21316*, *2004 TNT 214-16*, *vacated and remanded*, 454 F.3d 1340 (Fed. Cir. 2006), *Doc 2006-13276*, *2006 TNT 134-10*, *reh'g denied*, 2006 U.S. App. LEXIS 24771 (Fed. Cir. 2006), *cert. denied*, 127 S. Ct. 1261 (2007) (permitting refund for artificial tax losses by striking down the economic substance doctrine as a violation of the separation of powers).

[3]The response to the decision by tax and constitutional scholars was testament to its monumental shortcomings. According to Bernard Wolfman of Harvard Law School, the ruling was ''startling, misguided, and wrong.'' Sheryl Stratton, ''Experts Ponder *Murphy* Decision's Many Flaws,'' *Tax Notes*, Sept. 4, 2006, p. 822, *Doc 2006-18393*, *2006 TNT 171-3* (summarizing Wolfman). It was ''an embarrassment to the D.C. Circuit,'' observed George Yin, former Chief of Staff of the Joint Committee on Taxation and professor at the University of Virginia School of Law. *Id.* ''We law professors must not be doing our jobs right,'' Yin mused, ''if three federal judges and their clerks can reach a conclusion like this one.'' *Id.* at 823. According to Paul Caron, professor at the University of Cincinnati College of Law and publisher/editor of the TaxProf blog (http://taxprof.typepad.com), it is ''impossible to overstate the potential damage caused by this decision — in my 15-plus years in this business, this decision takes the cake for judicial mischief,'' undoing ''much of the work over the past 20 years by Congress, courts, IRS, and DOJ in stamping out the tax protester movement.'' Allen Kenney, ''*Murphy* a Boon for Protesters, Critics Say,'' *Tax Notes*, Sept. 4, 2006, p. 832, *Doc 2006-18436, 2006 TNT 171-5*. And Georgetown University Law Center constitutional professor Martin Lederman called the opinion ''woefully incomplete,'' in that it neglected to perform a full constitutional analysis even though it deemed to invalidate a federal tax statute as unconstitutional. Stratton, *supra*, at 823. *See also* Paul L. Caron, ''The Story of *Murphy*: A New Front in the War on the Income Tax,'' in *Tax Stories* (Foundation Press, 2d ed. 2008); Joseph M. Dodge, ''*Murphy* and the Sixteenth Amendment in Relation to the Taxation of Non-Excludable Personal Injury Awards,'' 8 *Fla. Tax Rev.* 369 (2007); Gregory L. Germain, ''Taxing Emotional Injury Recoveries: A Critical Analysis of *Murphy v. Internal Revenue Service*,'' 60 *Ark. L. Rev.* 185 (2007); Deborah A. Geier, ''*Murphy* and the Evolution of 'Basis,''' *Tax Notes*, Nov. 6, 2006, p. 576, *Doc 2006-21312, 2006 TNT 215-28*.

[4]*Murphy*, 460 F.3d at 92 (quoting Einstein as saying, ''The hardest thing in the world to understand is the income tax'').

[5]The circuit court failed to examine whether Congress has the power to tax damage awards apart from the 16th Amendment by virtue of the federal government's taxing power under Article I, section 8, clause 1, which grants Congress the ''power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare

(Footnote continued in next column.)

of the United States; but all duties, imposts and excises shall be uniform throughout the United States.''

[6]*United States v. Textron Inc. & Subsidiaries*, 507 F. Supp.2d 138 (D.R.I. 2007), *Doc 2007-20046, 2007 TNT 169-1*.

[7]SILO transactions, by form, purport to be a sale-leaseback with a tax-exempt entity, but amount in substance to a sale of tax benefits.

[8]Notice 2005-13, 2005-1 C.B. 630, *Doc 2005-2968, 2005 TNT 29-6*. A listed transaction is a transaction that is the same as or substantially similar to one that the IRS has determined to be a tax avoidance transaction and identified as such by published guidance. Taxpayers participating in a listed transaction must generally disclose the transaction to the IRS, register it, and, if applicable, maintain an investor list that must be made available to the IRS on request. Listed transactions are published in several IRS notices. *See* Notice 2004-67, 2004-2 C.B. 600, *Doc 2004-19024, 2004 TNT 187-8*; Notice 2005-13; Notice 2007-57, 2007-29 IRB 87, *Doc 2007-14723, 2007 TNT 120-10*; Notice 2007-83, 2007-45 IRB 960, *Doc 2007-23225, 2007 TNT 202-6*; and Notice 2008-34, 2008-12 IRB 645, *Doc 2008-4148, 2008 TNT 40-11*.

[9]*See* Announcement 2002-13, *Doc 2002-2652, 2002 TNT 22-7* (describing the Service's intent to request tax accrual workpapers for any tax return claiming tax benefits arising out of a listed transaction); Notice 2005-13 (*supra* note 8, identifying SILOs as listed transactions).

[10]Tax accrual workpapers support a corporate taxpayer's reserve for deferred or contingent tax liabilities and for related representations in the taxpayer's audited financial statements. They also typically discuss and provide support for all tax assets and liabilities reflected in financial statements, including deferred tax assets and liabilities.

[11]As the Supreme Court has stated, ''In order to encourage effective tax investigations, Congress has endowed the IRS with expansive information-gathering authority; section 7602 is the centerpiece of that congressional design.'' *United States v. Arthur Young*, 465 U.S. 805, 816 (1984). For a fuller discussion of the

(Footnote continued on next page.)

by the attorney-client privilege, the section 7525 tax practitioner-client privilege,[12] and the work product doctrine. With all administrative options exhausted, the government sought to enforce the summons through litigation. The district court found that while the workpapers were protected by virtue of the attorney-client and tax practitioner-client privileges, Textron waived both privileges when it disclosed the documents to a third-party independent auditor. The court also found that the workpapers were protected under the work product doctrine, and that disclosure to a nonadversary independent auditor did *not* waive work product protection. The court thus refused to enforce the summons, holding that the workpapers were protected work product, and the government appealed to compel disclosure.[13]

This article argues that *Textron* was wrongly decided, on both the facts and the law.

On the facts, the court confused why corporate taxpayers generate tax accrual workpapers, focusing on the documents' content rather than their function. To receive work product protection for a document, an applicant must demonstrate that it was created "in anticipation of litigation or for trial,"[14] and that it would not have been prepared in substantially the same manner regardless of the anticipated litigation.[15] The *Textron* court found that the tax accrual workpapers were prepared in anticipation of litigation, simply because the documents contained percentage determinations corresponding to likely success on the merits for various tax contingencies, and because the taxpayer said so. In reality, tax accrual workpapers contain determinations on levels of certainty by virtue of requirements mandated under federal securities law[16] and generally accepted accounting principles,[17] obligatory Treasury Department regulations governing tax practice (that is, Circular 230),[18] statutory obligations for both tax return preparers and taxpayers (for example, sections 6694 and 6662, respectively), and professional standards promulgated by the American Bar Association (that is, Formal Opinion 85-352),[19] and the American Institute of Certified Public Accountants (that is, SRTP No. 1).[20]

On the law, the district court failed to determine the reasonableness of Textron's privilege claims. For an expectation of litigation to be reasonable, the applicant must demonstrate more than a "remote possibility" of future litigation.[21] In fact, the applicant must show a "significant and substantial threat."[22] In so doing, the applicant must demonstrate not only "a subjective belief that litigation was a real possibility," but also that the

---

Service's summons power, see *infra* notes 253-262 and accompanying text. Summons provisions in the internal revenue laws date back to the Civil War. *See* Internal Revenue Act of 1864, section 14 (13 Stat. 226); *In re Lippman*, 15 F. Cas. 572 (S.D.N.Y. 1868). Modern section 7602 was codified in 1954. *See* Aug. 16, 1954, ch. 736, 68A Stat. 901. Earlier provisions granted the IRS a similarly strong summons power. *See* Internal Revenue Code of 1939, section 3614; Revenue Act of 1928, section 618 (45 Stat. 878); Revenue Act of 1926, section 1104 (44 Stat. 113); Revenue Act of 1924, section 1004 (43 Stat. 340); Revenue Act of 1921, section 1308 (42 Stat. 310); Revenue Act of 1918, section 1305 (40 Stat. 1142). Even after the Supreme Court recognized the government's "expansive information-gathering authority" in 1984 (*Arthur Young*, *supra*), the IRS practiced a widely recognized "policy of restraint," requesting tax accrual workpapers infrequently and not as part of standard examination procedures. *See* Announcement 84-46, 1984-18 IRB 18; Announcement 2002-63, 2002-2 C.B. 72, *Doc 2002-14466, 2002 TNT 117-12*; *infra* notes 259-262 and accompanying text.

[12]Section 7525 extends "the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney" to a communication between a taxpayer and "any federally authorized tax practitioner" (which includes lawyers, accountants, enrolled agents, and enrolled actuaries) "to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney." Congress enacted section 7525 in 1998. Within a few short years, during which time Congress was responding to egregious corporate accounting scandals, the privilege was narrowed considerably by the courts and the IRS. *See, e.g.*, Danielle M. Smith and David L. Kleinman, "What Remains of the Federal Tax Practitioner Privilege Established Under Internal Revenue Code Section 7525?" 111 *Daily Tax Rep.* (BNA) J-1 (June 9, 2006); Amandeep S. Grewal, "Selective Waiver and the Tax Practitioner Privilege," *Tax Notes*, Sept. 25, 2006, p. 1139, *Doc 2006-18795, 2006 TNT 186-37*; Sheryl Stratton, "Lawyers Discuss Postshelter Assault on Privilege," *Tax Notes*, Apr. 18, 2005, p. 289, *Doc 2005-7714, 2005 TNT 71-5*. The steady retrenchment has resulted in a privilege that does not protect the identity of a taxpayer (see *United States v. BDO Seidman*, 337 F.3d 802 (7th Cir. 2003), *Doc 2003-5515, 2003 TNT 41-44*), nontax proceedings (see *Chao v. Koresko*, 2005 U.S. App. LEXIS 22025 (3d Cir. 2005)); *Doe v. Wachovia Corp.*, 268 F. Supp.2d 627, 637 (W.D.N.C. 2003), *Doc 2003-15344, 2003 TNT 124-16*), or tax practitioner work product (see *United States v. KPMG*, 237 F. Supp.2d 35, 39 (D.D.C. 2002), *Doc 2002-22704, 2002 TNT 194-29*; *United States v. Frederick*, 182 F.3d 496, 502 (7th Cir. 1999), *Doc 1999-14337, 1999 TNT 74-21*).

[13]*United States v. Textron Inc.*, D.R.I., No. 06-198T, notice of appeal filed Dec. 22, 2007 (requesting an order to compel disclosure under section 7604).

[14]Federal Rule of Civil Procedure (FRCP) 26(b)(3).

[15]*United States v. Roxworthy*, 457 F.3d 590, 594 (6th Cir. 2006), *Doc 2006-15129, 2006 TNT 155-7*.

[16]*See* 15 U.S.C. sections 78l (registration requirements for securities) and 78m (periodical and other reports); 17 C.F.R. section 210 et seq. (registration and disclosure requirements for asset-backed securities).

[17]Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes"; "An Interpretation of FASB Statement No. 109," FASB (2006); Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" (1975).

[18]31 C.F.R. Part 10. Circular 230 regulations govern tax practice "in front of the IRS," which is construed broadly to include all written tax advice, from planning to litigation.

[19]ABA Comm. on Prof'l Ethics, Formal Op. 85-352 (1985).

[20]AICPA Federal Taxation Executive Committee, Statements on Responsibilities in Tax Practice (SRTP) No. 1, "Tax Return Positions" (rev. 1988).

[21]*In re Grand Jury Subpoena*, 220 F.R.D. 130, 147 (D. Mass. 2004).

[22]*SmithKline Beecham Corp. v. Apotex Corp.*, 232 F.R.D. 467, 484 (D. Pa. 2005).

belief was ''objectively reasonable.''[23] Furthermore, work product protection ''must be supported by . . . court findings on the circumstances of preparation and purpose of the documents.''[24] Such findings require courts ''to determine with specificity [the applicant's] motivation in creating'' the documents.[25] The district court in *Textron* never looked at the documents for which the applicant sought protection, let alone ''determine[d] with specificity'' the applicant's asserted reasons for creating the documents.[26] Moreover, while it appears that Textron produced a privilege log listing all withheld documents, the log never became part of the record,[27] and the court neglected to review a single withheld document from the list.[28]

Had the court undertaken the required reasonableness analysis, it would have been forced to conclude that Textron's anticipation of litigation was unreasonable. Not only were the tax accrual workpapers prepared ''in substantially the same manner irrespective of the anticipated litigation,''[29] they were prepared antecedent to even a remote possibility of litigation. The work product doctrine protects the adversarial process,[30] while the creation of tax accrual workpapers assists corporate taxpayers and their tax advisers in complying with various regulatory, statutory, and professional requirements and in preparing annual tax returns. Moreover, the period separating the creation of workpapers — including those for exceedingly aggressive transactions[31] — and the commencement of actual litigation is filled with myriad contingencies.

Even the audit process is contingent and nonadversarial, denying both the taxpayer and the government the right to cross-examine or to dispute the other party's presentation of materials before a neutral fact-finder. Indeed, as courts have recognized, a federal tax audit is an ''antechamber to litigation,''[32] and does not qualify as litigation as conceived under the work product doctrine.[33] The purpose of an audit ''is not to prepare for or conduct litigation, but to assess the amount of tax liability through administrative channels.''[34] Moreover, even for corporations subject to annual audit like Textron, there is no guarantee the IRS will identify and have the opportunity to evaluate aggressive transactions (such as the nine SILOs in which Textron invested), either because of gaps in the corporate taxpayer's records,[35] concealment of impermissible transactions,[36] or the practice of allowing corporations to set the audit agenda and to include for government scrutiny conservative transactions while obscuring or omitting aggressive transactions.[37] In the event the government actually learns of a taxpayer's aggressive position and decides to challenge it, the dispute is still not adversarial. Even at this late stage, far distant from the preparation of tax accrual workpapers, several levels of administrative appeal remain before the onset of litigation or an adversarial proceeding, including negotiations over proposed adjustments to a taxpayer's return positions, conferences with the IRS audit-team manager, accelerated issue resolution procedures such as the fast-track settlement program,[38] and an appearance before the IRS Office of Appeals.

Evaluating work product in the tax context presents unique challenges. Courts are familiar with conducting work product analysis in the traditional adversarial setting, with opposing parties battling out differences in court, and parties creating documents in furtherance of the adversarial process. Tax is different. The parties are not adversaries, but rather two elements of the tax regulatory regime, with one party reporting its self-assessed tax liability and the other party attempting to verify that self-assessment. Add the overlapping securities regulatory regime to the mix, and applying traditional adversarial considerations in the tax context becomes even more challenging, so much so that this article considers ways to adapt the work product doctrine to nonlitigation, regulatory investigations.[39] Until the doctrine is amended, however, courts have a responsibility to undertake a full work product analysis. That means requiring an applicant to show that it prepared the documents at issue in anticipation of litigation and not

---

[23] *In re Sealed Case*, 146 F.3d 881, 884 (D.D.C. 1998).

[24] *United States v. Rockwell Int'l*, 897 F.2d 1255, 1257 (3d Cir. 1990).

[25] *Id.* at 1277 (remanding to district court to ''determine with specificity'' why applicant created tax-reserve file).

[26] *See* Brief for the Appellant at 21 n.7, *United States v. Textron Inc. and Subsidiaries*, No. 07-2631, (1st Cir. Jan. 25, 2008) (stating that Textron ''did not submit the documents that it claimed were privileged for *in camera* review'').

[27] *See* Reply Brief for the Appellant at 69, *United States v. Textron Inc. and Subsidiaries*, No. 07-2631, (1st Cir. May 9, 2008) (identifying claimed, but unproduced, document ''in Textron's privilege log'').

[28] *Supra* note 26.

[29] *Roxworthy*, 457 F.3d at 594. *See also* notes 16-20 and accompanying text, as well as *infra* notes 112-127, 153-157, 174-192, and accompanying text.

[30] *See infra* notes 43-47, 111, and accompanying text.

[31] *See Fid. Int'l Currency Advisor A Fund, LLC v. United States*, No. 05-40151, slip op. 26 (D. Mass. Apr. 18, 2008) (finding ''the mere fact that the taxpayer is taking an aggressive position, and that the IRS might therefore litigate the issue, is not enough'' for the applicant to receive work product immunity).

[32] *Frederick*, 182 F.3d at 502.

[33] *United States v. Tel. & Data Sys., Inc.*, 2002 U.S. Dist. LEXIS 15510, *9-10, 90 A.F.T.R. 2d (RIA) 6585 (W.D. Wis. 2002).

[34] *United States v. Baggot*, 463 U.S. 476, 480 (1983).

[35] Joshua D. Rosenberg, ''The Psychology of Taxes: Why They Drive Us Crazy and How We Can Make Them Sane,'' 16 *Va. Tax Rev*. 155, 189 (1996) (writing that even in the event of an audit, the IRS ''may not notice whatever tax evasion the taxpayer may have engaged in'').

[36] Graeme S. Cooper, ''Analyzing Corporate Tax Evasion,'' 50 *Tax L. Rev.* 33, 100 (1994) (finding that businesses conceal tax-motivated transactions from auditors).

[37] Joint Committee on Taxation, ''Study of Present Law Penalty and Interest Provisions, as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998'' 212 (JCS-3-99) (1999).

[38] *See* Rev. Proc. 2003-40, 2003-25 C.B. 1044, *Doc 2003-13535, 2003 TNT 107-12* (2003); Announcement 2006-61, 2006-36 IRB 390, *Doc 2006-15911, 2006 TNT 163-5*.

[39] *See infra* ''III. The Future of Tax Work Product.''

for some other purpose, and, furthermore, that the applicant's anticipation was objectively reasonable. Absent such a showing, courts are obligated to deny work product protection.

If *Textron* were just another poorly reasoned tax case, the outcome of the government's appeal would be cause for less concern. But *Textron*, if affirmed, threatens the government's ability to enforce the nation's tax laws. It expands the work product doctrine beyond its historical role of protecting the adversarial process, and it effectively safeguards every document analyzing the potential tax treatment of transactions. In fact, the *Textron* court's conception of work product swallows the attorney-client privilege (which protects confidential communications between an attorney and a client), cloaking from disclosure not just all legal advice but all advice regarding potential litigation, no matter how attenuated.

In the end, the court's expansion of the work product doctrine protects precisely the kind of abusive tax avoidance that Congress and Treasury have worked for years to prevent, expose, and punish. Under the court's ruling, the most aggressive and abusive transactions receive the highest protection because, if discovered, they are more likely to result in litigation than conservative positions. In this way, and in direct contravention of long-standing Supreme Court precedent,[40] *Textron* substantially weakens the government's summons power,[41] conflicts with legislative and regulatory antishelter efforts,[42] and protects abusive tax avoidance.

I. Parameters of the Work Product Doctrine

The work product doctrine protects the adversarial system. In particular, it protects documents ''prepared in anticipation of litigation or for trial.''[43] First enunciated more than 60 years ago in *Hickman v. Taylor*,[44] the doctrine recognizes that ''it is essential [for] a lawyer to work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel.''[45] Were the work product of the lawyer made readily available to the opposition, ''an attorney's thoughts, heretofore inviolate, would not be his own. Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial. The effect on the legal profession would be demoralizing. And the interests of the clients and the cause of justice would be

[40] *See Arthur Young*, 465 U.S. at 816 (calling the IRS summons power the ''centerpiece'' of Congress' statutory regime to provide the Service ''expansive information-gathering authority''); *United States v. Euge*, 444 U.S. 707, 711 (1980) (calling the IRS summons power ''necessary for the effective performance of congressionally imposed responsibilities to enforce the tax Code''); *United States v. Bisceglia*, 420 U.S. 141, 146 (1975) (calling a vigorous summons power ''essential to our self-reporting system'').

[41] Until the district court's decision in *Textron*, no court had ever held that the work product doctrine immunizes tax accrual workpapers from an IRS summons. In May 2008 a district court in Alabama became the second court to grant work product protection to tax accrual workpapers. *See Regions Fin. Corp. v. United States*, 2008 U.S. Dist. LEXIS 41940, No. 2:06-CV-00895-RDP (N.D. Ala. May 8, 2008). The government has appealed the decision. Although the *Regions* court relied in part on *Textron* (''The circumstances present in this case were considered recently by the District of Rhode Island in *United States v. Textron*,'' *id.* at *20), and its decision therefore is subject to some of the same criticisms discussed in this article (particularly its equating ''contingent liabilities'' to ''anticipated litigation''), the cases are distinguishable. First, unlike Textron, Regions produced all of its tax accrual workpapers, and sought protection for select documents related to one transaction that it took great pains to show was likely to lead to litigation, a burden that Textron ignored. As the *Regions* court observed, the ''documents that Regions seeks to withhold are less broad than those withheld in *Textron* because Regions has already disclosed the fact and amounts of its reserves'' (*id.* at *24 n.12). Second, while Regions identified with particularity the one transaction for which it sought protection, a burden long recognized in work product jurisprudence (see *infra* notes 128-133 and accompanying text), Textron failed to identify even a single transaction contained in its workpapers. And third, the district court in *Regions* determined with specificity through an in camera review the applicability of the work product doctrine to the documents at issue, while the *Textron* court neglected this responsibility altogether.

[42] *See infra* notes 263-281 and accompanying text.

[43] FRCP 26(b)(3).

[44] 329 U.S. 495 (1947).

