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Attorney-Client Privilege in Internal Revenue Service Investigations

Gene A. Petersen*

I. HISTORY AND POLICY OF THE ATTORNEY-CLIENT PRIVILEGE

The notion that an attorney should not be compelled to disclose communications made to him by a client in confidence has its origin in early Roman law. While the extent of influence, if any, of the Roman experience is not clear, the basic principle of privileged communication between a lawyer and his client did gain common law recognition in the early sixteenth century as the use of compulsory testimony became an authorized source of proof in common law courts.

The original justification for the existence of the privilege was that "the oath and the honor" of the attorney would be violated if he were compelled to disclose the secrets of his client. By the eighteenth century, however, the importance of the attorney's express or implied pledge of secrecy diminished in relation to the significance of ascertaining the truth in judicial proceedings. With the repudiation of this doctrine, a new theory was offered to support the existence of the privilege, based on the client's need to consult freely and frankly with his legal advisor. Only if the client confides all facts and circumstances can the attorney give accurate advice and provide accurate representation. Such full disclosure can be expected, however, only if the client is convinced that his attorney cannot be compelled to disclose statements made in confidence to the attorney.

While this theory has enabled the attorney-client privilege to remain a viable legal doctrine, it has not been without critics.

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2. See C. McCormick, supra note 1, § 91.
4. Id.
5. See C. McCormick, supra note 1, § 91.
6. See generally C. McCormick, supra note 1, § 91; 8 J. Wigmore, supra note 3, §§ 2290-91; Radin, supra note 1.
7. The arguments for and against the privilege are presented and thoroughly analyzed in 8 J. Wigmore, supra note 3, § 2291.
Irrespective of objective merits or weaknesses in the doctrine's rationale, however, the confidential nature of the attorney-client relationship is now so deeply rooted in American legal history that it seems safe to say that the privilege will never be abolished. Nevertheless, as Wigmore has stated:

Its benefits are all indirect and speculative; its obstruction is plain and concrete . . . . It is worth preserving for the sake of a general policy, but it is nonetheless an obstacle to the investigation of the truth. It ought to be strictly confined within the narrowest possible limits consistent with the logic of its principle.

II. THE PRIVILEGE AND ITS APPLICABILITY TO INTERNAL REVENUE SERVICE PROCEEDINGS

The most often quoted statement of the privilege is that of Dean Wigmore:

(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.

Without reference to or recognition of the privilege, however, section 7602 of the Internal Revenue Code of 1954, using broad phraseology, authorizes the Internal Revenue Service to subpoena individuals and documents for examination.

Nevertheless, on only one occasion has the Internal Revenue

9. 8 J. Wigmore, supra note 3, § 2291 at 554.
10. Id. § 2292 at 554.
11. § 7602 provides in part:
   For the purpose of ascertaining the correctness of any return, . . . determining the liability of any person for any internal revenue tax, . . . or collecting any such liability, the Secretary or his delegate is authorized—
   (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
   (2) To summon the person liable for tax . . . or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax, . . . or any other person the Secretary or his delegate may deem proper, to appear . . . and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry . . . .

The subpoena or summons is enforced by filing an action in the federal district court requesting compliance. See Int. Rev. Code of 1954, §§ 7402(b), 7604(a). If the subpoenaed party has refused to comply because of a claimed attorney-client privilege, he must base his defense in the district court enforcement proceeding on the privilege.
Service contended that the attorney-client privilege is inapplicable to proceedings under section 7602. In *United States v. Summe* the IRS sought an order compelling an attorney to answer certain questions concerning the income tax returns of two of his clients. The government responded to the claim of privileged communication by asserting that “the attorney-client privilege has no application to an examination under section 7602 . . . .” While the opinion is confusing, the court appears to hold that since the privilege derives from common law and hence does not depend upon a statute, and since there is no authority squarely holding that the privilege does not apply in federal investigative proceedings, “it is therefore necessary that the court proceed on the premise that the attorney-client privilege must be recognized at this investigation.”

Conspicuously absent from the court’s opinion is any attempt to construe the specific language of the statute. Since the power of Congress to bar testimonial privileges in agency proceedings can hardly be questioned, it would seem that the court should have dealt directly with the government’s suggestion that the statute itself precluded the privilege.

The Civil Aeronautics Board has repeatedly contended that under similarly broad investigatory powers conferred on it by the Federal Aviation Act the attorney-client privilege is not available in proceedings before it. The Board’s rationale is that the statutory authorizations carry a congressional mandate for “untrammeled powers of visitation” and therefore doctrines of privilege must yield to “the concept of the agencies' need to know.” When this argument was finally presented to a federal

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13. Id. at 926. The government’s theory was essentially that the proceeding involved was a tax investigation only and not a court proceeding, thus making rule 43(a), FED. R. CIV. P., which requires application of state rules of evidence in certain federal court proceedings, inapplicable.
16. “The Board shall at all times have access to . . . all accounts, records, and memoranda, including all documents, papers, and correspondence, now or hereafter existing, and kept or required to be kept by air carriers . . . .” Federal Aviation Act, 49 U.S.C. § 1377(e) (1958).
18. Memorandum of Plaintiff at 10, CAB v. Air Transp. Ass’n of
district court in *CAB v. Air Transportation Association of America*, the court disposed of the Board’s contention in summary fashion, stating:

The attorney-client privilege is deeply embedded and is part of the warp and woof of the common law. In order to abrogate it in whole or in part as to any proceeding whatever, affirmative legislative action would be required that is free from ambiguity. The very existence of the right of counsel necessitates the attorney-client privilege in order that a client and his attorney may communicate between themselves freely and confidentially.

Based on the tenor of the decisions in these two judicial challenges to the applicability of the attorney-client privilege in agency investigatory proceedings, it seems assured that the privilege will, in the absence of specific legislation to the contrary, remain available.

### III. THE CHOICE OF LAW DILEMMA

The vast majority of the reported decisions involving the attorney-client privilege in agency investigations have assumed it to be applicable, often relying on the statement of Judge Learned Hand, made some thirty years ago, that “the conduct of investigations under these statutes is subject to the same testimonial privileges as judicial proceedings.” Of more immediate concern has been the question of whether the scope of the privilege is to be determined by federal common law or by state law. Initially it should be pointed out that in the vast majority of cases involving the attorney-client privilege, the choice of law problem will not affect the result since the federal common law of attorney-client privilege is based to a large extent on state decisions. Only in those few cases where the scope of the privilege under federal common law is materially different from

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20. Id. at 318. While there was some indication that the Board would appeal the decision, it apparently did not do so. *See Miller, supra note* 17, *at 264*.
that under state decisions or statutes will the choice of law question be of importance. What makes this a problem of great significance, however, is the fact that many states have statutorily created other forms of privileged communication not recognized by the common law, such as that between an accountant and his client or a physician and his patient. Thus, if the law governing the attorney-client privilege is federal common law, it most certainly also governs the question of whether an accountant-client or physician-patient privilege exists and state attempts to create such privileges would be ineffective. It is on this basis that the question deserves thorough analysis.