[45] *Id.* at 512.

poorly served.''[46] In the years since *Hickman*, the Supreme Court has affirmed the strong public policy of work product protection.[47]

Since 1970 the doctrine has been codified and substantially incorporated in Rule 26(b)(3) of the Federal Rules of Civil Procedure.[48] To receive protection under the rule, the material must satisfy a conjunctive test. That is, it must reflect ''documents and tangible things''; be ''prepared in anticipation of litigation or for trial''; and be created ''by or for another party or by or for that other party's representative.''[49] The work product doctrine does not protect facts ''concerning the creation of work product'' or facts ''contained within the work product.''[50] Nor does it necessarily exempt ''core'' work product from disclosure or limit disclosure to facts ''as opposed to mental impressions or opinions of counsel.''[51] Although not immune from discovery, opinion work product receives special consideration. Rule 26(b)(3)(B) carves out heightened protection for ''the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation.'' The Supreme Court has provided similarly special treatment for opinion work product because ''at its core, the work product doctrine shelters the mental processes of the attorney, providing a privileged area within which he can analyze and prepare his client's case.''[52] Thus, while confidential communications between clients and their attorneys are the privilege of the client, work product is the privilege of the attorney.[53] Moreover, while the two privileges may ''seem to overlap'' in some instances, such that ''their cognate natures . . . caus[e] basic misapplications,''[54] the work product privilege is ''not coextensive'' with the attorney-client privilege.[55]

Work product protection, like the privilege extended to attorney-client communications, must be narrowly construed.[56] If read expansively, its application ''can derogate from the search for the truth.''[57] Construing the privilege narrowly ''has particular force in the context of IRS investigations'' when there exists a recognized '''congressional policy choice *in favor of disclosure* of all information relevant to a legitimate IRS inquiry.'''[58] Moreover, the Supreme Court has found tax accrual workpapers to be highly relevant to an IRS audit.[59]

---

[46]*Id. See also United States v. Amer. Tel. & Tel. Co.*, 642 F.2d 1285, 1299 (D.C. Cir. 1980) (stating that work product protection exists to promote the adversary system ''by safeguarding the fruits of an attorney's trial preparations from the discovery attempts of the opponent. The purpose of the work product doctrine is to protect information against opposing parties, rather than against all others outside a particular confidential relationship, in order to encourage effective trial preparation''); *Coastal States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 864 (D.C. Cir. 1980) (the purpose of the work product doctrine is ''not to protect any interest of the attorney,'' per se, ''but to protect the adversary trial process'').

[47]*See, e.g., United States v. Nobles*, 422 U.S. 225, 236 (1975); *Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981).

[48]*Upjohn*, 449 U.S. at 398. For a history of the work product doctrine and its incorporation into the federal rules, see Charles Alan Wright, Arthur R. Miller, and Richard L. Marcus, *Federal Practice and Procedure: Civil 2d*, sections 2021-2023 (1994).

[49]This conjunctive test is also reflected in the case law. *See, e.g.*, *In re Grand Jury Subpoena*, 599 F.2d 504, 509 (2d Cir. 1979); *In re Grand Jury Investigation*, 599 F.2d 1224, 1228 (3d Cir. 1979); *McNulty v. Bally's Park Place*, Inc., 120 F.R.D. 27, 29 (D. Pa. 1988); *In re Joint E. & S. Dist. Asbestos Litig.*, 119 F.R.D. 4, 6 (E.D.N.Y. and S.D.N.Y. 1988); *Lott v. Seaboard Sys. R.R., Inc.*, 109 F.R.D. 554, 557 (S.D. Ga. 1985).

[50]*Coastline Terminals of Conn., Inc. v. United States Steel Corp.*, 221 F.R.D. 14, 19 (D. Conn. 2003). *See also Guardsmark, Inc. v. Blue Cross & Blue Shield*, 206 F.R.D. 202, 207 (W.D. Tenn. 2002); *Resolution Trust Corp. v. Dabney*, 73 F.3d 262, 266 (10th Cir. 1995).

[51]*Weil Long Island Sav. Bank FSB*, 206 F.R.D. 38, 40 (E.D.N.Y. 2001).

[52]*Nobles*, 422 U.S. at 238. *See also Upjohn*, 449 U.S. at 399 (finding that opinion work product ''cannot be disclosed simply on a showing of substantial need and inability to obtain the equivalent without undue hardship,'' although stopping short of holding that ''such material is always protected by the work product rule'').

[53]*See Official Comm. of Unsecured Creditors v. Fleet Retail Fin. Group* (*In re Hechinger Inv. Co. of Del., Inc.*), 303 BR 18, 24 (D. Del. 2003); *Ken's Foods, Inc. v. Ken's Steak House, Inc.*, 213 F.R.D. 89, 96 (D. Mass. 2002); *Data Gen. Corp. v. Grumman Sys. Support Corp.*, 139 F.R.D. 556, *10 (D. Mass. 1991). *See also Radiant Burners, Inc. v. Am. Gas Ass'n*, 207 F. Supp. 771, 776 (N.D. Ill. 1962), *rev'd*, 320 F.2d 314 (7th Cir. 1963), *cert. denied*, 375 U.S. 929 (1963) (''The attorney 'work product' privilege, to be distinguished from the attorney-client privilege, is historically and traditionally a privilege of the attorney and not that of the client. Its rationale is based upon the right of lawyers to enjoy privacy in the course of their preparations for suit'').

[54]*Radiant Burners*, 207 F. Supp. at 776.

[55]*Smith v. Texaco, Inc.*, 186 F.R.D. 354, 357 (E.D. Tex. 1999). *See also Scourtes v. Fred W. Albrecht Grocery Co.*, 15 F.R.D. 55, 58 n.1 (D. Ohio 1953). (''The term 'work product of the attorney' has been variously characterized a 'privilege,' 'exemption,' or 'immunity.' It matters little what terminology is employed, however, so long as it is understood that the phrase encompasses something apart from confidential communications between client and attorney.'')

[56]*See Pac. Gas & Elec. Co. v. United States*, 69 Fed. Cl. 784, 790 (2006) (stating that work product immunity must be ''narrowly construed''); *Mims v. Dallas County*, 230 F.R.D. 479, 484 (N.D. Tex. 2005) (same) (citing *McCook Metals L.L.C. v. Alcoa, Inc.*, 192 F.R.D. 242, 260 (N.D. Ill. 2000)) (work product doctrine ''significantly restricts the scope of discovery and must be narrowly construed in order to aid in the search for the truth''); *In re Grand Jury Subpoena*, 220 F.R.D. 130, 143 (D. Mass. 2004) (same); *In re Keeper of the Records (XYZ Corp.)*, 348 F.3d 16, 22 (1st Cir. 2003) (stating that privileges, including work product immunity, obstruct the search for truth and therefore ''must be narrowly construed''); *Allen v. Chicago Transit Auth.*, 198 F.R.D. 495, 500 (N.D. Ill. 2001) (''Only by strictly construing the elements of work product, can the doctrine's original intent be best served''); *Cooper Hosp./Univ. Med. Ctr. v. Sullivan*, 183 F.R.D. 119, 128 (D.N.J. 1998) (''Like all evidentiary privileges, the work product privilege is to be strictly construed, consistent with the goals underlying the privilege, namely, advancement of the adversarial system''); *Republican Party of N.C. v. Martin*, 136 F.R.D. 421, 429 (E.D.N.C. 1991) (''narrowly construed'').

[57]*United States v. 22.80 Acres of Land*, 107 F.R.D. 20, 22 (N.D. Cal. 1985).

[58]*Cavallaro v. United States*, 284 F.3d 236, 245 (1st Cir. 2002), *Doc 2002-7987, 2002 TNT 65-10* (emphasis in the original and quoting *Arthur Young*, 465 U.S. at 816).

[59]*Arthur Young*, 465 U.S. at 815.

The protection afforded work product is a qualified immunity or privilege in other respects as well.[60] Rule 26 allows for discovery of protected materials if the party seeking disclosure establishes that ''it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.''[61] Moreover, the applicant can waive work product immunity if it discloses the materials to an adversary, a potential adversary, or a potential conduit to a potential adversary.[62] Also, the qualified immunity afforded applicants is always subject to the crime-fraud and at-issue exceptions.[63] For crime-fraud, while documents otherwise protected as work product are denied protection if the documents were generated ''in furtherance of a crime, fraud, or other misconduct,''[64] the exception is read restrictively, carefully balancing society's interest in discouraging criminal or fraudulent behavior against society's interests that underlie the attorney-client and work-product privileges.[65] In a recent tax case, narrow application of the crime-fraud exception prevented the government from forcing disclosure of otherwise protected work product in the context of an IRS summons.[66] For the at-issue exception, an applicant waives work product immunity when it places ''at issue'' the same information for which it seeks protection.[67] Courts have applied the at-issue exception to tax return materials,[68] even overcoming the strong public policy against involuntary disclosure of tax return information.[69]

---

[60]*See, e.g.*, *Miyano Mach. USA v. Miyanohitec Mach., Inc.*, No. 08-C-526, 2008 U.S. Dist. LEXIS 44707 *10 (N.D. Ill. June 6, 2008) (''qualified privilege''); *Kallas v. Carnival Corp.*, No. 06-20115-CIV-MORENO/TORRES, 2008 U.S. Dist. LEXIS 42299 *13 (S.D. Flor. May 27, 2008) (''qualified privilege''); *Garcia v. Berkshire Life Ins. Co. of Am.*, No. 04-CV-01619-LTB-BNB, 2007 U.S. Dist. LEXIS 86639 *21 (D. Colo. Nov. 13, 2007); *El Bannan v. Yonts*, No. 5:06-CV-173-R, 2007 U.S. Dist. LEXIS 34870 at *17 (W.D. Ky. May 11, 2007); *In re Cendant Corp. Sec. Lit.*, 343 F.3d 658, 664 (3d Cir. 2003); *United States v. Torf (In re Grand Jury Subpoena)*, 357 F.3d 900, 903 (9th Cir. 2003); *Varuzza by Zarrillo v. Bulk Materials, Inc.*, 169 F.R.D. 254, 257 (N.D.N.Y. 1996); *Chiasson v. Zapata Gulf Marine Corp.*, 988 F.2d 513, 514 n.2 (5th Cir. 1993), *cert. denied*, 511 U.S. 1029 (1994); *In re San Juan Dupont Plaza Hotel Fire Litig.*, 859 F.2d 1007, 1015 (1st Cir. 1988); *In re Sealed Case*, 856 F.2d 268, 273 (D.D.C 1988); *In re Murphy*, 560 F.2d 326, 334 and 335 (8th Cir. 1977) (''qualified immunity'' and ''qualified privilege,'' respectively); *Duplan Corp. v. Moulinage et Retorderie de Chavanoz*, 487 F.2d 480, 485 (4th Cir. 1973).

[61]FRCP 26(b)(3)(A)(ii).

[62]*In re Raytheon Sec. Litig.*, 218 F.R.D. 354, 360 (D. Mass. 2003); *Bank of Am. v. Terra Nova Ins. Co.*, 212 F.R.D. 166, 170 (S.D.N.Y. 2002); *United States v. MIT*, 129 F.3d 681, 687 (1st Cir. 1997), *Doc 97-32547, 97 TNT 231-13*; *Westinghouse v. Republic of the Phil.*, 951 F.2d 1414, 1428 (3d Cir. 1991).

[63]*United States v. Ernstoff*, 183 F.R.D. 148, 154 n.5 (D.N.J. 1998) (stating that ''the crime-fraud exception and the at-issue exception to the attorney-client privilege are also applicable to the work product doctrine''). *See also In re Sealed Case*, 107 F.3d 46, 51 (D.C. Cir. 1997) (crime-fraud exception); *In re Grand Jury Proceedings*, 102 F.3d 748, 751 (4th Cir. 1996) (crime-fraud exception); *In re Grand Jury Proceedings*, 87 F.3d 377 (9th Cir.) (crime-fraud exception), *cert. denied*, 519 U.S. 945 (1996); *In re Richard Roe, Inc.*, 68 F.3d 38, 39-40 (2d Cir. 1995) (crime-fraud exception); *In re Grand Jury Proceedings*, 43 F.3d 966, 972 (5th Cir. 1994) (crime-fraud exception); *Cox v. Admin. United Steel & Carnegie*, 17 F.3d 1386, 1422 (11th Cir. 1994) (crime-fraud exception), *modified*, 30 F.3d 1347 (11th Cir. 1994), *cert. denied*, 513 U.S. 1110 (1995); *In re Grand Jury Proceedings*, 604 F.2d 798, 802-803 (3d Cir. 1979) (crime-fraud exception); *Pfohl Bros. Landfill Litig.*, 175 F.R.D. 13, 28 (W.D.N.Y. 1997) (at-issue exception); *Bowne of N.Y. City, Inc. v. AmBase Corp.*, 150 F.R.D. 465 (S.D.N.Y. 1993) (at-issue exception); *Ins. Corp. of Ireland, Ltd. v. Bd. of Trustees of So. Ill. Univ.*, 937 F.2d 331, 334, n.3 (7th Cir. 1991) (at-issue exception).

[64]*Nesse v. Pittman*, 202 F.R.D. 344, 351 (D.D.C. 2001). *See also In re Grand Jury Subpoena Duces Tecum*, 731 F.2d 1032 (2d Cir. 1984); *In re Sealed Case*, 676 F.2d 793, 812 (D.C. Cir. 1982); *Clark v. United States*, 289 U.S. 1, 14 (1933).

[65]*Id.* at 351. ''If legal advice loses its privileged status merely because the opponent claims that the advice was sought to conceal a fraud, the privilege quickly evaporates.'' *Id.* Although the party seeking disclosure of the materials must not prove the existence of a crime or fraud beyond a reasonable doubt, ''it must make a prima facie showing of a violation sufficiently serious to defeat the privilege.'' *In re Sealed Case*, 754 F.2d 395, 399 (D.C. Cir. 1985). *See also In re Sealed Case*, 107 F.3d at 50 (holding that the government ''had to demonstrate that the Company sought the legal advice with the intent to further its illegal conduct. Showing temporal proximity between the communication and a crime is not enough'').

[66]*See United States v. Windsor Capital Corp.*, 524 F. Supp.2d 74 (D. Mass. 2007) (involving general claim of fraud and inability of the government to show taxpayer's scienter for fraudulent activity).

[67]*See, e.g.*, *Coastline Terminals of Conn.*, 221 F.R.D. at 18 (citing *Occidental Chem. Corp. v. OHM Remediation Serv. Corp.*, 175 F.R.D. 431, 435 (W.D.N.Y. 1997)) (citing *Vermont Gas Sys. v. United States Fid. & Guar. Co.*, 151 F.R.D. 268, 276 (D. Vt. 1993)).

[68]*See, e.g.*, *United States v. Certain Real Prop.*, 444 F. Supp.2d 1258 (S.D. Fla. 2006) (tax records held discoverable because applicant placed his income at issue); *Shearson Lehman Hutton, Inc. v. Lambros*, 135 F.R.D. 195 (M.D. Fla. 1990) (former employer was entitled to applicants' tax returns because they were relevant to merits of employer's claims of financial impropriety and conversion by applicants and to issue of applicants' ability to mitigate damages); *Fox v. Cal. Sierra Fin. Serv.*, 120 F.R.D. 520 (N.D. Cal. 1988) (applicant-attorney's tax records were discoverable by means of posing interrogatories on subject of attorney's tax treatment of ownership interest in corporation which he allegedly fraudulently marketed as an investment scheme); *United States v. Bonanno Organized Crime Family of La Cosa Nostra*, 119 F.R.D. 625 (E.D.N.Y. 1988) (applicant's income tax returns were discoverable in civil RICO action in support of government's contention that applicant possessed inadequate income from legitimate sources to purchase or operate business in question and that applicant had no legitimate business or commercial dealings with other defendants in instant action); *Klein v. Checker Motors Corp.*, 87 F.R.D. 5 (N.D. Ill. 1979) (income tax returns and other financial documents of plaintiff not discoverable when financial ability of named plaintiffs is generally irrelevant to issue of propriety of class certification).

[69]*See, e.g.*, *United States v. Six Hundred Forty-Four Thousand Eight Hundred Sixty & 00/100 Dollars in United States Currency*, 99 AFTR 2d 2386 (C.D. Ill. 2007) (section 6103, pertaining to protections from disclosure of tax return information, did not prevent court from requiring applicants to produce tax returns for years in which applicants asserted ownership interest in funds that were the subject of forfeiture action brought by the federal government); *Yancey v. Hooten*, 180 F.R.D. 203 (D. Conn.

(Footnote continued on next page.)

Determining the scope and applicability of work product protection is a particularly nettlesome endeavor for courts. Indeed, according to the leading authority on federal practice, ''the most troublesome question relating to the scope of discovery is the extent to which a party may inspect documents developed in the course of his opponent's preparation of the case.''[70] Evaluating work product protection has proven so troublesome that more than one commentator has called for its abolition. ''Work product immunity should be eliminated entirely,'' according to law professor Elizabeth Thornburg.[71] ''Neither the traditional utilitarian justifications for work-product immunity nor their modern-day law and economics counterparts are theoretically or empirically sound. Work-product immunity is not needed to protect the adversary system or the legal profession. Rather, it results in the suppression of relevant information and in the imposition of gigantic transaction costs on the parties and the judicial system.''[72]

Despite its shortcomings, the work product doctrine is here to stay. Even so, 61 years after its articulation in *Hickman*,[73] and 38 years after its codification in the federal rules,[74] evaluating work product immunity remains ''one of the most controversial and vexing problems'' in federal practice, requiring courts to invest significant time, energy, and resources.[75]

Fortunately for courts undertaking the difficult work product inquiry, the federal rules provide relatively straightforward guidelines. The party seeking protection for documents and tangible things must demonstrate that they were created in anticipation of litigation or for trial by or for the applicant or its representative.[76] Federal courts have articulated two different tests for determining whether documents meet the ''in anticipation of litigation'' requirement. One test asks whether the documents were prepared ''primarily or exclusively to assist in litigation,'' while the other asks whether the documents were prepared ''because of'' existing or expected litigation. The ''primary motivating purpose'' inquiry is the more narrow of the two tests, and denies protection to documents created with an eye toward litigation ''if their primary, ultimate, or exclusive purpose'' assists in making nonlitigation decisions, such as business decisions.[77] By comparison, the ''because of'' test does not necessarily exclude those documents as long as they would not have been created in the absence of litigation, and as long as the asserted expectation of litigation was reasonable.

The ''primary motivating purpose'' test evolved largely out of a line of cases from the Fifth Circuit. In *United States v. Davis*, the court denied protection to documents created during the course of preparing the applicant's tax return.[78] It was an easy case for the court in that the applicant failed to demonstrate even the slightest anticipation of litigation, a failure that prompted the court to write that work product immunity applies only when the ''primary motivating purpose behind the creation of the document was to aid in possible future litigation.''[79] Shortly thereafter, in *United States v. El Paso Co.*, the Fifth Circuit denied protection to documents prepared to calculate and support reserves in the applicant-taxpayer's financial statements.[80] The court found that the applicant's primary motivating purpose behind creating the documents was ''not to ready . . . for litigation,'' but ''to bring its financial books into conformity with generally accepted auditing principles.''[81] Three years later, a Fifth Circuit judge applied the *El Paso* test in denying work product protection to documents that were created to help auditors prepare financial disclosure reports rather than to prepare for litigation or trial.[82] Courts have applied the primary motivating purpose test to deny immunity to documents prepared for other unconnected reasons and before litigation.[83] And while the test does not require imminent litigation to immunize documents, the primary motivating purpose behind creating the documents must have been, at the very least, to assist in future litigation.[84]

Although the circuits are split over which test governs, a substantial majority has adopted the ''because of'' test,

---

1998) (tax returns and other information regarding income, despite section 6103, found discoverable if relevant to issues in lawsuit).

[70]Wright, Miller, and Marcus, *supra* note 48, at 313.

[71]Elizabeth Thornburg, ''Rethinking Work Product,'' 77 *Va. L. Rev.* 1515, 1517 (1991).

[72]*Id. See also* D. Christopher Wells, ''The Attorney Work-Product Doctrine and Carry-Over Immunity,'' 47 *U. Pitt. L. Rev.* 675, 683 (1986) (arguing that the work product doctrine fails to fulfill the *Hickman* goal of protecting the adversarial system, and concluding that ''a closer look at the specific rationales [for the doctrine] . . . suggests that the work product immunity is largely designed to protect lawyers from themselves and their own unprofessionalism, rather than from their adversaries'').

[73]*See supra* notes 44-46 and accompanying text.

[74]*Supra* note 48 and accompanying text.

[75]Jeff A. Anderson, Gena E. Cadieux, George E. Hays, Michael B. Hingerty, and Richard J. Kaplan, ''Special Project: The Work Product Doctrine,'' 68 *Cornell L. Rev.* 760, 762 (1983). The same study found that work product immunity ''is the most frequently litigated discovery issue.'' *Id.* at 763.

[76]FRCP 26(b)(3).

[77]*United States v. Adlman*, 134 F.3d 1194, 1198 (2d Cir. 1998).

[78]636 F.2d 1028 (5th Cir. 1981), *cert. denied*, 454 U.S. 862 (1981).

[79]*Davis*, 636 F.2d at 1040.

[80]*United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982), *cert. denied*, 466 U.S. 944 (1984).

[81]*El Paso*, 682 F.2d at 543.

[82]*United States v. Gulf Oil Corp.*, 760 F.2d 292, 296-297 (Temp. Emer. Ct. App. 1985).

[83]*See, e.g., McEwen v. Digitran Sys., Inc.*, 155 F.R.D. 678, 684 (D. Utah 1994) (denying work product immunity to documents whose ''primary motivating purpose'' was not to assist attorneys in connection with pending or anticipated litigation or an Securities and Exchange Commission investigation, but merely to facilitate the reissuance of the corporation's financial statements to relist the corporation's stock).

[84]*See, e.g., Clover Staffing, Inc. v. Johnson Controls World Serv., Inc.*, 238 F.R.D. 576, 579 (S.D. Tex. 2006) (finding that imminent litigation is not required to protect documents as long as the primary motivating purpose behind the creation of a document is to aid in possible future litigation); *Smith v. Diamond Offshore Drilling*, 168 F.R.D. 582, 584 n.3 (S.D. Tex. 1996) (citing *Davis*, 636 F.2d at 1040) (finding that litigation need not necessarily be imminent as long as primary motivating purpose behind creation of document was to aid in possible future litigation).

including the First Circuit, the jurisdiction in which *Textron* was decided.[85] The ''because of'' standard for determining whether a document receives work product protection does not consider whether litigation was the primary, secondary, or tertiary purpose for its preparation.[86] Rather, it considers whether ''in light of the factual context,''[87] the document can fairly be said to have been prepared or obtained with existing or potential litigation in mind.[88] The ''because of'' test and its factual inquiry recognizes the reality that ''prudent parties anticipate litigation, and begin preparation prior to the time suit is formally commenced.''[89] Moreover, the test more closely tracks Rule 26(b)(3), which covers not just materials ''prepared . . . for trial,'' but also those ''prepared in anticipation of litigation.''[90] As importantly, a close examination of the facts surrounding the preparation of purportedly privileged materials allows courts to determine not just whether the applicant's anticipation of litigation was subjectively reasonable, but also whether it was objectively reasonable.[91]

What constitutes an objectively reasonable expectation of litigation has evolved over time. Early decisions required ''an identifiable prospect of litigation'' at the time the documents were prepared.[92] To make the prospect of litigation identifiable, litigation itself need not have commenced,[93] but courts, at the very least, required applicants to pinpoint a specific claim.[94] Under some interpretations, this temporal limitation on work product protection meant that if an applicant's documents were not prepared in anticipation of litigation after a claim arose, ''irrelevance and attorney-client privilege [were] the only applicable defenses to their production.''[95] Courts allowed for the contingency of litigation, but only in the presence of a specific claim.[96] Moreover, a showing of *specific* litigation was not necessary, but a showing of

---

[85]In fact, at least 9 of the 13 circuits have adopted the ''because of'' test. *See, e.g.*, *Maine v. United States*, 298 F.3d 60 (1st Cir. 2002); *Adlman*, 134 F.3d 1194; *In re Grand Jury Proceedings*, 604 F.2d 798; *Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co., Inc.*, 967 F.2d 980 (4th Cir. 1992); *Roxworthy*, 457 F.3d 590; *Binks Mfg. Co. v. Nat'l Presto Indus., Inc.*, 709 F.2d 1109 (7th Cir. 1983); *Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987), *cert. denied*, 484 U.S. 917 (1987); *Torf*, 357 F.3d at 907; *Senate of P.R. v. Dep't of Justice*, 823 F.2d 574 (D.C. Cir. 1987).

[86]*See, e.g.*, *Adlman*, 134 F.3d at 1203 (stating that it is not necessary for a document to be prepared ''primarily'' to assist in the litigation, merely that it was prepared ''because of'' existing or expected litigation).

[87]*Binks Mfg. Co.*, 709 F.2d at 1118.

[88]*Sanner v. Bd. of Trade*, 181 F.R.D. 374, 378 (N.D. Ill. 1998). *See also Martin v. Bally's Park Place Hotel & Casino*, 983 F.2d 1252, 1260 (3d Cir. 1993); *Binks Mfg. Co.*, 709 F.2d at 1118; *Status Time Corp. v. Sharp Electronics Corp.*, 95 F.R.D. 27, 29 (S.D.N.Y. 1982) (denying applicant protection for claim that it contemplated possible litigation in enforcement of patent when it prepared and filed its patent application); *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 604 (8th Cir. 1977); *Galambus v. Consol. Freightways Corp.*, 64 F.R.D. 468, 472 (D. Ind. 1974). The ''in light of the factual context/can fairly be said'' test reflects the test provided in the leading treatise on the subject. *See* Wright, Miller, and Marcus, *supra* note 48, at 343 (stating that ''the test should be whether, in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation'').

[89]Wright, Miller, and Marcus, *supra* note 48, at 343. *See also Fireman's Fund Ins. Co. v. McAlpine*, 391 A.2d 84, 89-90 (Sup. Ct. R.I. 1978). (''In our litigious society, when an insured reports to his insurer that he has been involved in an incident involving another person, the insurer can reasonably anticipate that some action will be taken by the other party. The seeds of prospective litigation have been sown, and the prudent party, anticipating this fact, will begin to prepare his case.'')

[90]*See Adlman*, 134 F.3d at 1198 (noting that Rule 26(b)(3) ''sweeps more broadly'' than ''limit[ing] protection to materials prepared to assist at trial'').

[91]*See Roxworthy*, 457 F.3d at 594 (embracing the ''because of'' test and its dual subjective and objective inquiry, which asks ''(1) whether a document was created because of a party's subjective

(Footnote continued in next column.)

anticipation of litigation, as contrasted with an ordinary business purpose, and (2) whether that subjective anticipation of litigation was objectively reasonable''); *In re OM Group Sec. Litig.*, 226 F.R.D. 579, 584-585 (N.D. Ohio 2005) (same); *Guardsmark*, 206 F.R.D. at 209-210 (same); *In re Sealed Case*, 146 F.3d at 884 (same); *Rexford v. Olczak*, 176 F.R.D. 90, 91 (W.D.N.Y. 1997); *Garvey v. Nat'l Grange Mut. Ins. Co.*, 167 F.R.D. 391, 394 (E.D. Pa. 1996) (noting the court's responsibility to determine whether the applicant's work product claim was ''objectively reasonable based upon the nature of the document(s) and the facts of this particular case''); *Martin*, 983 F.2d at 1260 (same); *Nat'l Union Fire Ins. Co.*, 967 F.2d at 984 (same). *See also Windsor Capital*, 524 F. Supp.2d at 82 (work product privilege applied to documents because planning and structuring of the transaction was objectively performed in anticipation of litigation in that at least one of the documents specifically referenced anticipated litigation by seeking advice regarding the likely outcome in the tax court proceeding of various positions, and the size of the donation and deductions at issue made it highly likely that the government would examine, challenge, and litigate the position).

[92]*Fox*, 120 F.R.D. at 525 (citing *Burlington Indus. v. Exxon Corp.*, 65 F.R.D. 26, 42-43 (D. Md. 1974)); *Stix Prod., Inc. v. United Merch. & Mfrs., Inc.*, 47 F.R.D. 334, 337 (S.D.N.Y. 1969).

[93]*See, e.g.*, *In re Grand Jury Investigation*, 599 F.2d at 1229 (''Indisputably, the work product doctrine extends to material prepared or collected before litigation actually commences. On the other hand, some possibility of litigation must exist''); *Ownby v. United States*, 293 F. Supp. 989 (D. Okla. 1968) (finding that statements from witnesses are entitled to work product protection although they were obtained before suit was filed).

[94]*SCM Corp. v. Xerox Corp.*, 70 F.R.D. 508, 515 (D. Conn. 1976), *appeal dismissed*, 534 F.2d 1031 (2d Cir. 1976).

[95]*In re Grand Jury Investigation*, 412 F. Supp. 943, 948 (E.D. Pa. 1976). *See also Linde Thomson Langworthy Kohn & Van Dyke, P.C. v. RTC*, 5 F.3d 1508, 1515 (D.C. Cir. 1993) (stating that the document must be ''created 'with a specific claim supported by concrete facts which would likely lead to litigation in mind''') (quoting *Coastal States Gas Corp.*, 617 F.2d at 864).

[96]*See, e.g.*, *Hercules, Inc. v. Exxon Corp.*, 434 F. Supp. 136, 151 (D. Del. 1977) (stating that ''the fact that litigation may still be a contingency at the time the document is prepared has not been held to render the privilege inapplicable, if the prospect of litigation is identifiable because of specific claims that have already arisen''); *Sylgab Steel and Wire Corp. v. Imoco-Gateway Corp.*, 62 F.R.D. 454, 457 (N.D. Ill. 1974) (same); *Congoleum Indus., Inc. v. G A F Corp.*, 49 F.R.D. 82 (E.D. Pa. 1969) (same), *aff'd*, 478 F.2d 1398 (3d Cir. 1973); *Stix Prods.*, 47 F.R.D. at 337 (same).

"some litigation" was.[97] Finally, the very fact that litigation may have actually materialized after the preparation of documents did not automatically "cloak" them with work product immunity.[98]

As courts' understanding of the doctrine matured, the absence of a specific claim[99] or adversarial government investigation[100] did not necessarily doom work product application. But in demonstrating that an expectation of litigation was objectively reasonable, it remained essential for an applicant to show more than a remote possibility of litigation.[101] The "mere mention of fear of being sued" is not enough[102] because "almost all of the work attorneys do, or the advice they dispense, is in anticipation of litigation or its avoidance."[103] Work product immunity requires "a more immediate showing"[104] of anticipated litigation, which, in turn, requires that a document be created with an identifiable, actual, potential, or specific claim in mind.[105] Moreover, the applicant must demonstrate a "genuine fear,"[106] a "real possibility,"[107] a "strong prospect,"[108] or a "substantial possibility"[109] of future litigation, and the threat of litigation must be "more likely than not"[110] and "imminent."[111]

---

[97]*In re Ford Motor Co.*, 110 F.3d 954, 967 (3d Cir. 1997) (stating that the "literal language of Rule 26(b)(3) requires that the material be prepared in anticipation of some litigation, not necessarily in anticipation of the *particular* litigation in which it is being sought") (emphasis in the original) (citing to *In re Grand Jury Proceedings*, 604 F.2d at 803).

[98]*Sanner*, 181 F.R.D. at 378 (citing *Binks Mfg. Co.*, 709 F.2d at 1118) (stating that the "mere fact that litigation does eventually ensue does not, by itself, cloak materials with work product immunity"); *Nat'l Union Fire Ins. Co.*, 967 F.2d at 984 (same).

[99]*See, e.g.*, *In re Sealed Case*, 146 F.3d at 887 (holding that when lawyers claim they advised clients about the risks of potential litigation, "the absence of a specific claim represents just one factor that courts should consider in determining whether the work product privilege applies").

[100]*See, e.g.*, *Senate of P.R.*, 823 F.2d at 586 n.42 (finding that it is not the case that "documents prepared while no active investigations were underway are necessarily unprotected by the work product doctrine"; rather, the presence or absence of an ongoing investigation "is but one aspect of the relevant 'factual situation' a court must consider in evaluating an agency's work product claim").

[101]*See, e.g.*, *In re Grand Jury Subpoena*, 220 F.R.D. at 147 (requiring more than "a mere remote possibility" of litigation); *Heath v. F/V Zolotoi*, 221 F.R.D. 545, 550 (W.D. Wash. 2004) ("more than the mere possibility of litigation") (citing *Detection Sys., Inc. v. Pittway Corp.*, 96 F.R.D. 152, 155 (W.D.N.Y. 1982)); *Fox*, 120 F.R.D. at 524 (same); *Diversified Indus.*, 572 F.2d at 604 ("remote prospect"); *Panter v. Marshall Field & Co.*, 80 F.R.D. 718, 725 n.6 (N.D. Ill. 1978) ("remote possibility"); *Garfinkle v. Arcata Nat'l Corp.*, 64 F.R.D. 688, 690 (S.D.N.Y. 1974); *Burlington Indus.*, 65 F.R.D. at 43 ("mere possibility"); *Zenith Radio Corp. v. Radio Corp. of Am.*, 121 F. Supp. 792, 795 (D. Del. 1954) (finding that "remote possibility of litigation such as surrounds nearly every act of the office attorney is an insufficient showing").

[102]*United States v. KPMG, LLP*, 316 F. Supp.2d 30, 41 (D.D.C. 2004), *Doc 2004-9558, 2004 TNT 87-12* (stating that the "mere mention of fear of being sued" for an action or inaction "is not the sort of 'anticipation of litigation' which is covered by the attorney work product doctrine").

[103]*Garfinkle*, 64 F.R.D. at 690. *See also Portsmouth Redevelopment & Hous. Auth. v. BMI Apartments Assoc.* 155 F.R.D. 136 (E.D. Va. 1994), *withdrawn*, reported at 28 Fed. R. Serv. 3d 1415 (E.D. Va. 1994), *vacated*, 1994 U.S. Dist. LEXIS 21561 (E.D. Va. 1994) (finding that applicant's blanket assertion that the possibility of litigation was "obvious" at the time requested documents were prepared was legally insufficient to secure work product protection because litigation is an "ever-present possibility in American life" and events are routinely documented with the general possibility of litigation in mind).

[104]*Id.*

[105]*See Nat'l Union Fire Ins. Co.*, 967 F.2d at 984 ("The document must be prepared because of the prospect of litigation when the preparer faces an actual claim or a potential claim following an actual event or series of events that reasonably could result in litigation"); *Pacamore Bearings, Inc. v. Minebea Co.*, 918 F. Supp. 491, 513 (D.N.H. 1996) (requiring "an identifiable prospect of litigation (i.e., specific claims that have already arisen) at the time the documents were prepared") (citing *Fox*, 120 F.R.D. at 525) (citing *Burlington Indus.*, 65 F.R.D. at 42-43; *Linde Thomson Langworthy Kohn & Van Dyke*, 5 F.3d at 1515 (the document must be "created 'with a specific claim supported by concrete facts which would likely lead to litigation in mind'") (citing *Coastal States Gas Corp.*, 617 F.2d at 864)).

[106]*Equal Employment Opportunity Comm'n v. Lutheran Soc. Serv.*, 186 F.3d 959, 968 (D.D.C. 1999).

[107]*Equal Rights Ctr. v. Post Props., Inc.*, 247 F.R.D. 208, 210 (D.D.C. 2008).

[108]*Briggs & Stratton Corp. v. Concrete Sales & Serv.*, 174 F.R.D. 506, 509 (M.D. Ga. 1997).

[109]*Sec. & Exch. Comm'n v. World-Wide Coin Invest., Ltd.*, 92 F.R.D. 65, 66 (N.D. Ga. 1981).

[110]*S.D. Warren Co. v. E. Elec. Corp.*, 201 F.R.D. 280, 285 (D. Me. 2001).

[111]*See World-Wide Coin Invest.*, 92 F.R.D. at 66; *In re Grand Jury Investigation*, 412 F. Supp. at 948. If an applicant cannot identify an adversary or even a specific claim likely to result in litigation, it should not get the benefit of work product immunity, which is reserved exclusively for protecting the adversarial process. Representative cases involving appropriate application of the work product privilege are mindful of the doctrine's purpose and the emphasis on "imminent" litigation. *See, e.g.*, *Hollinger Int'l, Inc. v. Hollinger, Inc.*, 230 F.R.D. 508 (N.D. Ill. 2005) (granting immunity to documents used to create a report of a corporation's special committee formed to investigate alleged looting of the company's assets by individual officers); *Ayuso Figueroa v. Victor Rivera Gonzalez*, 229 F.R.D. 41 (D.P.R. 2005) (granting immunity to documents prepared as part of determining whether government officials who had been sued by a former prison inmate were entitled to legal representation); *Willingham v. Ashcroft*, 228 F.R.D. 1 (D.D.C. 2005) (granting immunity to documents prepared by the Drug Enforcement Agency in preparation for a potential challenge to a former employee's indefinite suspension); *Chambers v. Allstate Ins. Co.*, 206 F.R.D. 579 (S.D. W.Va. 2002) (granting immunity to documents prepared by homeowner's liability insurer, after it became clear to the insurer that the insured might have been involved in starting the fire for which the insured submitted a claim); *Sperling v. City of Kennesaw Police Dep't*, 202 F.R.D. 325 (N.D. Ga. 2001) (granting immunity to document prepared by client at her attorney's request for the purpose of responding to another party's interrogatories); *Ryall v. Appleton Elec. Co.*, 153 F.R.D. 660 (D. Colo. 1994) (in the context of an employer's investigation responding to an employee's attorney who indicated that sexual harassment litigation was imminent, court granted immunity to employer's chief employment counsel's notes of interviews with allegedly harassing manager); *Suggs v.*

(Footnote continued on next page.)

Even in cases in which the applicant can show that it had the prospect of litigation in mind when it prepared a document, work product protection does not apply to documents prepared in the ordinary course of business or irrespective of the prospect of litigation.[112] Indeed, the drafters of Rule 26(b)(3) excluded from immunity ''materials assembled in the ordinary course of business, or under public requirements unrelated to litigation, or for other nonlitigation purposes.''[113] Thus, if a document would have been created without regard to litigation, even if it may also be useful in the event of litigation,[114] it will be deemed to have been made in the ordinary course of business and discoverable. For dual-purpose documents — that is, documents prepared for litigation as well as nonlitigation purposes — an applicant can still prevent discovery,[115] but only if the documents would not have been generated ''in the absence of pending or possible future litigation.''[116] Of course, the applicant must also satisfy the ''objectively reasonable'' and ''subjectively reasonable'' standards.[117]

Distinguishing between documents created for business versus litigation appreciates the work product doctrine's underlying purpose of protecting the adversarial process.[118] To this end, courts grant immunity to documents prepared in anticipation of litigation but deny it for documents prepared to determine *whether* to anticipate litigation.[119] Courts hold government applicants to the same standard, denying protection to documents prepared while a government agency investigates whether or not to pursue a litigation strategy against a regulated entity.[120]

In the same way, and because the prospect of litigation is premature, courts deny work product immunity for documents created for regulatory rather than litigation purposes.[121] In the tax context, the work product doctrine

---

Whitaker, 152 F.R.D. 501, 506, and 507 (M.D.N.C. 1993) (immunity granted to statements taken by insurance adjuster from the insured and auto accident witness in an accident in which insured crossed the median, collided with another car, and injured and killed another driver; likelihood of insured being found negligent ''immediately apparent,'' and ''prospect of litigation [was] immediate''); *United States v. Davis*, 131 F.R.D. 391, 406 (S.D.N.Y. 1990) (granting immunity for documents prepared as part of internal investigation that ''exactly paralleled ongoing criminal investigation as well as pending civil litigation'').

[112]*See, e.g.*, *Allied Irish Banks v. Bank of Am., N.A.*, 240 F.R.D. 96, 106 (S.D.N.Y. 2007); *Roxworthy*, 457 F.3d at 594; *Mims*, 230 F.R.D. at 484; *Minebea Co. v. Papst*, 355 F. Supp.2d 526, 529 (D.D.C. 2005); *S.D. Warren Co.*, 201 F.R.D. at 285; *Kidwiler v. Progressive Paloverde Ins. Co.*, 192 F.R.D. 536, 542 (N.D. W.Va. 2000); *Miller v. Fed. Express Corp.*, 186 F.R.D. 376, 387 (W.D. Tenn. 1999); *Adlman*, 134 F.3d at 1202; *Tayler v. Travelers Ins. Co.*, 183 F.R.D. 67, 70 (N.D.N.Y. 1998); *Sanders v. Ala. State Bar*, 161 F.R.D. 470, 473 (M.D. Ala. 1995); *Linde Thomson Langworthy Kohn & Van Dyke*, 5 F.3d at 1515; *Peterson v. Douglas County Bank & Trust Co.*, 967 F.2d 1186, 1189 (8th Cir. 1992); *Simon*, 816 F.2d at 401; *Gerrits v. Brannen Banks of Fla.*, 138 F.R.D. 574, 576 (D. Colo. 1991).

[113]*Martin*, 983 F.2d at 1260 (quoting Rule 26(b)(3), Advisory Committee Note). *See also Pacamore Bearings*, 918 F. Supp. at 513 (stating that ''materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes'' are not protected under the rule).

[114]*See Maine*, 298 F.3d at 70; *Smith v. Conway Org., Inc.* 154 F.R.D. 73, 78 (S.D.N.Y. 1994) (quoting *Redvanly v. NYNEX Corp.*, 152 F.R.D. 460, 465 (S.D.N.Y. 1993)) (quoting *Martin v. Valley Nat'l Bank*, 140 F.R.D. 291, 304 (S.D.N.Y. 1991)); Wright, Miller, and Marcus, *supra* note 48, at 346.

[115]*See Torf*, 357 F.3d at 910 (finding that the documents at issue were ''entitled to work product protection because, taking into account the facts surrounding their creation, their litigation purpose so permeates any non-litigation purpose that the two purposes cannot be discretely separated from the factual nexus as a whole''); *In re Special September 1978 Grand Jury (II)*, 640 F.2d 49 (7th Cir. 1980) (holding that preparation of documents for nonlitigation purposes does not disqualify them from protection if they were also prepared in anticipation of litigation).

[116]*In re OM Group Sec. Litig.*, 226 F.R.D. at 587 (finding that litigation and business purposes were ''inextricably intertwined'' with ''neither purpose dominat[ing] the other'' so that

(Footnote continued in next column.)

''the issue presented is whether the documents would have been generated in the absence of pending or possible future litigation'') (citing *Maine*, 298 F.3d at 70). The threshold is obviously higher for the minority of circuits that have adopted the ''primary motivating purpose'' test for preparing a document.

[117]*See supra* notes 92-111 and accompanying text.