At the outset, it should be understood that the question presented is not directly whether rules of privilege are "substantive" or "procedural" under the doctrine of Erie Railroad Company v. Tomkins,24 as modified by Hanna v. Plumer,25 since diversity jurisdiction is not involved in tax investigation proceedings. Of concern here is the problem of whether federal or state law should control the existence and scope of testimonial privileges in administrative and district court proceedings to enforce administrative subpoenas or orders to give testimony.26 An analysis of the confusion must begin with Falsone v. United States,27 one of the early cases discussing the availability of a state-created privilege in a federal tax investigation.

In Falsone a certified public accountant was served with a summons by a Treasury agent directing him to appear before the agent and to produce various workpapers, records and memoranda which were used in preparing a client's tax return. He appeared but refused to testify or produce the records. The Internal Revenue Service obtained a district court order directing him to comply. The accountant responded by filing a motion to vacate the order and quash the summons, which was denied. On appeal the accountant contended that the proceeding was a civil case governed by the Federal Rules of Civil Procedure un-

24. 304 U.S. 64 (1938).
25. 380 U.S. 460 (1965). This question has been judicially analyzed quite recently, however. See Republic Gear Co. v. Borg-Warner Corp., 381 F.2d 551, 555 n.2 (2d Cir. 1967). See also Annot., 95 A.L.R.2d 320 (1964).
26. This is one aspect of the broader problem of whether the availability and scope of testimonial privileges can be controlled by state law in non-diversity cases. See Louisell, supra note 15; Pugh, Rule 43(a) and the Communication Privileged Under State Law: An Analysis of Confusion, 7 Vand. L. Rev. 556 (1954). See also Annot., 95 A.L.R.2d 320 (1964).
27. 205 F.2d 734 (5th Cir.), cert. denied, 346 U.S. 864 (1953).
der which state law controls the availability of testimonial privileges. Therefore, Falsone argued, the accountant-client privilege statute of Florida, where the case arose, should control, making his records and testimony immune to discovery.

The court noted federal rule 81(a)(3) which provides that the rules are applicable "to proceedings to compel the giving of testimony or production of documents in accordance with a subpoena issued by any officer or agency of the United States under any statute of the United States. . . ." but drew a distinction between the judicial enforcement action and the agency proceeding. In the court's view, the issue before it was whether the privilege was available before the agency and not whether it could be asserted in the enforcement proceeding, thus making the Federal Rules and, therefore, the state-created accountant-client privilege inapplicable.

Falsone must be compared with the decision of the Ninth Circuit Court of Appeals in Baird v. Koerner. In Baird a tax attorney was summoned to identify certain clients for whom he had made an anonymous payment of back taxes. He appeared before the agent but declined to name any of the parties involved, asserting the attorney-client privilege. The Internal Revenue Service then filed a motion in the district court to compel the defendant to testify and the defendant in turn filed a motion to dismiss and to quash, which was denied. The determinative issue was whether the attorney-client privilege could be asserted in an administrative proceeding as to require that such agencies be restricted by the rigid rules of evidence. 205 F.2d at 742.

28. Even assuming this proceeding to be a "civil proceeding," it is arguable whether the Federal Rules of Civil Procedure compel application of state law to determine the existence and scope of testimonial privileges. See Fed. R. Civ. P. 43(a), discussed infra note 54, and accompanying text.

29. The court stated: [Rule 81(a)(3)] means that the rules are applicable to the court action to enforce the summons . . . . To contend that the proceeding itself before the Commissioner or the Internal Revenue agent is also a civil case subject to the Rules of Civil Procedure, and particularly to Rule 43(a) as to the admissibility of evidence, would be going too far . . . . Clearly . . . . Rule 81(a)(3) . . . was not intended to make so radical a change in administrative procedure as to require that such agencies be restricted by the rigid rules of evidence. 205 F.2d at 742.


31. 279 F.2d 623 (9th Cir. 1960).
fendant then appeared before the judge and was instructed to disclose the identity of the parties involved. He again refused, asserting that the information was privileged; he was found guilty of civil contempt and appealed. Thus, the issue squarely before the appellate court was whether the claim of privilege could be asserted in the enforcement proceeding itself, not whether it was available before the Internal Revenue Service as in Falsone. On the precise question before it, the Baird court properly held that the Federal Rules of Civil Procedure were applicable. In applying federal rule 43(a), the court held that the law of the forum state “should and does” control the question of the availability of the privilege in the enforcement proceeding and that under California law the identities of the clients were protected in these particular circumstances.

The procedural distinction drawn by these two decisions is difficult to support. Certainly the defendant’s right to refrain from responding should not turn on whether the judge orders him to comply in court or before the Internal Revenue Service. If federal common law is to control the existence or scope of the privilege before the agency, and state law is to control in the enforcement proceeding if the privilege is asserted there, then a privilege in one proceeding can be nullified by an order to testify in the other. As a practical matter it seems obvious that any claim of privilege must be tested by reference to the same body of law in both the agency investigation and the enforcement proceeding if consistent results are to be assured.