[118]*See, e.g.*, *Fid. Int'l*, No. 05-40151, slip op. 27 (denying protection to tax opinion letters ''prepared as part of a sophisticated effort to induce taxpayers to invest'' in a tax shelter strategy, ''not because of a specific and identifiable threat or prospect of litigation with the IRS''); *United States v. Ackert*, 76 F. Supp.2d 222 (D. Conn. 1999) (denying work product immunity and granting motion to enforce IRS summons because conversations with tax attorneys took place in connection with a proposed business investment rather than an impending lawsuit).

[119]*McFadden v. Norton Co.*, 118 F.R.D. 625, 632 (D. Neb. 1988) (finding that a report prepared in keeping with the applicant's prudent business policies of evaluating claims in-house before determining its response was not within the work product immunity because it was not prepared in anticipation of litigation but to determine whether to anticipate litigation in the first place).

[120]*See, e.g.*, *Abel v. United States*, 53 F.R.D. 485 (D. Neb. 1971) (withholding immunity from IRS reports and memoranda routinely prepared in each case and before filing of a lawsuit against a taxpayer even though the documents at issue contained mental impressions, conclusions, and legal theories of IRS employees); *Sec. & Exch. Comm'n v. Nat'l Student Mktg. Corp.*, 18 Fed. R. Serv. 2d 1302, 1310-1311 (D.D.C. 1974) (denying protection for memoranda prepared by SEC staff in the course of an investigation of a listed company and before a draft memorandum to the commission recommending that suit be filed).

[121]*Nat'l Union Fire Ins. Co.*, 967 F.2d at 984 (work product immunity inapplicable to documents prepared ''pursuant to regulatory requirements''). *See also Video Warehouse of Huntington, Inc. v. Boston Old Colony Ins. Co.*, 160 F.R.D. 83, 85 (S.D. W.Va. 1994) (no protection for documents prepared in response to directions from the Office of the Insurance Commissioner that compliance was required ''by regulation''); *Rockwell Int'l*, 897 F.2d at 1266 (no work product for documents created to comply with regulatory requirements); *Galambus*, 64 F.R.D. at 472 (denying protection to statements of an employee truck driver to his employers and to the carrier ''made pursuant to ICC regulations'' because such statements ''are made in the ordinary

(Footnote continued on next page.)

has not protected tax accrual workpapers, tax-pool analyses, audit opinion letters, tax opinion letters, or accountant worksheets to the extent the documents were created to satisfy public reporting and disclosure requirements or to generate annual tax returns.[122] As one court has explained, those materials do not constitute work product because taxpayer-applicants generate them ''with an eye on its business needs, not on its legal ones,'' the analysis contained therein ''is only a means to a business end,'' ''business imperatives, not the press of litigation, call these documents into being,'' and they reflect ''much more the aura of daily business than . . . of courtroom combat.''[123]

Once a government investigation has commenced, the work product doctrine may immunize documents prepared thereafter because the threat of litigation has increased.[124] Further, documents may be protected from discovery under the anticipation of litigation rubric if prepared for arbitration or an administrative hearing. Although the federal rules do not define the kind of litigation the applicant must have anticipated when it created a document, litigation generally encompasses ''a proceeding in a court or administrative tribunal in which the parties have the right to cross-examine witnesses or to subject an opposing party's presentation of proof to equivalent disputation.''[125] In other words, in determining what kind of anticipated litigation is covered by the work product doctrine, it is as important that the proceeding be adversarial as it is that it be in front of the appropriate tribunal.[126] Therefore, the preparation of documents associated with agency filings are generally

---

course of business under those regulations and were not work products''); Edna Selan Epstein, *The Attorney-Client Privilege & the Work product Doctrine* 532 (4th ed. 2001) (no work product protection for documents generated to ''comply with regulatory requirements,'' even if ''the resulting documents may be prepared with a high probability of litigation in mind'').

[122]*See Fid. Int'l*, No. 05-40151, slip op. 25 (denying protection to tax opinion letters because they could not ''be considered separately from the circumstances of their creation,'' even though when ''viewed in isolation,'' they ''could be construed as materials prepared in anticipation of litigation: the IRS was a potential adversary, and the law firm rendered opinions as to the likely tax consequences and the likelihood that the taxpayer would have to pay a penalty''); *In re Raytheon Sec. Litig.*, 218 F.R.D. at 359 (no protection for audit opinion letters prepared by an attorney for an independent auditor about pending lawsuits involving the audited company to the extent the letters must be disclosed in the company's public financial statements, even if the party is aware that the documents may also be useful in the event of litigation); *In re Royal Ahold Sec. & Erisa Lit.*, 230 F.R.D. 433, 435 (D. Md. 2005) (denying work product protection for documents created for independent auditors to complete work on public financial statements, even though the ''company was also preparing for litigation''); *Frederick*, 182 F.3d 496 (denying protection to accountant's worksheets created by a lawyer and used in preparing the client's tax returns because the tax preparation activity was a readily separable activity from litigation preparation, and using a lawyer rather than a nonlawyer preparer did not blur the distinction); *Indep. Petrochemical Corp. v. Aetna Cas. & Sur. Co.*, 117 F.R.D. 292, 298 (D.D.C. 1987) (denying work product immunity to audit letters prepared by an attorney because they were prepared ''in the performance of regular accounting work''); *Gulf Oil Corp.*, 760 F.2d at 296 (denying work product immunity when documents were created to help auditors prepare financial reports to satisfy the requirements of federal securities laws and not primarily with an eye toward potential litigation); *El Paso*, 682 F.2d at 542-544 (no protection for tax-pool analyses because they were prepared to comply with public reporting requirements and not potential litigation over the positions or transactions contained therein); *Davis*, 636 F.2d at 1040 (denying immunity for tax accrual workpapers that were prepared to aid in the preparation of tax returns and not primarily to litigate over the contents of the returns).

[123]*El Paso*, 682 F.2d at 543-544. *See also In re OM Group Sec. Litig.*, 226 F.R.D. at 586-587 (denying protection for documents created by a public company's audit committee's outside counsel ''for dual purposes'' of ''the possibility of litigation and business impact on past earnings and financial statements'' because the ''accuracy of earnings and financial statements is clearly a business matter for all publicly-held corporations, regardless of whether litigation is pending or anticipated'').

[124]*See Briggs & Stratton*, 174 F.R.D. 506 (granting protection to documents generated by a corporation's personnel during the course of responding to an order of the Environmental Protection Agency); *Martin v. Monfort, Inc.*, 150 F.R.D. 172, 173 (D. Colo. 1993) (finding that courts recognize that ''investigation by a federal agency presents more than a remote prospect of future litigation, and provides reasonable grounds for anticipating litigation sufficient to trigger application of the work product doctrine'') (citing *Kent Corp. v. NLRB*, 530 F.2d 612, 623 (5th Cir. 1976), *cert. denied*, 429 U.S. 920 (1976)); *In re LTV Sec. Litig.*, 89 F.R.D. 595, 612 (N.D. Tex. 1981) (stating that ''investigation by a federal agency presents more than a 'remote prospect' of future litigation and gives grounds for anticipating litigation sufficient for the work product rule to apply''). *But see Abel*, 53 F.R.D. at 489 (rejecting the government's argument that audit documents for a particular taxpayer investigation are prepared in anticipation of litigation); *Peterson v. United States*, 52 F.R.D. 317, 320 (S.D. Ill. 1971) (denying protection to IRS appellate conferee reports and field agent reports); *Nat'l Student Mktg. Corp.*, 18 Fed. R. Serv. 2d at 1310 (denying protection for documents prepared by SEC staff during its investigation of a listed company).

[125]*United States v. Am. Tel. & Tel. Co.*, 86 F.R.D. 603, 627 (D.D.C. 1979), *Special Masters' Guidelines for the Resolution of Privilege Claims*, authored by Paul R. Rice and Geoffrey C. Hazard Jr. *See also S. Union Co. v. Sw. Gas Corp.*, 205 F.R.D. 542, 549 (D. Ariz. 2002) (citing favorably to the Special Masters' definition). The definition articulated by the Special Masters covers criminal as well as civil matters, and has been extended to proceedings, such as the grand jury, that do not typically include the right to cross-examine, but which preserve other adversarial characteristics. *See* Epstein, *supra* note 121, at 504-505.

[126]*See* Wright, Miller, and Marcus, 2008 Pocket Part, vol. 8, ch. 6, at 167 (2008) (stating that ''litigation should be understood generally to include proceedings before administrative tribunals if they are of an adversarial nature''); *S. Union Co.*, 205 F.R.D. at 549 (finding that work product immunity applies to litigation before administrative tribunals, and that an ''administrative hearing constitutes litigation if there is a right to cross-examine witnesses''); *Samuels v. Mitchell*, 155 F.R.D. 195, 200 (N.D. Cal. 1994) (''Since arbitrations are adversarial in nature and can be fairly characterized as 'litigation' within the meaning of Rule 26(b)(3), documents prepared by or for a party in connection with arbitrations should ordinarily be protected by the work product doctrine'').

not considered to be in anticipation of litigation absent some adversarial component to the filing or proceeding.[127]

The party seeking immunity for purported work product bears the initial burden of establishing all the elements of the privilege,[128] lest "its claim will be rejected."[129] Even if litigation was subjectively anticipated when documents were created, the applicant still bears the burden of "demonstrating that the documents would not have been prepared but for the litigation."[130] Moreover, it is not enough for an applicant to assert a general claim of privilege when responding to a discovery request.[131] Instead, the applicant must satisfy its burden for each document using privilege log entries, affidavits, or the documents themselves.[132] The federal rules mandate that an applicant "expressly make the claim" of privilege, and "describe the nature of the documents, communications, or tangible things not produced or disclosed" so that other parties, including the court, can appropriately evaluate the claim.[133] The requirement expresses a strong preference for descriptive claims in the interest of judicial efficiency and cost saving. Courts, too, prefer explicit claims, particularly in the form of detailed privilege logs.[134]

Once the applicant meets its burden, the party seeking discovery must show good cause to overcome an otherwise sufficient showing for work product protection.[135] In particular, the party must show substantial need[136] for the undiscovered materials, and that it is unable, without undue hardship,[137] to obtain the substantial equivalent of the materials by other means.[138] Also, just as the applicant must prove the circumstances for protection for each

---

[127]*See United States v. Naegele*, 468 F. Supp.2d 165 (D.D.C. 2007) (no protection for documents prepared incident to debtor's bankruptcy filing which was not itself "litigation" in anticipation of which protected attorney work product could be generated); *Oak Indus. v. Zenith Elec. Corp.*, 687 F. Supp. 369, 373-375 (N.D. Ill. 1988) (finding that the preparation of a patent application was not in anticipation of litigation because it was principally ex parte administrative rather than adversarial); *Elec. Memories & Magnetics Corp. v. Control Data Corp.*, 1975 U.S. Dist. LEXIS 11757, 188 U.S.P.Q. 449 (N.D. Ill. 1975) (granting immunity to documents prepared in anticipation of an interference proceeding due to its adversarial nature). *See also* cases discussed *supra* notes 121-123 and accompanying text.

[128]Indeed, "it is axiomatic that the burden is on a party claiming the protection of a privilege to establish those facts that are the essential elements of the privileged relationship." *In re Grand Jury Subpoena Dtd. Jan. 4, 1984*, 750 F.2d 223, 224 (2d Cir. 1984).

[129]*United States v. Constr. Prods. Research, Inc.*, 73 F.3d 464, 473 (2d Cir. 1996) (quoting *Bowne of New York City*, 150 F.R.D. at 474.) *See also Jumpsport, Inc. v. Jumpking, Inc.*, 213 F.R.D. 329, 330-331 (N.D. Cal. 2003); *Gulf Islands Leasing, Inc. v. Bombardier Capital, Inc.*, 215 F.R.D. 466, 476 (S.D.N.Y. 2003); *In re Grand Jury Subpoenas Dtd. Mar. 19, 2002 and Aug. 2, 2002*, 318 F.3d 379, 384 (2d Cir. 2003); *Guardsmark*, 206 F.R.D. at 206-207; *Tayler*, 183 F.R.D. at 70; *In re Kidder Peabody Sec. Litig.*, 168 F.R.D. 459, 462 (S.D.N.Y. 1996); *von Bulow by Auersperg v. von Bulow*, 811 F.2d 136, 144 (2d Cir. 1987), *cert. denied*, 481 U.S. 1015 (1987); *In re Grand Jury Subpoena Dtd. Jan. 4, 1984*, 750 F.2d at 224-225; *Legin v. Blue Cross & Blue Shield*, 166 F.R.D. 496, 498 (D. Kan. 1996); *Coastal States Gas Corp.*, 617 F.2d at 865.

[130]*Grinnell Corp. v. ITT Corp.*, 222 F.R.D. 74, 78 (S.D.N.Y. 2003) (quoting *Weber v. Paduano*, 2003 U.S. Dist. LEXIS 858, at *20 (S.D.N.Y. 2003)).

[131]*Obiajulu v. City of Rochester, Dept. of Law*, 166 F.R.D. 293, 295 (W.D.N.Y. 1996).

[132]*Va. Elec. & Power Co. v. Sun Shipbuilding & Dry Dock Co.*, 68 F.R.D. 397, 410 (E.D. Va. 1975). *See also Grinnell*, 222 F.R.D. at 78; *CSC Recovery Corp. v. Daido Steel Co., Ltd.*, 1997 U.S. Dist. LEXIS 16346, at *7-8 (S.D.N.Y. 1997) (cases cited).

[133]FRCP 26(b)(5)(A)(i-ii).

[134]As one commentator has written, not only is it necessary for the applicant to assert the privilege with specificity, "but also that specific identification be provided in any privilege log so that a court can readily test the validity of the assertion. Absent such identifying indicia, courts will order documents produced, often without bothering to review the disputed document. If a party does not sufficiently value the privilege to prove it, why should a court bother to sustain the assertion of the privilege?" Epstein, *supra* note 121, at 648. *See Equal Rights Ctr.*, 247 F.R.D. at 213 (denying protection to "general claim of privilege" and ordering the production of a privilege log); *Breon v. Coca-Cola Bottling Co.*, 232 F.R.D. 49, 55 (D. Conn. 2005) (denying protection for failure to provide a privilege log or more than a "skeletal argument" for privilege claims); *Toler v. United States*, 2003 U.S. Dist. LEXIS 8565, at *16 (S.D. Ohio 2003) (denying in part taxpayer's motion to quash an IRS summons for failure to prepare a privilege log sufficiently identifying and describing allegedly privileged documents); *United States v. Constr. Prod. Research Inc.*, 73 F.3d 464, 474 (2d Cir. 1996), *cert. denied*, 519 U.S 927 (1996) (denying protection to documents in which the applicant's privilege log "simply [did] not provide enough information to support the privilege claim, particularly in the glaring absence of any supporting affidavits or other documentation"). A small minority of courts reject the federal rules' mandate and the majority's emphasis on express and descriptive claims of privilege. *See, e.g.*, *Toledo Edison Co. v. G A Tech., Inc. Torrey Pines Tech. Div.*, 847 F.2d 335, 341-342 (6th Cir. 1988) (merely requiring affidavits from applicants indicating that documents at issue were prepared in anticipation of litigation to meet prima facie burden).

[135]*See, e.g.*, *Ferko v. NASCAR*, 219 F.R.D. 396, 400 (E.D. Tex. 2003) (stating that if a party "proves that materials merit work product protection, the party seeking discovery must prove why those materials should still be produced"). Of course, the party seeking discovery can also always challenge the grounds for protection.

[136]Generally, as the Supreme Court held in *Hickman*, "Where relevant and non-privileged facts remain hidden in an attorney's file and where production of those facts is essential to the preparation of one's case, discovery may properly be had." *Hickman*, 329 U.S. at 511.

[137]*In re LTV Sec. Litig.*, 89 F.R.D. at 616 (stating that significant extra costs in obtaining substantially equivalent information could be grounds for finding "undue hardship" to overcome work product protection); *Jarvis, Inc. v. Am. Tel. & Tel. Co.*, 84 F.R.D. 286, 293 (D. Colo. 1979) (finding "undue hardship" when the party seeking discovery would otherwise be forced to depose 1,500 witnesses to obtain equivalent information).

[138]FRCP 26(b)(3)(A)(ii). For no readily available alternative means, see, e.g., *Reavis v. Metro. Prop. & Liab. Ins. Co.*, 117 F.R.D. 160, 164 (S.D. Cal. 1987) (finding that although the party seeking discovery "may be able to depose the insurance adjusters and other claims representatives who handled the claim, this may not be the substantial equivalent of the documentation contained in the claims files"); *In re Grand Jury Subpoena Dtd. Nov. 8,*

(Footnote continued on next page.)

document, the party seeking discovery must show substantial need and undue hardship for each document.[139] Even if the party seeking discovery shows good cause, the court may still provide immunity for opinion work product (that is, the ''mental impressions, conclusions, opinions or legal theories of an attorney or other representative''[140]), at which point the party seeking discovery must demonstrate more than an ordinary showing of substantial need and undue hardship to pierce the immunity.[141] Finally, determining whether the parties have met their respective burdens requires court scrutiny, including for burdens pertaining to claims of waiver.[142] The applicability or inapplicability of the work product doctrine ''must be supported by district court findings on the circumstances of preparation and purpose of the documents.''[143] Those findings, in turn, require the court to have examined the documents and the circumstances surrounding their creation and subsequent handling,[144] a responsibility that obligates courts to require sufficient document indexes and privilege logs,[145] conduct in camera inspections,[146] order production of carefully redacted documents,[147] and craft detailed protective orders.[148]

II. Tax, *Textron*, and Blanket Immunity

Work product analysis in the regulatory context, and particularly in the *tax* regulatory context, presents unique challenges to courts. More than other kinds of documents and tangible things, tax preparation materials require courts to recognize distinctions between content and function. While the *content* of tax materials — including tax accrual workpapers — can include discussions of potential litigation success or failure for particular transactions, the *function* of the materials — that is, why they were created in the first place — is mandated by independent, superseding authority unrelated to potential litigation. Courts regularly confuse this distinction, distracted by routine and required discussions regarding the likelihood of success on the merits of particular transactions. In so doing, courts disregard the work product doctrine's primary concern with *why* a document was prepared, rather than with what it includes.

Courts are accustomed to conducting work product analysis in the traditional adversarial setting. But tax is different. Not only are tax documents prepared for nonlitigation purposes, but their creation takes place in a distinctly nonadversarial setting. The relationship between taxpayers and the government is *not* inherently

---

1979, 622 F.2d 933, 935 (6th Cir. 1980) (preventing discovery when the party seeking materials was merely ''on a fishing expedition'' into the opposing attorney's files ''to satisfy itself that nothing has been overlooked'').

[139]*Va. Elec. & Power*, 68 F.R.D. at 410. *See also Delco Wire & Cable, Inc. v. Weinberger*, 109 F.R.D. 680, 689 (E.D. Pa. 1986) (denying discovery when the party seeking documents failed ''to show that they have a substantial need for any of the specific documents or information at issue''); *In re Grand Jury Investigation*, 599 F.2d 1224; *United States v. Chatham City Corp.*, 72 F.R.D. 640, 644 (S.D. Ga. 1976) (''Defendants have shown a general, not a particularized, need for the materials they seek. The claim of necessity for the intrusion into the investigative file appears to be little more substantial than a desire to learn what kind of a case the Government has'').

[140]FRCP 26(b)(3)(B). *See also supra* note 52 and accompanying text.

[141]Although a minority of courts grant absolute protection to opinion work product (see *In re Grand Jury Proceedings*, 473 F.2d 840, 848 (8th Cir. 1973) (stating that opinion work product is ''absolutely, rather than conditionally, privileged'')), the better treatment, and the one followed by the Supreme Court (see *Upjohn*, 449 U.S. at 400-402), is to require ''a far stronger showing of necessity and unavailability by other means'' before denying protection). *See also* Epstein, *supra* note 121, at 570. (''It seems fairly clear . . . that protection of opinion work product is not absolute, but that consideration is given to such factors as the extent to which the attorney's mental processes are involved, the inhibiting effect that disclosure would have, and the extent to which the discovering party is seeking a free ride on the attorney's thinking.'')

[142]It is harder to waive the work product privilege than the attorney-client privilege. *See, e.g.*, *Aiken v. Tex. Farm Bureau Mut. Ins. Co.*, 151 F.R.D. 621, 623 n.3 (E.D. Tex. 1993) (finding that work product protection is not automatically waived by disclosure to a third party). While the latter merely requires disclosure of confidential client communications to a third party, waiver of the former requires ''disclosure to an adversary, real or potential'' (*MIT*, 129 F.3d at 687), or to a ''conduit to a potential adversary'' (*Raytheon*, 218 F.R.D. at 360). *See also High Tech Commc'n, Inc. v. Panasonic Co.*, 1995 U.S. Dist. LEXIS 2547, at *8 (E.D. La. 1995) (stating that waiver of work product protection ''only occurs when the party asserting the privilege substantially increases the likelihood that the opposing party would come into the possession of the statements''). The party asserting waiver bears the burden of establishing facts necessary to support that finding. *See, e.g.*, *B.H. v. Gold Fields Mining Corp.*, 239 F.R.D. 652, 655 (N.D. Okla. 2005); *In re Convergent Tech.*, 122 F.R.D. 555, 565 (N.D. Ca. 1988). Moreover, the higher threshold associated with waiver of work product, by necessity, requires an elevated showing by the party seeking disclosure, as well as greater scrutiny by the court evaluating the waiver claim.

[143]*Rockwell Int'l*, 897 F.2d at 1257 (further stating, ''It will be necessary upon remand for the district court to determine with specificity [applicant's] motivation in creating and maintaining the free reserve file,'' *id*. at 1266).

[144]*See, e.g.*, *Nat'l Union Fire Ins. Co.*, 967 F.2d at 984 (noting a court's obligation to conduct a fact-intensive analysis to determine the reasons an applicant prepared each requested document); *Binks Mfg. Co.*, 709 F.2d at 1118 (acknowledging court responsibility to consider carefully whether materials sought to be protected from disclosure were in fact prepared in anticipation of litigation).

[145]*See supra* notes 132-134 and accompanying text.

[146]In fact, in camera review has become so commonplace among federal courts that failure to do so can result in a finding of plain error. *See, e.g.*, *In re Antitrust Grand Jury*, 805 F.2d 155, 168 (6th Cir. 1986) (ordering production of documents without in camera review).

[147]*See, e.g.*, *U.S. Postal Serv. v. Phelps Dodge Ref. Corp.*, 852 F. Supp. 156 (E.D.N.Y. 1994) (ordering privileged part of a document not otherwise privileged to be redacted and produced). If the discoverable part of the document is so ''intertwined'' with privileged information, the entire document may have to be produced, particularly ''where one party has control over the information sought.'' *Xerox Corp. v. Int'l Bus. Mach. Corp.*, 64 F.R.D. 367, 381 (S.D.N.Y. 1974).

[148]*See* Epstein, *supra* note 121, at 671. (''It is now standard operating procedure to produce documents, subject to a protective order.'')

adversarial, particularly as that term is used to describe litigation in the context of work product analysis.[149] Planning a transaction, reporting a position on a return, or even undergoing an audit is far removed from the adversarial arena. Anticipating litigation at these stages of interaction between the taxpayer and the government is premature and unreasonable. But courts regularly confuse these interactions as tantamount to litigation. With equal regularity, applicants exploit the confusion.

Tax is different for yet another reason. While discovery of documents prepared in anticipation of litigation could conceivably harm the adversarial process, discovery of tax preparation materials protects the nation's tax laws from abusive tax avoidance. Under our tax system, taxpayers self-assess their liability, and taxpayers engaged in aggressive tax planning enjoy greater flexibility in their self-assessment because of the legal ambiguity surrounding their transactions. The tax returns and accompanying disclosure statements for these taxpayers are exceedingly complex, run thousands of pages in length, and reflect the form rather than the substance of a taxpayer's transactional history. By requiring disclosure of tax preparation materials for these taxpayers, courts complement the taxing agency's regulatory function of identifying aggressive transactions, verifying their accuracy as reflected on tax returns, and evaluating their substance along with their form. Far from putting taxpayers at an unfair disadvantage, requiring disclosure reinforces legislative and regulatory antishelter efforts emphasizing transparency rather than secrecy, more rather than less cooperation.

The *Textron* court failed to appreciate the challenges involved in analyzing work product in the tax context. In this respect, the court was not alone.[150] But in addition to being wrong on the facts, wrong on the law, blind to the information asymmetries that threaten our self-assessment tax system, and seemingly unaware of recent legislative and regulatory efforts to root out and punish the tax avoidance practiced by the applicant appearing in front of it, the court failed to conduct an adequate work product analysis, even for the traditional litigation setting.[151] It accepted at face value the applicant's blanket privilege claim and in the process, ignored the mandate of the federal rules that applicants ''expressly make'' assertions of privilege, and that courts expressly evaluate whether an applicant's purported anticipation of litigation is objectively reasonable.[152] Moreover, in failing its responsibilities, the court adopted without hesitation the applicant's newly-coined and supremely loaded phrase ''hazard litigation percentages'' to describe the contents of tax accrual workpapers.[153] Finally, while claiming to safeguard the adversarial system, the court-protected documents that have nothing to do with that system. Worse and far more damaging, its decision endangers the government's regulatory powers, undermines federal antishelter legislation, and ultimately makes the government weaker and less effectual in fighting abusive tax avoidance.

A. Accrual Workpapers Are Not Prepared in Anticipation of Litigation

For tax preparation materials to receive work product protection, an applicant must demonstrate that they were created in anticipation of litigation or for trial, and that they would not have been prepared in substantially the same manner regardless of the anticipated litigation.[154] The key question is, *why* were the documents created? The *context* of document preparation, not the *content* of the documents themselves, is what matters. And the *context* surrounding the preparation of tax documents, including tax accrual workpapers, has nothing to do with anticipating litigation. Rather, it involves complying with public reporting requirements mandated by federal securities and tax laws, as well as with standards of best practices as promulgated by the major professional tax practitioner organizations.

Tax accrual workpapers support a corporate taxpayer's reserve for deferred or contingent tax liabilities and

[149]*See supra* notes 125-126, *infra* notes 231-234, and accompanying text.

[150]*See, e.g.*, *Roxworthy*, 457 F.3d at 598 (in granting immunity to memoranda analyzing the tax consequences of particular transactions, the court stated that the applicant ''anticipated litigation because of the *certainty* of an IRS audit, the *conspicuousness* of the $112 million discrepancy between tax and book loss, and the *unsettled law* surrounding'' the transactions at issue) (emphasis added). For criticisms of these three justifications, see, respectively, *infra* notes 216-230, 212-215, 239-244, and accompanying text. *See also United States v. Chevron Texaco Corp.*, 241 F. Supp.2d 1065, 1089 n.6 (N.D. Cal. 2002) (in granting immunity to audit documents analyzing a particular transaction, the court noted the ''unusual environment'' in which the transaction arose: ''First, at least one of the reasons Chevron considered this transaction was to achieve sizeable tax benefits. [Not so unusual.] Second, from the first day Chevron contemplated a transaction of this type it was a virtual certainty that the IRS would challenge the transaction in litigation. [Conclusory and factually wrong, see *infra* notes 205-211, 216-230, and accompanying text.] It was equally clear that that litigation would relate solely to treatment of the transaction under the tax code. Under these circumstances virtually every decision about how to structure a material aspect of the transaction was permeated with questions about how that structuring would affect treatment under the tax code. As this court noted in its earlier recommendations, determining treatment under the tax code is an intensely legal endeavor. [As in *Textron*, the *Chevron*

(Footnote continued in next column.)

Texaco court confused the content of the documents with their function, see *infra* notes 155-161 and accompanying text.]'').

[151]In this regard, the *Textron* court performed considerably worse than other courts. Although these courts may have demonstrated a similar level of ignorance on the unique work product challenges in the tax context, they at least ''determine[d] with specificity'' the applicant's claim. *See, e.g.*, *Roxworthy*, 457 F.3d at 600 (awarding work product protection to an applicant that ''identified a specific transaction that could precipitate litigation, the specific legal controversy that would be at issue in the litigation, the opposing party's opportunity to discover the facts that would give rise to the litigation, and the opposing party's general inclination to pursue this sort of litigation'').

[152]*Supra* note 133.

[153]*See infra* notes 170-174 and accompanying text.

[154]*See supra* notes 76-127 and accompanying text.

related representations in its audited financial statements.[155] The workpapers include discussion of all tax assets and liabilities reflected in the financial statements, including deferred tax assets and liabilities. Taxpayers generate these documents not because they want to but because they have to. Under federal securities laws, public corporations are required to file annual financial statements with the Securities and Exchange Commission.[156] These statements must be certified by an independent auditor to verify that they provide a fair representation of the entity's financial condition in compliance with generally accepted accounting principle standards.[157] Tax accrual workpapers are integral to this reporting process in that they provide an amount to be included in the tax reserve account that reflects potential future liability for additional taxes in the event the government identifies, challenges, and litigates certain positions taken on returns and a court disallows them. Moreover, public corporations produce tax accrual workpapers even if they do not anticipate having to set aside a tax reserve (because they have to justify to auditors the absence of a contingent-tax reserve), and they create tax reserves even if they do not anticipate litigation (including deferred-tax reserves for noncontingent taxes). In other words, tax accrual workpapers are generated every year in a public corporation's ordinary course of business, and would be generated whether or not the company anticipates any specific or potential litigation. In fact, a public corporation would cease to exist as a publicly traded entity if it failed to generate annual tax accrual workpapers; that is, if it neglected to prepare workpapers, its auditors would be unable to issue it a bill of health (clean or otherwise) in accordance with generally accepted accounting principles standards, it would likely be delisted by its exchange, and it would no longer be permitted to conduct business as a public company.[158]

In granting work product protection to Textron's tax accrual workpapers, the district court failed to understand why taxpayers create these documents. "If Textron had not anticipated a dispute with the IRS," the court opined, "there would have been *no reason* for it to establish any reserve or to prepare the workpapers used to calculate the reserve."[159] Moreover, according to the court, there would have been "*no need* to create a reserve in the first place, if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding."[160] Evidently, the court did not think much of the federal securities laws or the applicant's obligations under them. The court at least acknowledged that tax accrual workpapers could help Textron calculate its tax reserve, and that they were "useful in obtaining a 'clean' opinion" from Textron's auditors.[161] But that understanding of the workpapers is backwards. As discussed above, the prospect of litigation does not give rise to tax accrual workpapers. Nor is facilitating the calculation of tax reserves or auditors' opinions (unqualified *or* qualified) merely an ancillary benefit to creating workpapers. Rather, it is the primary, motivating, obligatory reason a public corporation prepares these documents. Of course, it is possible that similar documents, even with similar content, could be created in anticipation of litigation. But those documents would not be tax accrual workpapers.

The district court not only confused the purpose of workpapers, but based its conclusions on the misleading testimony of the applicant, and without conducting a full work product analysis.

The court accepted at face value the testimony of Textron's tax officers that the company's "ultimate purpose in preparing the tax accrual workpapers was to ensure that Textron was 'adequately reserved with respect to any potential disputes or litigation that would happen in the future.'"[162] Although it is true that workpapers include evaluations of potential challenges or litigation with the government, the testimony diverted the court's attention from the fact that the evaluations contained within the documents were required under federal securities law, which created an autonomous, preexisting responsibility to generate the documents and the evaluations contained therein.[163] Worse, the court

[155]Announcement 2002-63, *supra* note 11.

[156]*See supra* note 16.

[157]*See supra* note 17.

[158]*See, e.g., Arthur Young*, 465 U.S. at 818-819 and notes 13-14 (describing connection between tax accrual workpapers, auditors' opinions, and a company's status as a publicly traded entity).

[159]507 F. Supp.2d at 150 (emphasis added).

[160]*Id.* (emphasis added).

[161]*Id. See also id.* at 143. ("It seems reasonable to infer that Textron's desire to establish adequate reserves also was prompted, in part, by its wish to satisfy an independent auditor that Textron's reserve for contingent liabilities satisfied the requirements of generally accepted accounting principles so that a 'clean' opinion would be given with respect to the financial statements filed by Textron with the SEC.")

[162]*Id.* at 143.

[163]Amicus briefs filed in the case perpetrate similar obfuscation in arguing for blanket immunity. The brief submitted by the Chamber of Commerce and Association of Corporate Counsel, for instance, states, "The Workpapers prepared by Textron's counsel contain exactly the kind of 'mental processes of the attorney, providing a privileged area within which he can analyze and prepare his client's case'" (quoting *Nobles*, 422 U.S. at 238-239). Brief for Chamber of Commerce of the United States et al. as Amici Curiae Supporting Respondents at 17, *United States v. Textron Inc. and Subsidiaries*, No. 07-2631, (1st Cir. Apr. 8, 2008). Similarly, the brief filed by Financial Executives International (FEI) asserts that Textron's workpapers "reflect the kind of mental impressions and self-evaluation entitled to the highest degree of protection under the work product doctrine." Brief for Committee on Taxation and Committee on Corporate Reporting of Financial Executives International as Amici Curiae Supporting Respondents at 17, *United States v. Textron Inc. and Subsidiaries*, No. 07-2631, (1st Cir. Apr. 4, 2008). In fact, FEI goes beyond obscuring the facts when it factually misrepresents the summons, stating that the government "seeks disclosure of those mental impressions and conclusions to the IRS for assistance in litigating a tax dispute against Textron" (*id.* at 29). Currently, however, there is no active litigation between the IRS and Textron concerning Textron's abusive SILO transactions. In seeking enforcement of the summons, the IRS is merely performing its regulatory function of attempting to reconcile what the taxpayer says it owes and what the tax law says it owes. The

(Footnote continued on next page.)

never examined the documents to verify the purpose or the circumstances surrounding their creation.[164] Rather, it based its findings purely on ''the pleadings, affidavits submitted by the parties, and the evidence presented at a hearing.''[165] And while the record indicates that Textron produced a privilege log, it never became part of the record,[166] Textron never identified any issue in its workpapers as the subject of pending or potential litigation,[167] and the court never referred to specific documents as being prepared in anticipation of litigation. In this way, the court ignored Textron's failure to expressly make the claim of privilege for each document as required under the law.[168] Its own analysis also failed as a matter of law because it did not examine with specificity[169] each document — nor *any* document as far as the record indicates — to determine whether immunity was in fact justified.

The court further neglected its obligations by adopting without reservation Textron's fabricated, loaded description of the contents of tax accrual workpapers: ''hazard litigation percentages.''[170] Had the court conducted even the most superficial investigation of the phrase, it would have realized that the applicant was once again distracting it from determining the true function of tax accrual workpapers.[171] In fact, a simple Lexis or Google search would have revealed that ''hazard litigation percentages'' was a term of art that seemingly did not exist before the applicant introduced it into the proceedings.[172] Even if it were an industry term of art, it would hardly be dispositive of the purpose of the documents at issue. To the extent tax accrual workpapers provide percentage determinations regarding the likelihood of success on the merits of particular transactions in the event of litigation, they do so because, once again, federal securities law requires that those determinations be made to calculate tax reserves accurately and to satisfy generally accepted accounting principles standards.[173] They are not litigation documents, but accounting documents.[174]

Similar percentage determinations are routinely made by taxpayers and their advisers in preparing tax returns. Those documents are also not protected by the work

---

outcome of the regulatory investigation may lead to future litigation (although that is hardly certain, see *infra* notes 205-244 and accompanying text), but the investigation itself does not comprise litigation. More broadly, while workpapers evaluate possible litigation outcomes, they do so by virtue of superseding regulatory mandates rather than under any threat of litigation (see *supra* notes 155-161, *infra* notes 173-187, and accompanying text). Moreover, it is unclear how amici could opine authoritatively on documents at issue given that Textron failed to claim privilege with specificity for any document, providing, instead, an ambiguous and blanket claim. Also, mental processes of an attorney are not per se protected work product. Rather, they must meet all the requirements of the work product doctrine, and even if they do, they will be denied immunity if the applicant is found to have waived the privilege or if the party seeking discovery can show good cause. Courts are not well served by applicants and amici muddling work product inquiries, particularly given the fact that unwarranted application of the privilege ''can derogate from the search for the truth.'' *Supra* note 57.

[164]*See supra* notes 26, 28, and accompanying text. *See also supra* notes 142-148 and accompanying text describing a court's obligation to ''determine with specificity'' an applicant's privilege claim.

[165]507 F. Supp.2d at 141.

[166]*See supra* note 27.

[167]*See* Reply Brief for the Appellant, *supra* note 27, at 7 (stating that throughout the proceeding Textron ''never claimed that *any* issue in its tax accrual workpapers is the subject of pending or threatened litigation, let alone *every* issue identified in those workpapers'') (emphasis in original). *See also Maine*, 298 F.3d at 69 (finding that the ''general possibility of litigation'' does not justify work product protection, and holding that an applicant must ''make the correlation between each withheld document and the 'litigation for which the document was created''') (quoting *Church of Scientology Int'l v. United States*, 30 F.3d 224, 237 (1st Cir. 1994)).

[168]*Supra* note 133.

[169]*Supra* note 25.

[170]507 F. Supp.2d at 143, 148, and 150.

[171]As the government argued in the case, ''the name itself obscures the fact that tax accrual workpapers analyze *all* uncertain positions on a taxpayer's tax return, whether litigation is anticipated or not.'' Reply Brief for the Appellant, *supra* note 27, at 6-7 (emphasis in original).

[172]Web searches conducted on Lexis and Google on August 26, 2008, for the term ''hazard litigation percentages'' yielded, respectively, one and seven hits, all of which involved the instant case.

[173]The *Textron* court is not the first tribunal to confuse content with function, nor to view discussions in tax documents involving levels of certainty as equivalent to preparing documents in anticipation of litigation. *See, e.g.*, *Roxworthy*, 457 F.3d at 598 (stating that an opinion referencing ''substantial authority'' and a citation to reg. section 1.6662-4(d)(2) ''suggest that the arguments supplied were expected to be used'' by the applicant ''in articulating its tax-treatment rationale to the IRS during an audit in order to avoid a penalty''); *Adlman*, 134 F.3d at 1200 (noting that discussion in tax accrual workpapers prepared by a company's attorneys ''estimating the likelihood of success in litigation and an accompanying analysis of the company's legal strategies and options to assist it in estimating what should be reserved for litigation losses . . . falls squarely within *Hickman's* area of primary concern — analysis that candidly discusses the attorney's litigation strategies, appraisal of likelihood of success, and perhaps the feasibility of reasonable settlement'').

[174]The contents of tax accrual workpapers are as often and as capably prepared by accountants as by lawyers. Despite Textron's efforts to obscure the issue, unprotected accounting documents do not become protected litigation documents by virtue of being created by a lawyer rather than an accountant. Indeed, the work product doctrine ''is not an umbrella that shades all materials prepared by a lawyer.'' *El Paso*, 682, F.2d at 542. Nor can a taxpayer ''be allowed, by hiring a lawyer to do the work that an accountant, or other tax preparer . . . normally would do, to obtain greater protection from government investigators than a taxpayer who did not use a lawyer as his tax preparer would be entitled to. To rule otherwise would be to impede tax investigations, reward lawyers for doing nonlawyers' work, and create a privileged position for lawyers in competition with other tax preparers — and to do all this without promoting the legitimate aims of the attorney-client and work product privileges.'' *Frederick*, 182 F.3d at 500.

product doctrine.[175] Sections 6662 and 6694 require taxpayers and tax preparers, respectively, to attain certain levels of confidence for reporting positions.[176] For a taxpayer to avoid an understatement penalty for a tax return position that it chooses not to disclose, it must be able to demonstrate substantial authority for the position, corresponding to a 40 percent to 50 percent level of confidence that the position would be sustained on its merits.[177] For tax shelter items, the required level of certainty jumps to more likely than not for individual taxpayers (that is, greater than 50 percent),[178] while for corporate taxpayers, such as Textron, no level of certainty justifies including a tax shelter item on a return.[179] In fact, Congress has determined that those transactions are so egregious that taxpayers have an affirmative duty to disclose them to the IRS.[180] Failure to do so can result in some of the most severe penalties under the tax code.[181] While these requirements are imposed on taxpayers, in practice, tax professionals are the ones conducting the analysis and advising their taxpayer-clients whether or not specific positions or transactions meet the various levels of certainty. The tax code imposes additional, independent standards on tax professionals, requiring them to possess a ''reasonable belief''[182] that an undisclosed return position would more likely than not be sustained on its merits.[183] Treasury regulations governing federal tax practice impose similar requirements on practitioners advising certain transactions and issuing certain opinions.[184]

It is also worth noting that the two major tax practitioner organizations, the ABA and the AICPA, require its members to make the same kind of determinations in fulfilling their professional duties. ABA Formal Opinion 85-352 requires attorneys advising tax reporting positions to achieve a level of confidence of ''realistic possibility of success,'' a determination roughly corresponding to 33 percent.[185] The AICPA requires accountants to reach a similar level of certainty for tax reporting positions,[186] and a significantly higher level of certainty — more likely than not — for unrealized income tax benefits and liabilities reflected on financial statements.[187]

Those evaluations of potential litigation outcomes, by themselves, do not bestow work product protection on the prepared analyses, opinions, or documents at issue, just as the absence of those evaluations does not prevent them from receiving protection. In either case, the materials must fall within the parameters of the work product doctrine to receive immunity; that is, they are prepared in anticipation of litigation, there is objectively reasonable belief in the prospect of litigation, they are not prepared irrespective of pending or potential litigation, there is absence of good cause to overcome the privilege, and there is no waiver. If the materials do not satisfy these requirements, the applicant can still seek the protection of other privileges, such as the attorney-client or tax-practitioner privilege, but it must satisfy the parameters of those privileges as well; that is, confidential communications from a client to an attorney/tax practitioner seeking legal/tax advice not for the purpose of committing a crime or tort/promoting a tax shelter, and no waiver. If, at the end of the day the applicant cannot fit the documents or communications into recognized privileges, it is not entitled to make up an entirely new category of immunity.

Nor are district courts entitled to make up entirely new tests to immunize documents. The *Textron* court substituted its own work product test for the test adopted by its circuit. In *Maine*, the First Circuit adopted the

---

[175]*See, e.g.*, *Frederick*, 182 F.3d 496 (denying protection to worksheets generated to assist in filing tax returns rather than in preparing for litigation); *Davis*, 636 F.2d at 1040 (same).

[176]*See* section 6662, imposition of accuracy-related penalty on underpayments; section 6694, understatement of taxpayer's liability by tax return preparer.