Irrespective of the persuasiveness of the procedural dis-

32. Id. at 627.
34. Although not cited by the court, rule 81(a)(3) clearly justifies the court’s application of the Federal Rules of Civil Procedure. See note 29 supra, and accompanying text.
35. 279 F.2d at 632. The propriety of the court’s application of rule 43(a) in such a way as to find state law controlling is discussed infra note 54, and accompanying text.
36. Another argument used by the court to support the application of state law was that since federal courts accept the requirements of the forum state for the practice of law, they must also follow the state law concerning the attorney-client relation. This conclusion does not seem to follow from the premise. Cf. Comment, 49 Calif. L. Rev. 382, 384 (1961).
37. Cf. Fahey, supra note 30, at 498-99; Comment, 109 U. Pa. L. Rev. 1030, 1032 (1961). The question of whether the controlling law should be state or federal is explored infra note 41, and accompanying text.
tinction drawn by Falsone and Baird, however, it is important to recognize that both cases are consistent in their application of the distinction. The inference is clear in Falsone that had the question of the availability of the privilege been raised in the procedural fashion in which it was later raised in Baird, the Falsone court would have applied state law under the Federal Rules of Civil Procedure and thus presumably have recognized the state-created accountant-client privilege there claimed.38 Recent decisions involving claims of privilege before administrative agencies, particularly the Internal Revenue Service, have, however, failed to recognize that Baird and Falsone are consistent in their procedural approach to the choice of law problem. They seem content, in the main, to state erroneously that Baird and Falsone are in direct conflict as to whether state or federal law controls the availability of a privilege before an administrative agency.39 Accordingly, without a meaningful analysis of whether the Baird-Falsone approach to the choice of law problem is a sound one or of which body of law should control, they simply conclude that either the Baird view or the Falsone view is correct and correspondingly apply either state or federal law.40 A major source of this confusion is the decision of the Second Circuit Court of Appeals in Colton v. United States.41

In Colton an attorney was summoned by the Internal Revenue Service to appear before an agent to give testimony and to produce certain records relating to the tax return of a client. The attorney appeared but refused to respond to certain of the questions or to turn over any of the records, claiming that such information came within the attorney-client privilege. A motion to quash the summons was denied and the attorney ap-

38. See Falsone v. United States, 205 F.2d 734, 741-42 (5th Cir. 1953); Fahey, supra note 30, at 498; Comment, 49 CALIF. L. REV. 382, 384 n.13 (1961). In FTC v. St. Regis Paper Co., 304 F.2d 731 (7th Cir. 1962) a similar procedural alignment was recognized, although the court's statement reveals some confusion: Baird v. Koerner . . . is distinguishable from the case at bar because the appeal there was from a judgment of civil contempt against an attorney for his refusal to comply with a District Court order to identify, in an Internal Revenue Service inquiry, his client. We agree with that court that that case was "... a civil case" . . . The Falsone appeal was not from a judgment of contempt but, although an Internal Revenue proceeding, was from an order similar to the one before us. There is no inconsistency, therefore, between the view of the court in Baird v. Koerner and the decision in Falsone that such an administrative proceeding is not a civil case. Id. at 734-35.
40. See note 39 supra.
pealed. On the question of whether state or federal law controlled the availability of the privilege the court stated:

At the outset, we reiterate our view, stated in In re Albert Lindley Lee Memorial Hospital . . . , that questions of privilege in a federal income tax investigation are matters of federal law. See Falsone v. United States . . . . For the reasons stated . . . . we do not agree with the Court of Appeals for the Ninth Circuit, Baird v. Koerner . . . ., that a hearing held by the Internal Revenue Service under § 7602 of the Internal Revenue Code of 1954 is a “civil action” governed by state evidence law under Rule 43 (a) of the Federal Rules of Civil Procedure, . . . or that state law should govern for any other reason.42

From the discussion of the Baird case above, it should be apparent that the Colton court misread the Baird opinion since the latter held that the enforcement proceeding, not the agency hearing, was governed by the Federal Rules. The view taken in Colton, however, would bring Baird into direct conflict with Falsone and recent decisions have aligned the cases accordingly. Thus in United States v. Threlkeld,43 a district court proceeding to enforce an Internal Revenue Service summons to testify and produce documents before an agent, the court stated:

[R espondent relies on the state created privilege. Petitioner contends, on the other hand, that only federal law is applicable. Although there is authority that state law should govern (Baird v. Koerner . . . ), Colton v. United States . . . holds that federal law governs and this is the better reasoned opinion.44

In a similar proceeding, the court in United States v. Ladner45 noted the government's reliance on Falsone and Colton, but held that Baird was controlling and thus state law governed the claim of privilege.46

Other anomalous decisions have resulted from this confused line of cases. In In re Bretto,47 for example, involving an enforcement proceeding on an Internal Revenue Service summons, the District Court for Minnesota noted that the government and the defendant agreed that state law governed the claim of attorney-client privilege.48 Of interest also is Love v. United

42. Id. at 636.
44. Id. at 326.
46. Id. at 896. Commentators also have failed to recognize the procedural alignment of Falsone, Baird and Colton. “[T]he decision . . . in Baird . . . is in direct conflict with [Falsone and Colton].” Burroughs, supra note 22, at 250. Cf. Balter, A Ten Year Review of Fraud Prosecutions, N.Y.U. 19TH INST. ON FED. TAX. 1125, 1155 (1961); Orkin, supra note 22, at 794-95.
47. 231 F. Supp. 529 (D. Minn. 1964).
48. Id. at 531.
States, involving a criminal prosecution under the Dyer Act, in which the court held, citing Baird, that “this court is bound by the law of the forum state on the question of privileged communications.” This statement seems clearly incorrect, inasmuch as rule 26 of the Federal Rules of Criminal Procedure provides:

The admissibility of evidence and the competency and privileges of witnesses shall be governed, except when an act of Congress or these rules otherwise provide, by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.

Thus it appears that the perplexity which has surrounded the question of choice of law governing a claim of privilege before an agency has now become a source of confusion in the field of criminal law.

The most unsatisfactory aspect, however, of the muddled interpretations of Falsone and Baird is that in subsequent decisions, the courts did not find it necessary to undertake a meaningful analysis of the question of whether state or federal law should control the availability of a privilege before an agency such as the Internal Revenue Service. In order to make such an analysis, thought must be given to the formulative judicial opinions in the area and to important policy considerations which weigh heavily in any decision affecting the delicate structure of state-federal relations.

It has been noted previously that the distinction drawn by Falsone and Baird between the agency investigation and the enforcement proceeding cannot be maintained. The law governing one proceeding must, as a practical matter, govern the other. Nevertheless, an analysis of the rationale of Baird in applying state law will be helpful. The Baird court placed primary reliance on rule 43(a) of the Federal Rules of Civil Procedure which provides in part:

All evidence shall be admitted which is admissible under the statutes of the United States, or under the rules of evidence heretofore applied in the courts of the United States on the hearing of suits in equity, or under the rules of evidence applied in the courts of general jurisdiction of the state in which the United States court is held.

From this, the court reasoned that since there was no federal

49. 386 F.2d 260 (8th Cir. 1967), cert. denied, 390 U.S. 985 (1968).
50. Id. at 265.
52. See notes 39-40 supra, and accompanying text.
53. See note 37 supra, and accompanying text.
statute or rule governing privilege in civil cases, and since the old equity courts had apparently followed state statutes on the question of privilege, it could be inferred that the law of the forum state should be applied. While the court's analysis of the rule on its face may be valid, its applicability to the precise situation before the court is questionable. Though it may be conceded that under rule 81(a)(3) the Federal Rules are applicable to the enforcement proceeding, the Baird court failed to realize that in so applying the Rules to the question of privilege it was, for all intents and purposes, also applying them to the administrative hearing before the Internal Revenue Service. This result seems clearly contrary to the intentions of the drafters of the Federal Rules and, by inference at least, to the pronouncements of the Supreme Court.

The Baird court's reasoning can also be criticized on the basis of rule 43(a) itself since, in addition to that portion quoted above, it provides: "In any case, the statute or rule which favors the reception of the evidence governs . . . ." Thus, although rule 43(a) was intended to promote broad admissibility, the Baird court utilized it to apply a state exclusionary rule. In United States v. Brunner, the Sixth Circuit relied on this aspect of rule 43(a) in refusing to allow a claim of privilege under a state statute making confidential communications between husband and wife inadmissible.

It has also been contended that under the Rules of De-

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55. Id. The practice of the old equity courts is somewhat in doubt, however. Cf. 5 J. MOORE, FEDERAL PRACTICE § 43.07 (1968); Green, The Admissibility of Evidence under the Federal Rules, 55 Harv. L. Rev. 197, 208-09 (1941).
56. 279 F.2d at 628.
57. See note 29 supra, and accompanying text.
58. See note 37 supra, and accompanying text.
60. See FTC v. Cement Institute, 333 U.S. 683, 705-06 (1948).
62. 200 F.2d 276 (6th Cir. 1952).
63. The court stated: [The state statute] which makes confidential communications between husband and wife inadmissible, does not here control in view of Rule 43(a), . . . which provides for the widest rule of admissibility, whether under Federal law or State rule . . . . Id. at 280 n.2.
64. Cf. Lofts, supra note 22, at 412-13; Note, supra note 14, at 404-08.
cision Act, state law governs the question of privileges in administrative and enforcement proceedings. That Act provides:

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.65

An initial problem with this argument, however, is that if the question of availability of a privilege is covered by rule 43(a), then it seems that by adopting the Federal Rules in Title 28, U.S.C., Congress has spoken on the issue and the Rules of Decision Act is, by its very terms, inapplicable.66 It should also be pointed out that since the Act applies to "civil actions in the courts of the United States," it is somewhat difficult to argue that it should also apply to proceedings before an administrative agency.

The most compelling argument for the application of state law is the view that state statutes that create privileges for confidential communications give rise to substantive rights, as opposed to mere procedural evidentiary rights, which should be honored as a matter of policy by both federal courts and administrative agencies.67 Such rights are substantive, it is argued, because they insure freedom of consultation between a client and his attorney or accountant, and protect the client's confidences by prohibiting the attorney or accountant from testifying as to any confidential communications.68 Rules of evidence, on the other hand, are concerned with the probative value of evidence and whether the jury will be improperly influenced by it and hence, are procedural in nature.69 Thus, just as federal courts in diversity cases consider privilege to be a matter of substantive law and, therefore, apply the law of the forum state under the Erie doctrine,70 federal courts in enforcement proceedings and administrative agencies themselves should also defer to

68. Id.
69. Id.
At this point, however, a number of federal policies which would be affected must be given consideration.

Initially it must be emphasized that the sweeping terms of the statute granting investigatory powers to the Internal Revenue Service\(^\text{72}\) reflect a congressional awareness that in order effectively to enforce the Internal Revenue Code, inhibitions on the power to compel full disclosure must be extremely limited.\(^\text{73}\) If all state-created privileges were to be recognized, the government's ability to gather evidence could be seriously hampered. While some states might be content to enact an accountant-client privilege, for which an arguable case can be made by analogy to the attorney-client privilege, other states might enact broker-client, bank-client or other privileges. The resulting inhibition of the Internal Revenue Service's enforcement powers probably would far outweigh the tenuous benefit which might result from protecting client confidences in such areas.\(^\text{74}\)

Another undesirable effect of applying state law in this area would be the inconsistent administration of federal tax law which would result.\(^\text{75}\) Thus, a client's confidential communications to his accountant would be protected from compulsory disclosure by the Internal Revenue Service in one state while similar communications would not be protected in another state. In addition to the inherent inequity of such an approach, it could also lead to evasive forum shopping. Since a district court action to compel testimony must be brought in "the district in which such person resides or may be found,"\(^\text{76}\) a taxpayer intent on assuring the confidentiality of his communications with an advisor would likely consult an advisor in a state whose law would render the communications privileged.\(^\text{77}\) This type

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\(^2\) The statute is quoted in note 11 supra.


\(^4\) See Cohen, supra note 61, at 216.


\(^6\) Int. Rev. Code of 1954, § 7402(b).

of activity would further thwart the evident congressional policy of minimizing the impediments to full disclosure in Internal Revenue Service investigations.

A final policy aspect of the choice of law problem involves the particular status of the Internal Revenue Service investigation; quite often it is a preliminary step toward a federal tax prosecution. Rule 26 of the Federal Rules of Criminal Procedure specifically states that the competency and privileges of witnesses shall be governed by federal common law. If state-created privileges are available in proceedings before the Internal Revenue Service, the net effect will be to produce the anomalous situation of a taxpayer's advisor successfully refraining from testifying during the administrative investigation only to be compelled to testify at the taxpayer's criminal trial. In addition, these circumstances would likely encourage the Service to engage in judicial fishing expeditions. It might proceed with the criminal prosecution when it has insufficient evidence for a conviction on the theory that the testimony of the taxpayer's advisor, which was protected under state law during the administrative investigation, will be compelled during the trial and provide the additional evidence necessary for the conviction.

To encourage such a course of action seems undesirable from the point of view of both the Internal Revenue Service and the taxpayer.

In balance, considerations of uniformity and equality seem to require the application of federal law to determine the availability of a privilege for confidential communications before the Internal Revenue Service and before the district courts in enforcement proceedings. State law and policy must yield to these pervasive federal interests.