[177]*See* section 6662(d)(2)(B)(i), defined in reg. section 1.6662-4(d)(2). (''The substantial authority standard is an objective standard involving an analysis of the law and application of the law to relevant facts. The substantial authority standard is less stringent than the more likely than not standard (the standard that is met when there is a greater than 50 percent likelihood of the position being upheld), but more stringent than the reasonable basis standard.'') The reasonable basis standard, in turn, is defined in reg. section 1.6662-3(b)(3). (''Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim.'') Commentators have pegged substantial authority somewhat more narrowly than the regulations at between 40 percent and 50 percent likelihood of success (see Timothy Philipps, Michael W. Mumbach, and Morgan W. Alley, ''What Part of RPOS Don't You Understand?: An Update and Survey of Standards for Tax Return Positions,'' 51 *Wash. & Lee L. Rev*. 1163, 1193 (1994) (''around 40%''); IRS, Executive Task Force, *Commissioner's Penalty Study, Report on Civil Tax Penalties*, ch. 8 (1989), at 43 (substantial authority ''should approach'' 51 percent but could extend as low as 45 percent)), and reasonable basis somewhere between 10 percent and 20 percent (see Philipps et al., *supra*, at 1193; Sheldon I. Banoff, ''Dealing With the ''Authorities'': Determining Valid Legal Authority in Advising Clients, Rendering Opinions, Preparing Tax Returns and Avoiding Penalties,'' 66 *Taxes* 1072, 1128 (1988)).

[178]*See* section 6662(d)(2)(C)(i).

[179]*See* section 6662(d)(2)(C)(ii).

[180]*See, e.g.*, section 6662A, imposition of accuracy-related penalty on understatements for reportable transactions; *infra* notes 265-281.

[181]*See, e.g.*, section 6662A (20 percent understatement penalty for ''reportable transactions'' (see *infra* note 180) increased to 30 percent if not disclosed to the IRS); *infra* notes 265-274.

[182]A practitioner possesses a ''reasonable belief'' that the position would more likely than not be sustained on the merits if the pertinent facts and authorities are analyzed in the manner described in reg. section 1.6662-4(d)(3)(ii) and the practitioner, in reliance on that analysis, ''reasonably concludes in good faith that there is a greater than fifty percent likelihood that the tax treatment of the item will be upheld if challenged by the IRS.'' Notice 2008-13, 2008-3 IRB 282, *Doc 2008-28351, 2008 TNT 1-6*.

[183]*See* section 6694, *supra* note 176.

[184]*See infra* notes 275-279 and accompanying text.

[185]For Op. 85-352, see *supra* note 19. For 33 percent likelihood of success, see reg. section 1.6694-2(b); *Philipps et al.*, *supra* note 177, at 1193; *Banoff*, *supra* note 177, at 1128.

[186]SRTP No. 1, *supra* note 20.

[187]*See* FIN 48, *supra* note 17.

Second Circuit's ''because of'' test in determining whether a document was prepared in anticipation of litigation.[188] The district court in *Textron* eschewed its jurisdiction's ''because of'' test in favor of an ill-conceived ''but for'' test: ''It is clear that the opinions of Textron's counsel and accountants regarding items that might be challenged by the IRS, their estimated hazards of litigation percentages and their calculation of tax reserve amounts would not have been prepared at all 'but for' the fact that Textron anticipated the possibility of litigation with the IRS.''[189] It then wrongly applied the wrong test.

Once again, the court confused content for context, transfixed by what the documents purportedly contained rather than why they were created. Having wrongly determined that tax accrual workpapers provide only incidental assistance in calculating contingent tax liabilities and reserves, the court also ignored undisputed facts that Textron would have created a tax reserve and supporting workpapers regardless of the prospect of litigation. The court had before it, for instance, evidence that public corporations produce workpapers even if they do not anticipate having to set aside a tax reserve (because, as discussed above, they must justify the absence of a contingent-tax reserve), and they create tax reserves even if they do not anticipate litigation (including deferred-tax reserves for noncontingent taxes). Also, Textron submitted affidavits stating that its tax reserve included the full amount of the intended tax benefit for items that it expected to concede in the event of a dispute.[190] Even more revealing, Textron and the IRS resolved the overwhelming majority of its disputes without resorting to litigation.[191] Any one of these undisputed facts fatally undermines the court's conclusion that the tax reserves and workpapers would not have been created ''but for'' the prospect of litigation.

In the end, tax accrual workpapers do not constitute work product. Even though they may ''forecast the cumulative results of IRS audit, settlement, and litigation,'' they are ''not prepared to respond to a specific charge by the IRS or to any pending or impending lawsuit,'' but instead are generated to ensure that the tax reserve is ''sufficient'' and ''to comply with the securities laws.''[192] The work product doctrine protects materials prepared in anticipation of litigation, not those merely describing or assessing anticipated litigation. The analysis must focus on *why* a document was created, not what it says. As one recent work product decision concluded for opinion letters, the materials ''cannot . . . be considered separately from the circumstances of their creation . . . . Their purpose was not to analyze pending or imminent claims; instead, it was to induce the taxpayers to invest in the strategy (or, put differently, to provide comfort to those investors, particularly for the possible imposition of future tax penalties). Taken in context, therefore, the opinion letters were not specifically connected to any actual or potential litigation, audit, or IRS investigation.''[193] Indeed, the work product doctrine does not protect materials prepared in anticipation of investment decisions, marketing purposes, or tax penalties, or for that matter, regulatory requirements or business purposes. Rather, it protects only documents prepared in anticipation of litigation. And, as the next section discusses, that anticipation must be objectively reasonable.

B. Anticipating Litigation Over Workpapers Is Not Objectively Reasonable

An applicant seeking protection under the work product doctrine must demonstrate not only ''a subjective belief that litigation was a real possibility,'' but also that the belief was objectively reasonable.[194] For an expectation to meet that standard, the applicant must show ''a significant and substantial threat,''[195] a ''genuine fear,''[196] a ''real possibility,''[197] a ''strong prospect,''[198] or a ''substantial possibility''[199] of future litigation. A remote possibility of litigation is not sufficient.[200] Moreover, under the federal rules, the applicant must expressly make its claim that it possessed an objectively reasonable anticipation of litigation, while the court must expressly make a determination that the applicant's anticipation of litigation was objectively reasonable enough to receive work product protection.[201]

The previous section of this article demonstrated that neither Textron nor the court satisfied its obligations in, respectively, asserting and evaluating work product immunity. It also argued that tax accrual workpapers *never* deserve work product protection because they are prepared in substantially the same manner on an annual basis irrespective of any claim of anticipated litigation. That is, they exist to help corporate taxpayers and their

---

[188] *Maine*, 298 F.3d 60; *Adlman*, 134 F.3d at 68. For a discussion of the ''because of'' test, see *supra* notes 85-91 and accompanying text.

[189] 507 F. Supp.2d at 150. After the *Textron* court issued its decision, another district court relied on the flawed ''but for'' test to analyze the application of the work product doctrine, citing *Textron* favorably in the process. *See Regions Fin.*, 2008 U.S. Dist. LEXIS 41940 at *19-20. (''Regions counters that it would not have contingent liabilities at all if it did not think that it was going to be sued by the Service over the tax consequences of the Transaction. Regions has the stronger argument. Were 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.'')

[190] *See* Brief for the Appellant, *supra* note 26, at 20.

[191] For the 1995-1997 audit cycle, for instance, the IRS proposed 312 adjustments, all of which were resolved between Textron and the audit team. During the 1998-2001 audit cycle, the IRS issued 221 proposed adjustments, 188 of which Textron agreed to by the time of the summons-enforcement proceedings. *See* Brief for the Appellant, *supra* note 26, at 11. *See also infra* notes 203, 236, and accompanying text.

[192] *El Paso*, 682 F.2d at 534-535.

[193] *Fid. Int'l*, No. 05-40151, slip op. 25-26.

[194] *In re Sealed Case*, 146 F.3d at 884.

[195] *SmithKline Beecham*, 232 F.R.D. at 484.

[196] *EEOC*, 186 F.3d at 968.

[197] *Equal Rights Ctr.*, 247 F.R.D. at 210.

[198] *Briggs & Stratton*, 174 F.R.D. at 509.

[199] *SEC*, 92 F.R.D. at 66.

[200] *In re Grand Jury Subpoena*, 220 F.R.D. at 147.

[201] FRCP 26(b)(5)(A)(i-ii).

advisers comply with regulatory, statutory, and professional requirements, not to prepare for litigation or for trial. Given the discussion in the previous section, we would not usually have occasion to reach the ''objectively reasonable'' inquiry. However, since the *Textron* court did not feel so constrained, neither will we.

Summarily, the court found, ''Nor can there be any doubt that Textron's belief in the likelihood of litigation with the IRS was well-founded.''[202] To support its conclusion, the court noted that the content of Textron's workpapers, which it never examined, ''dealt with issues on which the law was unclear''; that Textron and the IRS had in fact litigated three issues (out of thousands) in the previous eight audit cycles (spanning nearly 50 years); and that a lower federal court had recently granted work product protection to audit and opinion letters (the letters at issue were created in preparation of specific, identified, pending litigation rather than in preparation of yet-to-materialize-perhaps-years-later litigation).[203] In other parts of the opinion, the court found it especially relevant that Textron testified that it anticipated its positions would ultimately be challenged or disputed by the IRS during an audit investigation.[204]

The *Textron* court, like others before it,[205] confused the likelihood of an IRS audit, challenge, or dispute with the likelihood of litigation. The federal rules provide work product protection only to documents prepared in anticipation of litigation or for trial, not for an audit, challenge, or dispute. Moreover, recall that ''litigation'' is generally understood to mean ''a proceeding in a court or administrative tribunal in which the parties have the right to cross-examine witnesses or to subject an opposing party's presentation of proof to equivalent disputation.''[206] An audit proceeding, challenge, or dispute provide different forums altogether. An audit, for example, is at most an ''antechamber to litigation,''[207] and is not itself litigation.[208] Its purpose is ''to assess the amount of tax liability through administrative channels'' rather than to prepare for litigation.[209] Even documents prepared after an audit has commenced do not necessarily qualify as prepared in anticipation of litigation.[210] Rather, these are prepared ''in the assessment and review process and, if they be held to be in anticipation of litigation, it is hard to see what would not be.''[211]

Courts that have inappropriately broadened the term ''litigation'' in the tax context to include nonadversarial proceedings, including *Textron*, have also inappropriately overemphasized the importance of items that could lead to a dispute between the taxpayer and the taxing authority. These courts have noted, for instance, the ''conspicuousness'' of a $112 million loss recognized for tax purposes but not for book purposes,[212] an applicant's intent to achieve noticeably sizable tax benefits,[213] and significant tax losses followed by a $35 million tax refund claim.[214] For its part, the *Textron* court thought it salient that the analysis contained in Textron's workpapers (which, again, the court never examined) involved aggressive positions ''on which the law was unclear.''[215]

Just because an applicant-taxpayer has taken or plans to take an aggressive reporting position does not mean that workpapers or other materials analyzing that position should automatically receive work product immunity.

First, the IRS may never identify the transaction to challenge it, let alone, to litigate it. Although corporations are effectively subject to annual audit through perpetual audit cycles, their tax returns are exceedingly complex. Textron's audit documents for the audit cycle at issue, for instance, filled nine four-drawer file cabinets.[216] Its consolidated tax return exceeded 4,000 pages and covered more than 190 different entities.[217] Given the sheer volume of materials and the complexity of the transactions involved,[218] in addition to the funding and personnel

---

[202]507 F. Supp.2d at 150.

[203]*Id.* at 150-151.

[204]*Id.* at 143, 150, and 155.

[205]*See, e.g., Roxworthy*, 457 F.3d at 598 (in granting work product immunity, stating that applicant ''anticipated litigation because of the certainty of an IRS audit''); *Chevron Texaco*, 241 F. Supp.2d at 1089 n.6 (finding that ''from the first day [the applicant] contemplated a transaction of this type it was a virtual certainty that the IRS would challenge the transaction''); *Adlman*, 134 F.3d at 1196 (finding that litigation was ''virtually certain'' when the applicant generated significant tax losses and submitted a large tax refund claim).

[206]*Supra* note 125. *See also supra* notes 126-127 and accompanying text.

[207]*Frederick*, 182 F.3d at 502. *See also Abel*, 53 F.R.D. at 489 (rejecting government's argument that once a taxpayer's return is selected for audit, all documents later prepared are prepared ''in anticipation of litigation'' and thus protected under the work product doctrine).

[208]*Tel. & Data Sys., Inc.*, 2002 U.S. Dist. LEXIS 15510, *9-10.

[209]*Baggot*, 463 U.S. at 480. *See also In re Special September 1978 Grand Jury*, 640 F.2d at 65 (holding that ''although litigation could ultimately . . . ensue in connection with . . . tax filings, a remote prospect of future litigation is not sufficient to invoke the work product doctrine,'' and finding a distinction between tax materials ''prepared with an eye toward a possible administrative proceeding'' and in anticipation of litigation).

(Footnote continued in next column.)

[210]*See, e.g., Abel*, 53 F.R.D at 502 (cited in *supra* note 207); *Peterson*, 52 F.R.D. at 320 (finding that ''IRS appellate conferee reports and IRS field agent reports are not prepared in anticipation of litigation or for trial'').

[211]*Peterson*, 52 F.R.D. at 320.

[212]*Roxworthy*, 457 F.3d at 598.

[213]*Chevron Texaco*, 241 F. Supp.2d at 1089 n.6.

[214]*Adlman*, 134 F.3d at 1196 (finding that litigation was ''virtually certain'' because section 6405 required the applicant-taxpayer to submit a report of the claim to the Joint Committee on Taxation). *See* section 6405 (requiring the Treasury Department to report to the JCT any ''refund or credit of any income, war profits, excess profits, estate, or gift tax, or any tax imposed on public charities, private foundations, operators' trust funds, pension plans, or real estate investment trusts'' exceeding $2 million).

[215]507 F. Supp.2d at 150.

[216]Brief for the Appellant, *supra* note 26, at 12.

[217]*Id.*

[218]*See* JCT, ''Investigation of Enron Corporation & Related Entities'' 17 (JCS-3-03) (Feb. 2003) (stating that the ''complexity'' of corporate tax shelters ''makes it exceedingly difficult for the IRS to timely identify and properly evaluate these transactions'').

limitations that plague the taxing authority,[219] there is no guarantee the IRS will successfully identify and evaluate aggressive positions.[220] Even with sufficient resources, the IRS could still encounter gaps in the corporate taxpayer's records because of active concealment of impermissible transactions.[221] Also, the IRS's ability to examine some transactions may be affected by the growing practice of allowing corporate taxpayers to dictate the audit agenda and include for examination conservative transactions while obscuring or omitting aggressive ones.[222] Other information asymmetries exist as well.

In many respects, this information gap separating the government from taxpayers and their representatives is more of a threat to effective tax enforcement than the more easily quantifiable resource gap. IRS enforcement is so severely handicapped by informational deficiencies that taxpayers can engage in abusive tax planning and accurately report transactions associated with that planning on appropriate disclosure forms, yet still provide no indication of abusive behavior.[223] The only way for the IRS to expose such schemes is to examine the returns of all relevant participants at the same time or, if one of the parties is a public corporation, to examine that party's tax accrual workpapers.

Even if the IRS successfully identifies a potentially abusive transaction during audit, it may be unable to assess the substance of the transaction without additional information. Recent legislative and regulatory efforts to facilitate transparency in tax compliance attempt to increase the flow of information to the government, and to discourage a destructive game of tax avoidance cat-and-mouse.[224] While taxpayers are certainly not obligated to pay more than they owe, the recent enforcement efforts have embraced the idea that taxpayers must satisfy liabilities beyond those ''the IRS is able to ferret out,'' to avoid turning tax compliance into ''a sophisticated game of hide and seek.''[225] The new Schedule M-3 for corporate taxpayers, for instance, helps the IRS find relevant information on 1,000-page tax returns by reconciling a corporation's financial accounting income (book income) with its taxable income (tax income), a reconciliation that was previously ambiguous and provided myriad avoidance opportunities.[226] Of course, Schedule M-3 works as designed only if all cash is accounted for properly. Similarly, a taxpayer that has invested in a tax shelter may satisfy the reporting requirement and disclose that activity on a Form 8271,[227] as Textron did for its nine SILO transactions. But that reporting may not provide the IRS sufficient information to evaluate and understand the transaction, as was the case with Textron's SILO deals.[228] In these instances, tax accrual workpapers can help the IRS verify the accuracy and completeness of return positions and required disclosures, as well as the substance of transactions. In other words, they can be crucial to the government's ability to perform its regulatory function. Tax accrual workpapers translate opaque facts and data, disclose unidentified issues and positions, and, perhaps most importantly, expose information hidden from view on transaction documents. As the government observed in *Textron*, ''tax benefits are based on a transaction's substance, not its form.''[229] To appreciate the substance of a transaction and to determine ''whether it

[219]I have discussed elsewhere the implications of this ''resource gap'' separating the government and the private bar. *See* Dennis J. Ventry Jr., ''Cooperative Tax Regulation,'' 41 *Conn. L. Rev.* (forthcoming 2008).

[220]Rosenberg, *supra* note 35, at 189.

[221]Cooper, *supra* note 36, at 100. *See also Long Term Capital Holdings v. United States*, 330 F. Supp.2d 122, 211-212 (D. Conn. 2004) (describing how the taxpayer had taken ''steps to conceal'' questionable tax benefits on tax form ''designed to notify the IRS of differences in book income/loss and tax income/loss''), *aff'd*, No. 04-5687 (2d Cir. 2005); Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, ''The Role of Professional Firms in the U.S. Tax-Shelter Industry,'' S. Rep. No. 109-54, at 11 (2005) (noting that accounting firms in the late 1990s and early 2000s ''took steps to conceal their tax shelter activities from tax authorities and the public, including by failing to register potentially abusive tax shelters with the IRS'').

[222]JCT, *supra* note 37, at 212.

[223]Consider the intermediary transaction tax shelter, typically involving four parties: a seller (S) who wants to sell the stock of a target corporation (T); a promoter-controlled intermediary entity (E); and a buyer (B) who wants to purchase the assets but not the stock of the target. Under the terms of a prearranged plan, S purports to sell the stock of T to E. E has arranged financing for the sale through a bridge loan, which is secured by the assets of T. At the same time or shortly after the stock sale, E purports to sell T's assets to B. The bridge loan is repaid from the proceeds, while any excess proceeds are retained by E as a fee for serving as the accommodation party. As a result of the transaction, S recognizes reduced gain because of its high basis in the stock of T; B receives larger depreciation and amortization deductions based on the fair market value of the assets (that is, B's purchase price rather than T's basis in the assets); and E avoids paying tax on the gain from the asset sale by offsetting the gain with losses from the sale of inflated-basis assets. As far as the IRS is concerned, S's tax return reflects a simple sale, while B's reflects a straight asset purchase. *See* Notice 2001-16, 2001-1 C.B. 730, *Doc 2001-2019, 2001 TNT 13-3*.

[224]For a fuller discussion of these efforts, see *infra* notes 265-290 and accompanying text.

[225]*United States v. Price Waterhouse & Co.*, 515 F. Supp. 996, 999-1,000 (N.D. Ill. 1981) (enforcing an IRS summons seeking ''opinions or judgments with respect to issues not identified by the IRS'' contained in independent auditor's tax accrual workpapers).

[226]*See* Schedule M-3 (Form 1120-F), ''Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More,'' *available at* http://www.irs.gov/pub/irs-dft/f1120fm3—dft.pdf.

[227]*See* Form 8271, ''Investor Reporting of Tax Shelter Registration Number,'' *available at* http://www.unclefed.com/IRS-Forms/2007/f8271.pdf.

[228]According to the government's reply brief in the case, ''The examining agents were unable to completely understand the transactions from the information disclosed by Textron on the form. As [one of the agents] explained, 'it wasn't until [he] actually received information from the Office of Tax Shelter Analysis that [he] had a basis to believe the taxpayer had engaged in a SILO transaction.'" Reply Brief for the Appellant, *supra* note 27, at 16 n.7.

[229]Brief for the Appellant, *supra* note 26, at 12.

passes muster under the tax laws,''[230] the IRS must be afforded the opportunity to examine the documents in the context of the transaction as a whole, not just in the context of its constituent parts.

Once the IRS identifies and challenges a potentially abusive transaction, various levels of administrative review and dispute resolution procedures remain for the taxpayer and the IRS to resolve differences without resorting to litigation. The taxpayer can enter into negotiations over proposed adjustments to its return positions, for instance, by engaging in conferences with IRS audit team managers, requesting accelerated resolution of its positions through the fast track settlement program,[231] and, ultimately, seeking a fresh, independent review of its positions before the IRS Office of Appeals. This review and resolution stage of the regulatory process is still nonadversarial, and does not approximate litigation as contemplated under the work product doctrine. The relationship between the taxpayer and the government is not yet sufficiently adversarial, and the taxing authority is not yet an adverse party. In fact, FASB has instructed tax practitioners to adopt an even broader nonadversarial perspective of the IRS. In the context of accounting for tax contingencies and creating tax reserves, FASB advises practitioners not to ''equate a taxing authority with a counterparty in a lawsuit.''[232] While a counterparty in a lawsuit acts in its own interest, a taxing authority acts ''in the broader public interest in regulating compliance with self-reporting income tax laws.''[233] The relationship may become adversarial in the future, but not before the taxpayer has exhausted all levels of administrative review, and not merely because the IRS seeks, and even achieves, an adjustment to the taxpayer's liability.[234]

It is simply unreasonable, both as a matter of logic and mathematical probability, for a taxpayer to anticipate litigation with the IRS when preparing tax accrual workpapers. Given the uncertainty that the government will identify a transaction, sufficiently understand it, gain access to crucial information on the substance of the transaction to be able to challenge it, and then fail to resolve differences with the taxpayer despite the multiple levels of administrative review and appeal, it is not surprising that so few issues reach litigation.[235] Take Textron. For the last eight audit cycles dating back to 1959, involving thousands of proposed adjustments to the taxpayer's reporting positions, Textron and the IRS resorted to litigation over disputed issues just three times.[236] Those are lousy odds, even for the eternal, litigious optimist. Moreover, they make anticipating litigation when generating workpapers — and even when undergoing a federal tax audit[237] — unmistakably unreasonable.[238]

While it is always possible that the government will challenge a taxpayer's reporting position, a challenge is not equivalent to litigation, as discussed above. Were that the standard, documents evaluating any position falling short of 100 percent likelihood of success on the merits would receive blanket immunity under the work product doctrine. ''There must be a closer nexus between the lawyer's advice and a specific potential claim for the work product doctrine to apply. The mere fact that the taxpayer is taking an aggressive position, and that the IRS might therefore litigate the issue is not enough.''[239] Yet the *Textron* court was particularly sensitive to the aggressiveness of Textron's positions in bestowing work product immunity on the documents discussing the nine prohibited tax shelter transactions.[240] In the process, it created a perverse standard whereby more aggressive,

---

[230]*Id.* at 13.