IV. SCOPE OF THE ATTORNEY-CLIENT PRIVILEGE IN FEDERAL TAX INVESTIGATIONS

The scope of the attorney-client privilege is often narrower than expected. It is said to extend "only to communications or

79. Rule 26 is quoted in text accompanying note 51 supra.
81. See Cohen, supra note 61, at 216; Special Subcommittee on Formal Internal Revenue Service Question and Answer Representation, Representations by Counsel at Formal Internal Revenue Interrogation, 18 ABA BULL. SEC. OF TAX. 37, 43 (April, 1965); Note, supra note 73, at
conversations between the attorney and his client and not to activities engaged in by the attorney on behalf of his client.\(8^{2}\)

In recent years, however, judicial decisions in a number of borderline areas have changed substantially the scope of the privilege. The discussion of these various aspects of the privilege operates on the assumption that federal law is and will continue to be determinative of its scope.

A. Identity of the Taxpayer and the Nature of the Employment Relation

As a general rule it may be said that the identity of the client does not come within the scope of this privilege.\(8^{3}\) Two important reasons for this principle are: (1) every litigant is entitled to know the identity of his opponent who is instigating judicial proceedings;\(8^{4}\) and (2) in most cases the identity of the client is not communicated in confidence as the privilege requires.\(8^{5}\) In certain situations, however, the courts have found the reasons for the rule inapplicable and have allowed the identity of the client to be protected.\(8^{6}\)

One of the early cases upholding the privilege in such circumstances is Ex parte McDonough.\(8^{7}\) In McDonough, an attorney had been employed by certain clients to represent them in matters connected with the investigation of election frauds and to defend three other persons who were already under indictment for such frauds. The grand jury sought to compel the attorney to disclose the identity of the clients who had hired him, but the court held that their identity was protected by the attorney-client privilege. The court noted that the communication did not involve the furtherance of a criminal act, that it was clearly intended by the clients to be held in confidence and


85. See note 83 supra. One commentator includes as a third reason the need of the courts to know that the attorney actually has a client. See Lofts, supra note 80, at 497-13 (1964).

86. Wigmore recognizes this by noting that "much ought to depend upon the circumstances of each case." 8 J. WIGMORE, supra note 83, § 2313.

87. 170 Cal. 230, 149 P. 566 (1915).
that the clients were not parties to any litigation. It then concluded:

[N]one of the various reasons advanced in the authorities for the disclosure of the name of the client who employed the attorney is applicable here, in view of the circumstances of this case. We cannot escape the conclusion that, . . . to require the petitioner to answer any of the questions . . . would be to require him to divulge a confidential communication made to him by a client in the course of his employment—a communication tending to show, and, under the circumstances of this case, material only for the purpose of showing, an acknowledgment of guilt on the part of such client of the very offenses on account of which the attorney had been employed to defend him.\(^\text{88}\)

A leading case holding that under comparable circumstances the identity of the client is not protected is United States v. Pape.\(^\text{89}\) Pape was accused of transporting a woman across state lines for immoral purposes. At the trial the district court required Pape's attorney to reveal that Pape had retained him to defend the woman against an earlier prostitution charge. The Second Circuit affirmed, quoting from the opinion of the district judge which states: "There is nothing in the books to show that the privilege was to extend to the fact of retention of counsel. No point is made that the employment of counsel should be shrouded with secrecy."\(^\text{90}\) The court recognized, how-

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88. Id. at 236-37, 149 P. at 568. Other cases upholding the privilege as to the identity of the client include: Elliot v. United States, 23 App. D.C. 456 (1904); Ex parte Enson, 270 Ala. 254, 117 So. 2d 361 (1960); In re Kaplan, 8 N.Y.2d 214, 203 N.Y.S.2d 836, 168 N.E.2d 660 (1960); Neugass v. Terminal Cab Corp., 139 Misc. 699, 249 N.Y.S. 631 (Sup. Ct. 1931); In re Shawmut Mining Co., 94 App. Div. 156, 87 N.Y.S. 1059 (1904).

89. 144 F.2d 778 (2d Cir. 1944).

90. Id. at 783. Judge Learned Hand dissented on the ground that retention of counsel for the woman "was a communication between an attorney and client, a step in his own defense . . . . That direction to his own attorney in his own interest was as much a privileged communication as any direction would have been, made in the course of preparing for a trial." Id. Hand's argument seems persuasive. It is difficult to see how any injustice would have been done had the state been unable to determine who had hired the attorney to defend the woman. See Note, supra note 84, at 537. Other cases denying the applicability of the privilege to the identity of the client include: Behrens v. Hironimus, 170 F.2d 627 (4th Cir. 1948); Mauch v. Commissioner, 113 F.2d 555 (3d Cir. 1940); United States v. Lee, 107 F. 702 (C.C.E.D.N.Y. 1901); Gertsky v. Miller, 160 F. Supp. 914 (D. Mass. 1958); Brunner v. Superior Court, 51 Cal. 2d 616, 335 P.2d 484 (1959); In re Selser, 15 N.J. 393, 105 A.2d 395 (1954); People ex rel. Vogelstein v. Warden, 150 Misc. 714, 270 N.Y.S. 362 (Sup. Ct.), aff'd, 242 App. Div. 611, 271 N.Y.S. 1059 (1934).
ever, that "there may be situations in which . . . the disclosure of the client will result in a breach of the privilege."91

The leading case involving the identity of a client in a federal tax investigation is *Baird v. Koerner*.92 This case, it will be recalled, involved a payment of back taxes by an attorney for an unidentified client. While the court relied upon state law in finding the identity of the client to be a privileged communication, it also explored the rationale of the privilege to determine whether or not it should apply to such a situation. The court noted that since no litigation existed, there could be no necessity for the government to know the taxpayer's identity as there would be if he had filed a suit against the government.93 Also, it was clear under the circumstances that the client intended that his identity be held in confidence by the attorney. Thus, since the traditional reasons for requiring the disclosure of the client were inapplicable, the *Baird* court felt justified in striking a balance between the policy of the attorney-client privilege and the policy of full disclosure in favor of protecting the client's confidences.94

The conclusion reached by the court, in light of the facts involved in this particular case, seems entirely correct.95 In the normal investigatory situation, the identity of the suspect is known, and evidence of his activities is sought to incriminate him. The attorney-client privilege, however, protects the client from having his attorney compelled to testify as to incriminating statements made to the attorney, thereby encouraging free communication between the client and attorney. In the *Baird* situation, however, the illegal activity of the client was known by the government and the incriminating link necessary to pursue a criminal prosecution was the identity of the client. In these circumstances, then, it seems that the client's identity must be protected if he is to obtain effective legal representation.96

While the *Baird* decision was based on state law, any doubts that the scope of the privilege under federal common law would not be equally broad were dispelled by *Tillotson v. Boughner*.97

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91. 144 F.2d at 783.
92. 279 F.2d 623 (9th Cir. 1960). This aspect of the case is discussed in: Comment, 10 BUFFALO L. REV. 364 (1961); Comment, 49 CALIF. L. REV. 382 (1961); Comment, 47 VA. L. REV. 126 (1961).
93. 279 F.2d at 630.
94. Id. at 631.
96. Id.
97. 350 F.2d 663 (7th Cir. 1965).
Applying federal common law to facts very similar to those in *Baird*, the court found the identity of the client to be protected by the attorney-client privilege.

As a general rule, the attorney-client relation is a preliminary fact to be established before any claim of privilege may be upheld. Thus in *Colton v. United States*, an attorney was required to answer questions concerning the general nature of legal services rendered to a taxpayer. Similarly, an attorney was required to testify as to the amount and date of fees paid by a client. It is difficult to argue with these decisions since they seem to present no serious impediment to free communication between the attorney and client. Nevertheless, applying state law, the court in *United States v. Ladner* refused to compel an attorney to testify as to his fees or to his involvement in the purchase of a residence for a client.

In some circumstances, however, certain facts of the relationship may be elements of proof of a crime. In such a case, by analogy to the *Baird* and *Boughner* cases, it would seem that the facts should be cloaked with the protection of the attorney-client privilege. For example, if a taxpayer is accused of willfully failing to file a tax return and the date of his first consultation with the attorney was shortly before the return's due date, that fact might give rise to an inference that there had been timely advice to file and thus should be privileged.

**B. The Taxpayer's Records in Possession of an Attorney**

Under the "pre-existing document" rule, the attorney-client privilege may not be asserted to protect documents in the hands of an attorney which were created prior to the attorney-client relationship. The rationale for this exception to the privilege is based on the fear that if documents could be withheld by an

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98. In fact, the *Boughner* court noted: "There is little doubt but that defendant Boughner planned the transaction in the instant case... in light of the decision of *Baird v. Koerner*..." Id. at 665.


105. Id.

106. See generally 8 J. Wigmore, supra note 83, § 2307.
attorney as can oral communication, a client could foreclose any discovery of his documents and records simply by transferring them to his attorney, even though they would have been subject to discovery in his own hands.\textsuperscript{107} While a client may make an oral communication to the attorney of a fact which would be protected by the attorney-client privilege, the client could still be compelled to reveal that fact unless he possessed an individual privilege, such as that against self-incrimination. Were documents to be protected by the attorney-client privilege when handed to an attorney, however, production of the document could not be compelled though it could have been compelled had the client retained possession. While the client could be questioned as to his knowledge of facts contained in the documents or records, such an examination would be of little value where extensive and complicated records were involved.\textsuperscript{108}

Conversely, however, it would seem unjust if documents which were protected by the privilege against self-incrimination in the hands of the client lost that protection when handed to an attorney. Such a result would follow from the fact that the fifth amendment privilege is personal in nature,\textsuperscript{109} and under the "pre-existing document" rule documents do not qualify for the protection of the attorney-client privilege. The undesirable result of such a situation would be that the possession of documents protected in the hands of the client by the fifth amendment could not be transferred to an attorney for examination without becoming subject to production. One court has realistically phrased the problem as follows:

Clearly, if the taxpayer in this case . . . had been subpoenaed and directed to produce the documents in question, he could have properly refused . . . But instead of closeting himself with his myriad tax data drawn up around him, the taxpayer retained counsel. Quite predictably, in the course of the ensuing attorney-client relationship the pertinent records were turned over to the attorney. The government would have us hold that the taxpayer walked into his attorney's office unquestionably shielded with the Amendment's protection, and walked out with something less.\textsuperscript{110}

Wisely the majority of courts have not accepted the government's position and generally have held that documents which were protected in the hands of the client do not lose their protection when transferred to an attorney.\textsuperscript{111} The ve-

\textsuperscript{107} See Comment, 74 Yale L.J. 539, 546 (1965).
\textsuperscript{108} Id.
\textsuperscript{109} See Hale v. Henkel, 201 U.S. 43 (1906).
\textsuperscript{110} United States v. Judson, 322 F.2d 460, 466 (9th Cir. 1963).
\textsuperscript{111} See United States v. Judson, 322 F.2d 460 (9th Cir. 1963);
hicle for reaching this result, however, has been to allow the attorney to assert the client's privilege against self-incrimination. In doing so, it was necessary for the courts to distinguish and by-pass a substantial amount of case law and it may be questioned whether they have done this successfully and convincingly. A strong argument can be made that a more proper course to follow in providing the needed protection would have been to extend the attorney-client privilege to cover documents which were protected in the hands of the client. This solution would have avoided a confrontation with prior decisional law and provided a nonconstitutional rationale for the result reached.

C. THE ACCOUNTANT AND HIS WORKPAPERS

No accountant-client privilege is recognized by either the common law or the federal courts in tax investigation proceedings. Thus if communications to an accountant or his reports and workpapers are to be protected, they must be brought within the scope of other categories of privilege. In many situations the attorney-client privilege may be available.

The most critical factors in determining the availability of the attorney-client privilege to protect the workpapers of an accountant are whether or not an attorney has been retained by the taxpayer prior to the preparation of the workpapers, and whether they were prepared at the direction of the attorney or the client.

Where an accountant is retained and workpapers are prepared before an attorney is consulted, it seems clear that they cannot be cloaked with the protection of the attorney-client privilege. Irrespective of the equity of such a result, it
seems to follow logically from the rationale of the privilege, since the client's communication was not made to an attorney or to one working under the direction of an attorney as his agent. In addition, since the workpapers were subject to discovery in the hands of the accountant, it seems equally clear that transferring possession of the workpapers to an attorney who was subsequently retained would not bring them within the privilege. The leading case upholding this view is Bouschor v. United States where workpapers and tax returns had been prepared by an accountant for several years before the attorney involved was consulted. After the tax investigation began, the attorney was consulted and he instructed the accountant to transfer all workpapers to him. When the attorney was summoned to produce the workpapers and other material he had received, he refused, contending inter alia that the papers were privileged communications. The court, noting that the workpapers were prepared by the accountant prior to the attorney's appearance in the case, and that they had already been reviewed once by Internal Revenue agents, reasoned correctly that no confidential communication by the client to an attorney existed and thus the privilege was inapplicable. Troublesome, however, is the court's view that the privilege was inapplicable for the additional reason that the ownership of the documents and workpapers lay with the accountant and not with the taxpayers. While the question of ownership or at least rightful possession of workpapers is critical in assessing the validity of a fifth amendment claim of self-incrimination, its relevance to the availability of the attorney-client privilege is