[231]*See supra* note 38.

[232]FIN 48, App. B: Background Information & Basis for Conclusions para. B64 (2006). FASB is the private organization charged with establishing standards of financial accounting and reporting. The standards promulgated by FASB are recognized as authoritative by the SEC (see Financial Reporting Release No. 1, Section 101 and reaffirmed in its April 2003 Policy Statement) and the AICPA (Rule 203, Rules of Professional Conduct, as amended May 1973 and May 1979).

[233]*Id.*

[234]Amicus for the respondent misrepresents the relationship between the taxpayer and the IRS. It notes an ''adversity'' between the parties ''apparent from the IRS' posture vis-à-vis Textron's tax returns and the history between Textron and the IRS.'' Brief for Chamber of Commerce of the United States et al., *supra* note 163, at 26. However, as the government has correctly observed in the case, amicus ''ignore[s] the dynamics of the U.S. tax system in which a taxpayer's correct tax liability is determined based on the IRS's audit of the taxpayer's self-assessment. That the IRS adjusts a taxpayer's original tax-return positions does not in and of itself create litigation 'adversity.'" Reply Brief for the Appellant, *supra* note 27, at 11 n.6.

[235]*See* Alison Bennett, ''Korb Says Government Unlikely to Yield on *Textron*; Practitioners Praise Court Ruling,'' 169 *Daily Tax Rep.* (BNA) K-1 (Aug. 31, 2007) (quoting Christopher Rizek, former associate tax legislative counsel at the Treasury Department, as saying that *Textron* represents a ''huge, huge expansion of the work product doctrine,'' particularly because ''most taxpayers don't actually litigate'').

[236]*See also supra* note 191 discussing the last two audit cycles for Textron and the phenominally low likelihood of litigation.

[237]*Peterson*, 52 F.R.D. at 320 (discussing ''anticipation of litigation'' in the context of an audit, and concluding that ''litigation cannot be anticipated in every such case when relatively few result in litigation''); *Abel*, 53 F.R.D. at 490 (stating ''to hold that any intra-agency or inter-agency report which eventually could be relayed to the attorney who must try the case for the government is a report or document prepared in anticipation of litigation would be effectively to shield all government reports,'' and is ''clearly contrary to the intent of Rule 26'').

[238]*See also Adlman*, 134 F.3d at 1205 (Kearse, J., dissenting). (''Where the only prospect of litigation is what would be anticipated if the party undertakes a contemplated transaction but not otherwise, and the materials in question were prepared in connection with providing legal advice to the party as to whether or not to undertake that transaction, I do not regard the materials as having been prepared 'in anticipation of litigation.'" To do otherwise would ''extend the work product privilege to a stage that precedes any possible 'anticipation' of litigation.'')

[239]*Fid. Int'l*, No. 05-40151, slip op. 26.

[240]*See supra* note 215 and accompanying text.

abusive behavior receives a greater degree of protection than less aggressive, compliant behavior.[241]

That standard would blow a hole in the fisc. It would undermine the government's summons power, which the Supreme Court has said "should be upheld absent express statutory prohibition or substantial countervailing policies."[242] And it would immunize nearly every document analyzing the potential tax benefits of a transaction because the analysis necessarily involves a discussion of the position's likelihood of success on the merits. Tax professionals would no longer need to rely on the attorney-client or tax practitioner-client privileges because the work product doctrine would swallow them both. And because it is harder to waive work product protection than the two other privileges,[243] tax advice would receive greater protection than other forms of legal advice.[244]

In the end, the district court's inappropriate expansion of the work product doctrine conflicts with its own circuit's standard for analyzing work product.[245] It ignores the historical practice of construing the doctrine narrowly,[246] particularly in the tax context.[247] And it provides absolute immunity to precisely the kind of abusive tax advice and avoidance that Congress and the Treasury Department have worked for decades to eradicate.

C. Blanket Immunity Threatens Tax Enforcement

When the district court looked at Textron and the IRS, it saw two adverse parties rather than a taxpayer with an obligation to pay what it owes and a taxing authority with an obligation to verify that the taxpayer satisfies that obligation. Consequently, in the eyes of the court, compelling discovery of Textron's tax accrual workpapers would unfairly disadvantage the taxpayer. Forced disclosure of the "opinions of Textron's counsel" had "little to do with" determining Textron's tax liability, and would provide "an unfair disadvantage in any dispute that might arise with the IRS, just as requiring the IRS to disclose the opinions of its counsel regarding areas of uncertainty in the law or the likely outcome of any litigation with Textron would place the IRS at an unfair disadvantage."[248] In so concluding, the court once again confused the differences between litigation and regulation.[249]

First, a dispute in the tax context culminates in litigation only in a fraction of cases.[250] Second, to support its argument that imposing the government's disclosure standard on the IRS would put the agency at a similarly unfair disadvantage, the court cited to an inapposite and distinguishable work product case in which the issue was whether a specific claim was required to receive immunity for documents prepared in anticipation of litigation.[251] Third, discovering the kind of materials at issue in *Textron* allows the IRS to perform its essential regulatory function of collecting the appropriate amount of revenue under the nation's tax laws. Given the regulatory function of tax accrual workpapers,[252] compelling their disclosure is no different than allowing the SEC an opportunity to review and verify a listed company's financial representations or other corporate materials prepared in the ordinary course of business.

Far from providing the government an unfair advantage, discovery of tax accrual workpapers partially levels a distinctly unlevel playing field. In the world of tax regulation, taxpayers and their advisers possess the information that tax regulators seek. The goal is to keep as much of the information from the IRS as possible, and taxpayers pay considerable sums of money to those advisers most skilled at concealment. Denying immunity

---

[241]A few other courts have followed the same, perverse logic in granting work product immunity to tax materials. *See, e.g.*, *Roxworthy*, 457 F.3d at 597 (finding it persuasive in granting immunity that applicant anticipated litigation "because of the uncertainty surrounding the area of tax law at issue").

[242]*Euge*, 444 U.S. at 711. *See also United States v. Bisceglia*, 420 U.S. 141, 146 (1975) (stating that restrictions on the IRS summons power should be avoided "absent unambiguous directions from Congress")

[243]*See supra* note 142.

[244]The government made a similar argument in *Textron*. *See* Reply Brief for the Appellant, *supra* note 27, at 3. ("What Textron and the amici seek — in the form of a bright-line, per se rule — is blanket protection of a company's tax accrual workpapers if the company (like Textron) uses attorneys in the process of generating those accounting workpapers. In so arguing, Textron and the amici treat all work performed by a lawyer as legal advice (even when — as here — that work is accountants' work) and then compound that error by treating all legal advice as work product, thus conflating the work product doctrine and the attorney-client privilege.")

[245]*See Adlman*, 134 F.3d at 1204 (applicant not entitled to work product protection simply because it "had the prospect of litigation in mind when it" prepared a document).

[246]*See supra* notes 56-57 and accompanying text.

[247]*See supra* notes 58-59 and accompanying text.

[248]507 F. Supp.2d at 155. As a threshold matter, one wonders how the court determined that it was protecting the "opinions of Textron's counsel" without examining any of the documents at issue. *See supra* notes 26, 28, and accompanying text.

[249]Other courts have exhibited the same confusion. *See, e.g.*, *Roxworthy*, 457 F.3d at 595 (stating that requiring disclosure to the IRS of tax adviser's "detailed legal analysis of the strengths and weaknesses" of claimant's tax positions would provide the IRS "an unfair advantage" and would undermine the adversarial process).

[250]*See supra* notes 216-222, 235-238, and accompanying text.

[251]*See Delaney, Migdail & Young, Chartered v. IRS*, 826 F.2d 124, 127 (D.C. Cir. 1987) (concluding that a "specific claim" was not required for work product protection under the Freedom of Information Act, and noting: "The documents withheld by the IRS here serve a function quite different from those involved in *Coastal States* [which required a "specific claim" for protection]. There the documents were like an agency manual, fleshing out the meaning of the statute it was authorized to enforce. Here the IRS memos advise the agency of the types of legal challenges likely to be mounted against a proposed program, potential defenses available to the agency, and the likely outcome. Similarly, plaintiff here is not trying to ascertain the agency's view of the law in order to comply or to advise clients on how to comply; it is seeking the agency's attorneys' assessment of the program's legal vulnerabilities in order to make sure it does not miss anything in crafting its legal case against the program. This is precisely the type of discovery the Court refused to permit in *Hickman v. Taylor*").

[252]*See supra* notes 155-158, 192, and accompanying text.

to tax accrual workpapers and protecting a vigorous IRS summons power appropriately mitigates the severe information asymmetries separating the government from the private sector.[253] As the Supreme Court found in *United States v. Bisceglia*, the purpose of the summons power ''is not to accuse, but to inquire. Although such investigations unquestionably involve some invasion of privacy, they are essential to our self-reporting system.''[254] In *United States v. Euge*, moreover, the Court stated that a strong summons power was ''necessary for the effective exercise of the Service's enforcement responsibilities,'' and that over the years it had ''consistently construed congressional intent to require that if the summons authority claimed is necessary for the effective performance of congressionally imposed responsibilities to enforce the tax code, that authority should be upheld absent express statutory prohibition or substantial countervailing policies.''[255] And in *United States v. Arthur Young*, the Court explicitly rejected the taxpayers' ''position that fundamental fairness precludes IRS access to accountants' tax accrual workpapers.''[256] In holding that tax accrual workpapers are ''highly relevant'' to an IRS audit, the Court explained that ''our complex and comprehensive system of federal taxation, relying as it does upon self-assessment and reporting, demands that all taxpayers be forthright in the disclosure of relevant information to the taxing authorities. Without such disclosure, and the concomitant power of the Government to compel disclosure, our national tax burden would not be fairly and equitably distributed.''[257] The sum of Supreme Court jurisprudence mandates an expansive government discovery power.

That power is not unrestricted. In particular, it is subject to ''the traditional privileges and limitations,'' including the work product doctrine.[258] But those privileges and limitations do not provide blanket immunity to tax preparation materials that fail to fit within the four corners of the privileges. Also, both before and after the broad discovery mandate delivered by *Arthur Young*, the IRS exhibited ''administrative sensitivity''[259] in following a widely recognized policy of restraint respecting tax accrual workpapers by which it requested workpapers only in ''unusual circumstances'' and only as a ''collateral source for factual data.''[260] The most notable substantive change in the policy over the last 20 years has involved responding to the proliferation of abusive tax shelters.[261] In 2002 the IRS announced that it would seek tax accrual workpapers from taxpayers who claimed tax benefits from a ''listed transaction.''[262] If the taxpayer has invested in more than one listed transaction, as Textron did with its nine SILO transactions, the IRS now seeks all of the taxpayer's workpapers for the corresponding tax year.

The regulatory decision to use the summons power to root out abusive tax shelters paralleled a legislative antishelter attack. Government efforts to address abusive tax avoidance precede World War II,[263] and the familiar attack on mass-marketed tax shelters is more than three decades old.[264] But government antishelter efforts have

---

[253]In similar fashion, the government has argued in *Textron* that in seeking the taxpayer's workpapers, ''the IRS seeks not to gain a litigation advantage, but to perform its obligation to verify the self-assessment [of Textron] despite the information disadvantage inherent in our self-reporting system.'' Reply Brief for the Appellant, *supra* note 27, at 11.

[254]*Bisceglia*, 420 U.S. at 146.

[255]*Euge*, 444 U.S. at 711. *See also id.* at 716 n.9 (noting that Congress has granted to the IRS ''broad latitude to adopt enforcement techniques helpful in the performance of [its] tax collection and assessment responsibilities'').

[256]*Arthur Young*, 465 U.S. at 820.

[257]*Id.* at 815-816.

[258]*Euge*, 444 U.S. at 714.

[259]*Arthur Young*, 465 U.S. at 820.

[260]*See* IRM section 4024.4 (CCH 1981); Announcement 84-46, 1984-18 IRB 18.

[261]Over the last year, the government has been evaluating how its long-standing policy of restraint might interact with the new FASB reporting requirement pertaining to FIN 48 disclosures. In particular, it is considering the extent to which, if at all, the IRS will view these disclosures as a way to obtain underlying tax accrual workpapers. *See* Alison Bennett, ''Tax Accrual Workpapers Policy of Restraint in FIN 48 Context Still Applies, Official Says,'' 135 *Daily Tax Rep.* (BNA) G-4 (July 17, 2007). *See also supra* note 226 and accompanying text.

[262]For the revised policy, see Announcement 2002-63, *supra* note 11. For ''listed transaction,'' see *supra* note 8.

[263]Neither tax shelters nor government efforts to prevent them are new phenomena. Indeed, taxpayers and their advisers have been trying to figure out how to reduce tax liability throughout the history of the federal income tax. For two excellent studies documenting, in different contexts, the tax avoidance behavior of previous generations, see Assaf Likhovsi, ''The Duke and the Lady: *Helvering v. Gregory* and the History of Tax Avoidance Adjudication,'' 25 *Cardozo L. Rev.* 953 (2004); Ethan G. Stone, ''Adhering to the Old Line: Uncovering the History and Political Function of the Unrelated Business Income Tax,'' 54 *Emory L. J.* 1475 (2005).

[264]Mass-marketed tax shelters are relative newcomers to the tax planning world. Beginning in the 1970s, shelter promoters began peddling tax-favored investments for high-income individuals involving the leveraged purchase through partnerships of tax-preferred assets such as real estate or oil and gas tax shelters. These transactions were effectively shut down in the 1980s by a combination of legislative fixes — primarily through the combination of the at-risk rules (enacted in 1976 and fine-tuned over 10 years) and passive loss rules — falling inflation, and general tax reform that curtailed tax preferences and lowered tax rates. *See* sections 465 and 469. Other statutory efforts included tightening the depreciation recapture rules (section 1250), revising the partnership special allocation rules (sections 704(b) and (d)), limiting investment interest (section 163(d)), and enacting the tax return preparer understatement penalty (section 6694). Tax lawyers are a creative bunch, however. New sheltering techniques involving complex financial transactions and aggressive arbitrage were soon available to high-income taxpayers and corporations. Unlike the individual tax shelters of the 1970s and 1980s, there was no magic legislative bullet to undercut the modern tax shelter transaction. The tax shelter marketplace of the 1990s and 2000s was a different creature altogether, in terms of complexity, dollars lost to the federal treasury, and tax advisers playing loose with the rules. For starters, the modern tax shelter was marketed to corporations and privately held companies controlled by individuals with vast wealth rather than middle- and upper-income professionals trying to shelter wage and salary income. The new

(Footnote continued on next page.)

accelerated significantly over the last several years, with an emphasis on disclosure and transparency.

In 2004 Congress enacted the American Jobs Creation Act,[265] which heightened reporting and disclosure requirements[266] for reportable transactions.[267] The new statutory regime raised existing penalties while adding new ones.[268] It mandated more stringent requirements for asserting a defense for engaging in reportable transactions[269] by making it available only in the presence of

---

corporate tax shelter was much more sophisticated than its comparatively primitive 1970s and 1980s counterpart, involving not only tangible assets but also complex financial instruments. While older shelters were in fact mass-marketed, with promoters taking over huge meeting rooms at hotels and providing the complete package to potential investors, the marketing did not reach the level of coordination achieved in the more recent shelter wave. Recent tax shelters were also significantly more aggressive with respect to how much income and wealth they shunted from taxation. *See* Joseph Bankman, ''Tax Enforcement: Tax Shelters, the Cash Economy, and Compliance Costs,'' *Tax Notes*, July 12, 2004, p. 185, *Doc 2004-13203, 2004 TNT 134-43*; *Internal Revenue Service: Challenges Remain in Combating Abusive Tax Shelters, Hearing Before the Senate Committee on Finance* 13 (2003) (statement of Michael Brostek, Government Accountability Office); Martin A. Sullivan, ''The Cost of Corporate Tax Shelters: An Educated Guess,'' *Tax Notes*, Nov. 22, 1999, p. 981. Corporate tax shelters were big business, with organizational transformations within large accounting and law firms reflecting and reinforcing the lucrative tax shelter marketplace. Radical structural changes saw consulting services at the nation's leading accounting firms replace audit services as the firms' primary source of revenue. Value added services to corporate executives and managers included tax services headed by tax lawyers lured away from white-shoe law firms. Tax practice at big law firms also changed dramatically, with tax departments doing considerably more than simply servicing other transactional practices. Indeed, tax departments began generating huge profits from fees for opinion letters costing as much as $1 million per opinion, which were sold multiple times to different clients with little or no additional work. In-house tax departments experienced major transformations as well, facing constant ''pressure to de-emphasize traditional legal compliance and become profit centers.'' Tanina Rostain, ''Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry,'' 23 *Yale J. on Reg*. 77, 86 (2006). The pressure to bring in money from tax shelter transactions altered the professional culture among tax practitioners. The traditional ethos among tax lawyers, in particular, recognized a duty to uphold rather than undermine the public purposes of the tax law, with tax professionals owing an obligation ''to help make our self-assessing income tax system work.'' Norris Darrell, ''The Practitioner's Duty to His Client and His Government,'' 7 *Prac. Law*. 23, 25 (1961). *See also* George Cooper, ''The Avoidance: A Tale of Tax Planning, Tax Ethics, and Tax Reform,'' 80 *Colum. L. Rev*. 1553, 1578 (1980) (arguing that tax lawyers had a duty beyond ''unalloyed avoidance-seeking,'' and owed ''at least a measure of allegiance to the fisc and to higher principle''); David E. Watts, ''Professional Standards in Tax Practice: Conflicts of Interest, Disclosure Problems Under Regulatory Agency Rules, Potential Liabilities,'' 33 *NYU Inst. Fed. Tax*. 649, 649 (1975) (stating that tax lawyers ''play an essential role in promoting informed tax reporting, in building mutual confidence between taxpayers and the Service, and in correspondingly reducing the burden on the Service's audit system''). Overaggressive transactions might be legal in a technical, formalistic sense, according to the old guard, but they also destroyed the coherence of the system and made a mockery of laws designed to protect and promote the public interest. By comparison, the emergent ethos among some tax practitioners in the last two decades of the 20th century exalted creative noncompliance over preservation of the tax system. For a discussion of the new ethos and generational divide among tax practitioners, see Dennis J. Ventry Jr., ''Raising the Ethical Bar for Tax Lawyers: Why We Need Circular 230,''

(Footnote continued in next column.)

Tax Notes, May 15, 2006, p. 823, *Doc 2006-8999, 2006 TNT 94-35*; Joseph Bankman, ''The Business Purpose Doctrine and the Sociology of Tax,'' 54 *S.M.U. L. Rev*. 149 (2001). The new culture preferred textualism over purposivism, the letter of the law over its spirit, and rules over standards, preferences that allowed practitioners to create and advise transactions that when viewed individually were technically legal but substantively invidious. Armed with formalist, rulebound interpretations of the tax code, tax practitioners abdicated responsibility to the system, advised overaggressive transactions, and cost the government (and all other taxpayers) hundreds of billions of dollars in forgone tax revenue.

[265]P.L. 108-357 (2004).

[266]*See, e.g.,* sections 6111, 6112, 6662A, 6707, and 6707A. Congress replaced the former registration and list maintenance rules with new rules requiring material advisers to disclose reportable transactions and maintain detailed lists of investors. *See* section 6111 (material adviser reporting requirement) and section 6112 (material adviser list maintenance requirement).

[267]A reportable transaction is the tax code's term of art for prohibited tax shelter transactions. Section 6707A(c)(1) defines reportable transactions generally as ''of a type which the Secretary determines as having a potential for tax avoidance or evasion,'' while reg. section 1.6011-4(b) specifies particular prohibitive transactions, including (i) ''listed'' transactions that have a ''significant tax avoidance purpose'' (see reg. section 301.6111-2(b)(2)), and are the same as, or substantially similar to, a transaction specifically identified by the Treasury as a tax avoidance transaction; (ii) ''confidential'' transactions in which the adviser imposes a condition of confidentiality to protect the adviser's planning strategy; (iii) transactions in which the adviser's fee is contingent on the success of the planning strategy; (iv) ''loss'' transactions in which a gross loss exceeds particular thresholds; and (v) ''transactions of interest'' that have the potential for abuse, but for which the Treasury lacks sufficient information to determine whether they should be identified specifically as tax avoidance transactions. Several code provisions still refer to ''tax shelters'' rather than ''reportable transactions,'' and continue to define the former as a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose is the avoidance or evasion of federal income tax. *See* section 6662(d)(2)(C)(iii); reg. section 1.6662-4(g)(2).

[268]*See* section 6700 (shelter organizer penalty for a false statement raised from $1,000 to 50 percent of gross income derived from the activity); section 6707 (penalty for failure to register a tax shelter transaction raised from $500 to $50,000 for reportable transactions other than listed transactions and up to 75 percent of gross income derived from the activity for listed transactions); section 6707A (new taxpayer penalty for failure to disclose a reportable transaction); section 6708 (new penalty replacing $50 penalty for failure to maintain investor lists under section 6112 with $10,000 per day penalty for failure to turn over information on request from the IRS); section 6662A (new taxpayer 20 percent understatement penalty for reportable transactions, increased to 30 percent if not disclosed).

[269]*See* section 6664(d).

adequate disclosure,[270] substantial authority,[271] and a reasonable belief that the position was more likely than not correct.[272] Moreover, the Jobs Act authorized the Treasury Department to impose stringent monetary penalties on practitioners and firms for violating the new reporting obligations.[273] In particular, the IRS Office of Professional Responsibility may now levy steep monetary sanctions (rising to double the expected fees for advising a reportable transaction) either in addition to or in lieu of other sanctions, including censure, suspension, or disbarment.[274]

New rules governing tax practice further reinforce the reporting requirements. Between 1980 and 2002, Treasury, with the support of Congress, amended Circular 230 regulations five times.[275] Each effort ratcheted up reporting requirements for tax practitioners, and deputized them (largely involuntarily) in the fight against abusive tax shelters.[276] In 2004 Treasury finalized its most ambitious plan to regulate practitioners.[277] The recent amendments to Circular 230 mandate that practitioners affirmatively disclose[278] transactions in covered written opinions failing to meet the more likely than not standard.[279] They further specify that disclosures failing to meet the heightened standard must state that fact prominently, as well as that the opinion cannot be used by the taxpayer for purposes of avoiding underpayment penalties. In other words, if a practitioner cannot conclude at a confidence level of at least more likely than not, that lack of confidence must be disclosed, both to the taxpayer and to the government.

In 2006 Treasury issued additional reporting requirements for an entirely new category of deals. Treasury believes that these ''transactions of interest'' have the potential for abuse, but it currently lacks sufficient information to determine whether they should be identified specifically as tax avoidance transactions.[280] The government has continued to press for broader disclosure requirements by amending the tax preparer penalty. In 2007 Congress raised the reporting standard under section 6694, requiring preparers to possess a reasonable belief that the tax treatment of an undisclosed position would more likely than not be sustained on the merits before advising the position. For disclosed positions, preparers must show a reasonable basis for the position

---

[270]*See* section 6664(d)(2)(A) and defined in reg. section 1.6662-3(c)(2), -4(e) and (f).

[271]*See* section 6664(d)(2)(B) and defined in reg. section 1.6662-4(d).

[272]*See* section 6664(d)(2)(C) and defined in reg. section 1.6662-4(g)(4).

[273]*See* P.L. 108-357, section 822(a)(1) (2004); 31 C.F.R. section 10.50.

[274]*Id.*

[275]*See* ''Proposed Amendments, Tax Shelters; Practice Before the Internal Revenue Service,'' 45 *Fed. Reg*. 58,594 (Sept. 4, 1980); ''Final Rule, Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries Before the Internal Revenue Service,'' 49 *Fed. Reg.* 6,719 (Feb. 23, 1984); ''Notice of Proposed Rulemaking, Tax Practitioners,'' 51 *Fed. Reg.* 29,113 (Aug. 14, 1986); ''Notice of Proposed Rulemaking and Withdrawals of Proposed Rule, Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries Before the Internal Revenue Service,'' 57 *Fed. Reg.* 46,356 (Oct. 8, 1992); ''Notice of Proposed Rulemaking, Amendments to the Standards of Practice Governing Tax Shelters and Other General Matters,'' 65 *Fed. Reg.* 30,375 (May 5, 2000); ''Notice of Proposed Rulemaking, Amendments to Regulations Relating to Practice Before the Internal Revenue Service; Tax Shelters,'' 66 *Fed. Reg.* 3,276 (Jan. 12, 2001); ''Final Regulations, Amendments to Regulations Relating to Practice Before the Internal Revenue Service,'' 67 *Fed. Reg.* 48,760 (July 26, 2002).

[276]For a discussion of some of these amendments, complementary legislative enactments, and practitioners' response to both, see Dennis J. Ventry Jr., ''Tax Politics and a New Substantial Understatement Penalty,'' *Tax Notes*, Oct. 2, 2006, p. 91, *Doc 2006-19805, 2006 TNT 191-53*; Ventry, ''IRS Penalty Report: A Call for Objective Standards,'' *Tax Notes*, Sept. 25, 2006, p. 1183, *Doc 2006-19076, 2006 TNT 186-43*; Ventry, ''Vices and Virtues of an Objective Reporting Standard,'' *Tax Notes*, Sept. 18, 2006, p. 1085, *Doc 2006-18619, 2006 TNT 181-35*; Ventry, ''Filling the Ethical Void: Treasury's 1986 Circular 230 Proposal,'' *Tax Notes*, Aug. 21, 2006, p. 691, *Doc 2006-14952, 2006 TNT 162-25*; Ventry, ''Lowering the Bar: ABA Formal Opinion 85-352,'' *Tax Notes*, July 3, 2006, p. 69, *Doc 2006-12419, 2006 TNT 128-15*; Ventry, ''No Joke: Circular 230 Is Here to Stay,'' *Tax Notes*, June 12, 2006, p. 1409, *Doc 2006-11426, 2006 TNT 118-31*; Ventry, ''ABA Formal Opinion 346 and a New Statutory Penalty Regime,'' *Tax Notes*, June 12, 2006, p. 1269, *Doc 2006-10482, 2006 TNT 113-38*; Ventry, ''The Reaction to the 1980 Proposed Amendments to Circular 230,'' *Tax Notes*, June 5, 2006, p. 1141, *Doc 2006-9965, 2006 TNT 108-30*; Ventry, ''Reasonable Basis and Ethical Standards Before 1980,'' *Tax Notes*, May 29, 2006, p. 1047, *Doc 2006-9503, 2006 TNT 104-54*; Ventry, ''Tax Shelter Opinions Threatened the Tax System in the 1970s,'' *Tax Notes*, May 22, 2006, p. 947, *Doc 2006-9413, 2006 TNT 99-30*.

(Footnote continued in next column.)

[277]''Final Regulations, Regulations Governing Practice Before the Internal Revenue Service,'' 69 *Fed. Reg.* 75,839 (Dec. 20, 2004). For the federal regulation of tax lawyers, see Ventry, ''Cooperative Tax Regulation,'' *supra* note 219 (discussing, in particular, Circular 230); Dennis J. Ventry Jr., ''Whistleblowers and *Qui Tam* for Tax,'' 61 *Tax Law*. 357, 393-405 (2008) (federal regulation of lawyers in the context of the newly revamped IRS whistle-blower statute); Anthony C. Infanti, ''Eyes Wide Shut: Surveying Erosion of Professionalism of the Tax Bar,'' *Tax Notes*, Oct. 27, 2003, p. 517, 528 n.121, *Doc 2003-23172, 2003 TNT 208-50* (examining the ''creeping external regulation of lawyers by administrative agencies'').

[278]31 C.F.R. section 10.35(c)(3).

[279]Covered opinions include listed transactions or a substantially similar transaction (31 C.F.R. section 10.35(b)(2)(i)(A)); a transaction the ''principal purpose'' of which is the avoidance of tax (section 10.35(b)(2)(i)(B)); for the definition of principal purpose, see section 1.6662-4(g)(2)(i)(C) (defining principal purpose as any plan or arrangement designed to avoid or evade federal income tax so that the motive to avoid or evade exceeds any other motivation)); or a transaction, a significant purpose of which is the avoidance of tax, if the opinion is either a reliance opinion, a marketed opinion, an opinion subject to conditions of confidentiality, or an opinion subject to contractual protection (section 10.35(b)(2)(i)(C)).

[280]REG-103038-05 (2006), *Doc 2006-22252, 2006 TNT 212-8*. In September 2007 the IRS specified the first two such transactions. *See* Notice 2007-72, 2007-36 IRB 544, *Doc 2007-18825, 2007 TNT 158-5* (regarding contribution of successor member interest) and Notice 2007-73, 2007-36 IRB 545, *Doc 2007-18826, 2007 TNT 158-6* (regarding Toggling Grantor Trust).

(rather than prior law's nonfrivolous standard, corresponding to a lowly 5 percent to 10 percent likelihood of success).[281] The message is clear: Disclose the position for government inspection or demonstrate a level of certainty in line with the purpose of the statute.

Heightened disclosure rules under a more likely than not standard in the tax context should be viewed as part of a larger trend toward greater transparency in corporate governance and financial accounting. Over the last several years, and under the Sarbanes-Oxley Act of 2002,[282] corporations have become subject to significantly stricter disclosure rules[283] and internal controls.[284] Sarbanes-Oxley also established the Public Company Accounting Oversight Board to regulate the auditors of public companies and to conduct independent investigations and disciplinary proceedings when necessary.[285] Other recent changes to securities laws require registered companies to provide ''material historical and prospective textual disclosure''[286] relevant to an understanding of its financial condition.[287] Moreover, and as already discussed,[288] the IRS rolled out a new Schedule M-3 for corporate taxpayers, requiring them to reconcile book and tax income. And FASB has instituted significant changes to how companies account for uncertainty in income taxes recognized on financial statements. FIN 48 clarifies the treatment of unrealized income tax benefits and liabilities by requiring domestic public companies to assess whether their tax positions are more likely than not correct, and to reflect the results of that assessment on financial disclosures.[289] If a taxpayer determines that the position meets or exceeds the more likely than not standard, it can report the tax benefit without setting aside corresponding reserves; if not, it must provide adequate reserves to cover the contingency.

The trend toward disclosure and transparency is strong and pervasive, which is what makes the district court's decision in *Textron* most troubling. By denying the government petition to enforce an IRS summons Textron's tax accrual workpapers related to its investments in abusive tax shelters, the court subordinated disclosure to secrecy. In the process, it immunized the kind of abusive tax avoidance that Congress, the Treasury Department, and federal courts[290] have fought mightily to discourage, uncover, and punish.

III. The Future of Tax Work Product

This article has argued that tax accrual workpapers never deserve protection under the work product doctrine because they are prepared for regulatory rather than for litigation purposes. It has also argued that in preparing tax accrual workpapers, it is not objectively reasonable for a taxpayer to anticipate litigation because the nexus between the two events — that is, preparation of the documents and actual litigation — is so attenuated and fraught with contingencies that one leads to the other only a fraction of the time.

These conclusions do not prevent other kinds of tax materials or advice, such as legal opinions, from qualifying for protection. Indeed, the above conclusions preserve the vitality of the attorney-client privilege, the tax practitioner-client privilege, and, for that matter, the work product doctrine. In fact, in many respects, this article and its conclusions aim to save these privileges

---

[281]Small Business and Work Opportunity Act of 2007, P.L. 110-28, section 8246 (2007). *See also* Notice 2008-13. For the definition of reasonable belief, see *supra* note 182. Reasonable basis under the new law will be interpreted in accordance with reg. section 1.6662-3(b)(3). *See supra* note 177. To address practitioner concerns over the implementation of the new standard, Treasury issued transitional relief applying prior law standards for tax returns filed for tax year 2007. Notice 2007-54, 2007-27 IRB 12, *Doc 2007-13936, 2007 TNT 113-14*; Notice 2008-11, 2008-3 IRB 279, *Doc 2007-28348, 2008 TNT 1-4*. *See also* IRS Proposed Rules (REG-129243-07), ''Notice of Public Hearing on Tax Return Preparer Penalties Under Sections 6694, 6695'' (June 16, 2008), *Doc 2008-13243, 2008 TNT 117-9*. The former reporting standard merely required preparers to attain a level of certainty corresponding to realistic possibility of success, or 33 percent likelihood of success. See *supra* note 185.

[282]P.L. 107-204 (2002).

[283]*See* sections 406 and 407 of the Sarbanes-Oxley Act, *supra* note 282; Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Securities Act Release No. 33-8177, Exchange Act Release No. 34-47,235 (Jan. 24, 2003).

[284]*See* section 404 of Sarbanes-Oxley, *supra* note 282.; ''Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports,'' Securities Act Release No. 33-8238, Exchange Act Release No. 34-47,986 (June 5, 2003).

[285]*See* section 101, P.L. 107-204 (2002); 15 U.S.C. sections 7211-7219. Notably, section 7215(b)(2)(B) of the statute authorizes the PCAOB to ''require the production of audit work papers and any other document or information in the possession of a registered public accounting firm . . . that the Board considers relevant or material to the investigation, and [it] may inspect the books and records of such firm . . . to verify the accuracy of any documents or information supplied.''

[286]''Management's Discussion and Analysis of Financial Condition and Results of Operations Certain Investment Company Disclosures,'' Securities Act Release No. 33-6835, Exchange Act Release No. 34-26831 (May 18, 1989).

[287]*See* Item 303 of Regulation S-K, ''Management's Discussion and Analysis of Financial Condition and Results of Operations,'' 17 CFR 229.303.

[288]*See supra* note 226 and accompanying text.

[289]*See supra* note 17.

[290]Abusive transactions have received a universally cool reception in federal courts as of late. *See, e.g., Stobie Creek Investments v. United States,* 2008 U.S. Claims LEXIS 230 (Fed. Cl. July 31, 2008), *Doc 2008-5274, 2008 TNT 49-13*; *BB&T Corp. v. United States*, 2008 U.S. App. LEXIS 9250 (4th Cir. 2008), *Doc 2008-9547, 2008 TNT 84-15*; *Jade Trading LLC v. United States*, 81 Fed. Cl. 173 (2008), *Doc 2008-6282, 2008 TNT 57-28*; *Cemco Investors, LLC v. Forest Chartered Holdings, Ltd.*, 515 F.3d 749 (7th Cir. 2008), *Doc 2008-2695, 2008 TNT 27-8*; *H.J. Heinz Co. v. United States*, 76 Fed. Cl. 570 (2007), *Doc 2007-12834, 2007 TNT 103-16*; *Klamath Strategic Inv. Fund, LLC v. United States*, 472 F. Supp.2d 885 (E.D. Tex. 2007), *Doc 2007-2603, 2007 TNT 22-9*; *Coltec Indus.*, 454 F.3d 1340; *TIFD III-E, Inc. v. United States*, 459 F.3d 220 (2d Cir. 2006) (*Castle Harbour*), *Doc 2006-14691, 2006 TNT 150-8*; *Black & Decker, Corp. v. United States*, 436 F.3d 431 (4th Cir. 2006), *Doc 2006-2133, 2006 TNT 23-8*; *Dow Chem. Co. v. United States*, 435 F.3d 594 (6th Cir. 2006), *Doc 2006-1308, 2006 TNT 15-11*, *cert. denied*, 127 S. Ct. 1251 (2007).

either from irrelevance[291] (that is, with the attorney-client and tax practitioner-client privileges being swallowed by the work product doctrine) or irreparable alteration (that is, with work product expanding beyond its traditional province of protecting the adversarial process). If tax professionals and their clients want the protection of these privileges, their tax advice must fit within the privileges' respective requirements. If the advice falls outside the requirements, tax professionals are not entitled to manufacture an entirely new category of protection just because it would make their job easier (or, alternatively, because they carelessly waived the privilege or cannot overcome a showing of good cause or other applicable exception).

Strictly applying the work product doctrine in the tax context can arguably produce harsh results. Taxpayer-applicants will always lose on the threshold question of whether tax materials were prepared in anticipation of litigation or for some other purpose due to the regulatory and statutory requirements compelling preparation of these documents. Taxpayer-applicants invested in listed transactions — for which the likelihood of litigation might be a near certainty — will also be denied work product immunity for materials supporting these transactions under traditional work product analysis. The outcome does not change even for taxpayer-applicants that invested in prohibited transactions with the explicit purpose of challenging in good faith the government's published position before a neutral fact-finder. To the extent these results seem inappropriately harsh — at least in these stylized examples — we could contemplate a more nuanced approach to work product analysis that represents a clear departure from present law.

We might consider, for instance, a sliding scale of protection for attorney work product in not just the context but the larger regulatory context. Under a sliding-scale analysis, if an applicant could show that its documents were not merely tangential to potential litigation, even for documents prepared under regulatory mandates, a court could grant varying degrees of immunity depending on the strength of the applicant's showing. In the process, it could make more precise distinctions between protected and unprotected documents and even protected and unprotected *portions* of documents, making more liberal use of redaction, for instance, to fine tune work product immunity. The sliding-scale model could also provide courts a more precise instrument than current law to evaluate the discovery of facts versus "mental impressions or opinion of counsel," which traditionally receive heightened levels of protection.[292] Often, discovery of facts alone will not provide the government sufficient information to figure out what is going on behind raw data contained on tax returns and disclosure forms.[293] To adequately perform its regulatory function of verifying a taxpayer's self-assessed liability, the government may need to see hidden information contained on transaction or tax accrual documents. In those situations, the court could award partial or full discovery under the sliding-scale model of materials, depending on the government's showing of need.

A sliding scale of protection would be especially beneficial in clarifying claims of opinion work product. Given courts' reluctance to compel discovery of opinion work product,[294] applicants have an incentive to behave opportunistically and to distort the market for tax advice by passing documents through a lawyer's office that just as easily (and perhaps more easily) could be prepared by an accountant or other tax professional. A sliding-scale standard as conceived here would impose a heightened burden on applicants to receive full protection for the documents at issue. If an applicant succeeded in shifting the burden, the government would be afforded a similar sliding scale for good cause. A satisfactory showing of substantial need or undue hardship might include demonstrating threats to the government's ability to perform its regulatory function of enforcing the nation's tax laws, shifting tax burdens to other taxpayers, or undermining legislative and regulatory compliance efforts. Just as the applicant could receive partial protection under a sliding-scale standard, the government could receive partial discovery.

It might also be worth considering incorporating into the sliding-scale approach a modified form of selective or limited waiver for documents prepared for regulatory purposes. Typically, selective or limited waiver is sought by a company that has released privileged materials to a federal regulatory body during the course of a criminal investigation with the hope that such disclosures and assistance in the investigation will result in lenient treatment. The perennial issue is whether disclosure to the government waives the attorney-client and work product privileges as to third-party litigants. The majority of federal courts have declined to apply selective waiver, construing the waiver doctrine strictly, and holding that waiver to the government constitutes waiver of further protection.[295] If a selective waiver rule were to apply in the regulatory context (although not as part of criminal investigations), generating and disclosing documents to

[291] *See supra* notes 242-244 and accompanying text.
[292] *See supra* notes 51-52 and accompanying text.
[293] *See supra* notes 216-230 and accompanying text.

[294] *See supra* notes 52, 140-141, and accompanying text.
[295] In response to the judicial resistance, a concerted effort has emerged to codify selective waiver of the attorney-client and work product privileges. The Advisory Committee on Evidence Rules for the Committee on Rules of Practice and Procedure of the Judicial Conference has proposed amending the Federal Rules of Evidence, Rule 502, to allow for limitations on waiver of the attorney-client privilege and attorney work product. *See* http://www.uscourts.gov/rules/Reports/EV05-2006.pdf. Moreover, Congress is considering codification along the lines of the advisory committee's recommendations. S. 2450, passed in February 2008, amends Rule 502 by permitting selective waiver for disclosures made in a federal proceeding or to a federal office or agency. *See* http://www.govtrack.us/congress/bill.xpd?bill=s110-2450. Also, H.R. 3013 (passed Nov. 2007) and S. 186 (introduced Jan. 2007), cover a related waiver issue by amending the federal criminal code to prohibit the government in a civil or criminal investigation from "demanding, requesting, or conditioning treatment" (also known as providing "cooperation credit") on the disclosure by the organization or person under investigation of any communication

(Footnote continued on next page.)

comply with reporting requirements would not automatically constitute waiver to future third-party litigants, including to the government agency charged with overseeing the reporting requirement that triggered the selective waiver claim. Thus, selective or limited waiver would allow a company to produce attorney-client or work product materials (such as tax accrual workpapers) to an outside law firm, accounting firm, the SEC, or even the IRS without fear that it was also waiving future protection from a third-party discovery request, even from the same parties or agencies. Such selective waiver would allow regulated entities to comply with statutory and agency requirements and to cooperate with government investigations without necessarily putting themselves at a disadvantage in future litigation because of their earlier compliance and cooperation. In this way, a selective waiver rule would reinforce the underlying premise of the work product doctrine as being solicitous of the adversarial process. The applicant would still have to meet all the work product requirements to receive selective waiver and courts would still have to conduct full work product analyses, but documents originally produced for regulatory purposes would no longer be discoverable per se.

Alterations to the work product doctrine, either those offered here or elsewhere, may or may not improve its functionality while respecting its traditional role in our adversarial system. Arguably, the doctrine has adapted quite well over the years to modern processes of dispute resolution and regulatory investigation. Whatever one's position on the doctrine's current utility, all parties remain subject to its limits until future amendment. An applicant must still demonstrate that it prepared the documents at issue in anticipation of litigation or for trial and not for some other purpose, and, furthermore, that its expectation was objectively reasonable. In the context of tax accrual workpapers, an applicant cannot meet either requirement. Workpapers are prepared in compliance with superseding regulatory mandates rather than in anticipation of litigation. Moreover, an applicant's asserted anticipation of litigation over workpapers is objectively unreasonable given the myriad contingencies separating preparation of workpapers and potential litigation with the government over their contents. To conclude otherwise would distort work product protection, and provide a safe haven for abusive tax avoidance.

---

protected by the attorney-client privilege or attorney work product. *See* http://www.govtrack.us/congress/bill.xpd?tab=summary&bill=h110-3013.