117. Cf. Lofts, supra note 80, at 434.
118. In United States v. Kovel, 296 F.2d 918 (2d Cir. 1961), the court left open the possibility that the privilege may be applicable in such circumstances by stating: "We do not deal in this opinion with the question under what circumstances [accountant-client communications] could be deemed privileged on the basis that they were being made to the accountant as the client's agent for the purpose of subsequent communication by the accountant to the lawyer." Id. at 922 n.4. Assuming the attorney-client privilege inapplicable, however, it may be possible for the workpapers or other documents to become protected from discovery under the privilege against self-incrimination if possession or ownership is transferred to the client or possibly the attorney. This problem is explored infra note 119, and accompanying text.
119. 316 F.2d 451 (8th Cir. 1963).
120. Id. at 456.
not clear. Where an attorney employs an accountant to prepare workpapers and reports, it seems likely that such documents would still be the property of the accountant, and yet other courts have held the privilege applicable in such circumstances. Nevertheless, the prudent attorney would be well advised to obtain a surrender of title from the accountant to all reports and workpapers if reliance on the attorney-client privilege is anticipated.

Where the accountant is employed directly by the attorney or by the client at the attorney’s request, the status of the accountant’s testimony or workpapers is less clear. One of the earliest cases to deal with the question was Himmelfarb v. United States where the attorney retained an accountant who was present at meetings between the taxpayer and the attorney. The testimony of the accountant was objected to by the attorney on the ground that the accountant was an agent of the attorney and thus the communications between attorney, accountant and taxpayer were protected. The court held to the contrary, however, stating: “[The accountant’s] presence was not indispensable in the sense that the presence of an attorney’s secretary may be. It was a convenience which, unfortunately for the accused, served to remove the privileged character of whatever communications were made.”

As might be expected, the Himmelfarb decision has received strong criticism. Certainly it can be argued that the services of an accountant are essential to an attorney if he is to provide effective legal representation in a tax fraud case. The accountant can analyze the taxpayer's financial records and translate technical accounting data into materials more readily understandable by the attorney. Nevertheless, Himmelfarb was subsequently approved by the Sixth Circuit in Gariepy v. United States.

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123. See Lofts, supra note 80, at 427.
124. 175 F.2d 924 (9th Cir.), cert. denied, 338 U.S. 860 (1949).
125. Id. at 938-39.
126. Id. at 939.
128. See Lofts, supra note 121, at 509.
129. 189 F.2d 459 (6th Cir. 1951).
In *United States v. Kovel,* however, the Second Circuit expanded the scope of the attorney-client privilege to cover employees or agents of an attorney with more than "menial or ministerial" duties. In *Kovel* the accountant, though not an attorney, was a full-time employee of a law firm specializing in tax matters. The client was instructed to turn over his records to the accountant and to make any necessary explanations of financial transactions. When the accountant was summoned to disclose statements made by the taxpayer, he refused, claiming the communications were protected by the attorney-client privilege. The court rejected both the argument of the government that the privilege covered non-lawyer employees of a law firm only if their duties were "menial or ministerial," and the argument of the attorneys that a communication by a client to any employee of a law firm was privileged. In the court's view the essential element was "that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer." In applying this principle to the facts involved the court reasoned:

Accounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases. Hence the presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated tax story to the lawyer, ought not to destroy the privilege . . . ; the presence of the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit. By the same token, if the lawyer has directed the client, either in the specific case or generally, to tell his story in the first instance to an accountant engaged by the lawyer, who is then to interpret it so that the lawyer may better give legal advice, communications by the client reasonably related to that purpose ought fall within the privilege; there can be no more virtue in requiring the lawyer to sit by while the client pursues these possibly tedious preliminary conversations with the accountant than in insisting on the lawyer's physical presence

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130. 296 F.2d 918 (2d Cir. 1961).
131. Id. at 920–23. The attorney's view was rejected on the ground that "[n]othing in the policy of the privilege suggests that attorneys, simply by placing accountants, scientists or investigators on their payrolls and maintaining them in their offices, should be able to invest all communications by clients to such persons with a privilege the law has not seen fit to extend when the latter are operating under their own steam." Id. at 921. Cf. United States v. McKay, 372 F.2d 174 (5th Cir. 1967). The *McKay* court held that a report prepared by appraisers employed by the attorney for possible use in tax litigation was not protected from disclosure under the attorney-client privilege.
132. 296 F.2d at 922.
while the client dictates a statement to the lawyer's secretary. . . . 138

In *United States v. Judson* 134 the Ninth Circuit followed *Kovel* and apparently overruled, sub silentio, its much criticized earlier decision in *Himmelfarb*. 135 In *Judson*, the attorney consulted by the taxpayer requested that an accountant be retained by the taxpayer to prepare a net worth statement for the attorney's use in providing adequate representation. Subsequently the attorney was served with a subpoena which directed him to produce the accountant's workpapers and the net worth statement. In summary fashion, the court upheld the attorney's claim that the documents were privileged, stating:

The accountants' role was to facilitate an accurate and complete consultation between the client and the attorney about the former's financial picture. The lower court was correct in determining that these documents constituted confidential communications within the attorney-client privilege. 136

The most recent decision to affirm the liberal view of *Kovel* and *Judson* is *Bauer v. Orser*. 137 In *Bauer* the taxpayers consulted an attorney who retained an accountant to assist him so that he "could properly advise the [taxpayers] as to their legal rights." 138 The court held that workpapers and other documents prepared by the accountant were protected by the attorney-client privilege since the communications between the accountant and client were made in confidence for the purpose of obtaining legal advice. 139

The Supreme Court has never delineated its view of the scope of the attorney-client privilege in tax fraud investigations or, more specifically, to what extent the privilege will protect the workpapers and reports prepared by an accountant at the attorney's direction. This issue was recently before the Court in *Reisman v. Caplin*, 140 but was not decided, since the case was disposed of on procedural grounds. 141

From the cases discussed, it should be observed that work-

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133. Id. The Court expressly rejected the rationale of the *Himmelfarb* case. Id. at 922 n.3.
134. 322 F.2d 460 (9th Cir. 1963).
135. See Cohen, supra note 115, at 191.
136. 322 F.2d at 462. This language appears to reject the *Himmelfarb* view that the accountant could not be an "indispensable" party to attorney-client communications. See text accompanying note 126 supra.
138. Id. at 340.
139. Id. at 342-43.
140. 375 U.S. 440 (1964).
141. See Cohen, supra note 115, at 183-85.
papers and reports of an accountant in most cases will be protected by the attorney-client privilege if the accountant has been retained by the attorney or by the client at the attorney's direction. Where the client tells his story to an accountant before the attorney enters the picture, the privilege will apparently be inapplicable.\textsuperscript{42} One commentator has observed that this places an unjustifiable burden on the taxpayer to understand the legal technicalities involved in the law of privileged communication and that, to remedy this inequity, recognition should be given to a testimonial privilege for accountant-client communications.\textsuperscript{43} A more likely solution to the problem is for the accountant to realize that any communications made to him will be discoverable and to insist that an attorney be retained and accounting services be provided only at the attorney's direction. This practice would seem particularly advisable in the normal situation where an Internal Revenue Service investigation has begun before the taxpayer consults the accountant. Immediately upon learning that the taxpayer is under investigation, the accountant should explain the legal implications of further communication and insist that an attorney be retained.

D. \textbf{The Attorney Performing Non-Legal Services}

It should be recalled that in order for communications between an attorney and client to be privileged, the attorney must have been acting in his capacity as a professional legal advisor at the time the disclosures were made.\textsuperscript{44} "Not all communications between an attorney and his client are privileged . . . . Attorneys frequently give to their clients business or other advice which, at least insofar as it can be separated from their essentially professional legal services, gives rise to no privilege whatever."\textsuperscript{145} Thus where the attorney handles financial transactions for the client,\textsuperscript{146} acts as his business manager or collection agent\textsuperscript{147} or gives investment advice,\textsuperscript{148} com-

\textsuperscript{142} But see note 118 supra.
\textsuperscript{144} See text accompanying note 10 supra.
\textsuperscript{146} See Lowy v. Comm'r, 262 F.2d 809 (2d Cir. 1959); McFee v. United States, 206 F.2d 872 (9th Cir. 1953); Pollock v. United States, 202 F.2d 281 (5th Cir.), cert. denied, 345 U.S. 993 (1953); Toothaker v. Orloff, 4 Am. Fed. Tax R.2d 5029 (S.D. Cal. 1959).
communications between the attorney and client are not protected by the privilege. It is easily appreciated, however, that in numerous situations it may be extremely difficult, if not impossible, to determine the capacity in which the lawyer was acting. Those situations which have proven most troublesome for the courts usually involve quasi-legal services performed by an attorney who also happens to be an accountant and quite often involve specifically the preparation of tax returns by an attorney or an attorney-accountant.

In re Fisher\(^\text{149}\) is an early federal case dealing with a claim of privileged communication by an attorney-accountant. The attorney-accountant involved had in the past given legal advice to the client, but on the occasion in question had been retained to audit the client's books and sought to protect the client's records and workpapers prepared during the audit from discovery based on a claimed attorney-client relationship. The court correctly compelled production of the records and documents. Where the services performed by the professional are characteristically rendered by an accountant, such as an audit of the financial records, it seems clear that the fact that the person employed happens to be an attorney should not change the status of what would otherwise be unprivileged communications.\(^{150}\)

In Olender v. United States,\(^{151}\) however, the services performed did not lend themselves to such easy categorization. Involved was an attorney-accountant who had prepared federal income tax returns for the client and a net worth statement requested by the Internal Revenue Service after the tax investigation had begun. Nevertheless the court concluded, without apparent difficulty, that the attorney-accountant was retained as an accountant to prepare a financial statement and income tax returns, and nothing more.\(^{152}\) Thus, the privilege was held inapplicable. Of major concern to practicing attorneys is the court's implied characterization of the preparation of income tax returns as the work of an accountant.\(^{153}\) If the preparation

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\(^{150}\) Id. at 638.
\(^{151}\) 51 F.2d 424 (S.D.N.Y. 1931). See also United States v. Chin Lim Mow, 12 F.R.D. 433 (N.D. Cal. 1952).
\(^{152}\) Id. at 806.
\(^{153}\) Cf. Lofts, supra note 143, at 417-19.
of income tax returns cannot be a legal service when performed by an attorney-accountant, it would seem to follow that an attorney who is not an accountant is not acting in his capacity as a professional legal advisor when he prepares an income tax return. Consequently, the attorney-client privilege would not protect statements made by the client to the attorney in connection with tax return preparation and such statements could be the basis of subsequent civil or criminal litigation against the client. It should be pointed out, however, that the Olender court was not faced with the latter situation and that the decision on the facts before the court was somewhat simplified by additional circumstances. The attorney-accountant was an employee of an accounting firm and not actively engaged in the practice of law. In addition, when a question arose as to whether certain information should or should not go into the net worth statement, a practicing attorney was consulted for legal advice on the matter. These factors point sharply to the conclusion that the individual involved was providing services as an accountant, not as a lawyer, and on this basis the result reached by the court is readily justified. Nevertheless, the court's view is clear that irrespective of the particular circumstances involved it did not consider preparation of a federal income tax return a legal service.

A different view of the applicability of the attorney-client privilege to the preparation of tax returns was adopted by the Second Circuit in Colton v. United States. The government sought to compel testimony and the production of copies of tax returns, workpapers, correspondence, memoranda and all other data relating to the preparation of federal income tax returns by the attorneys for a particular client under investigation by the Internal Revenue Service. The attorneys subsequently appeared but refused to give any substantial testimony or turn over the records requested claiming that to do so would "flagrantly induce a violation of their duty to the taxpayer arising out of the relationship of attorney and client." The court,

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154. Thus the court would apparently include income tax return preparation in the same category with other non-legal services to which the privilege would not apply, such as giving investment advice or handling financial transactions. Cf. text accompanying notes 146-50 supra.
155. See Lofts, supra note 143, at 417-19.
156. 210 F.2d at 806.
158. Id. at 634.
159. Id. at 635.
without citing or discussing the Olender decision, assumed the applicability of the attorney-client privilege stating:

There can, of course, be no question that the giving of tax advice and the preparation of tax returns—which unquestionably constituted a very substantial part of the legal services rendered . . . are basically matters sufficiently within the professional competence of an attorney to make them prima facie subject to the attorney-client privilege . . . . But, . . . the authorities are clear that the privilege extends essentially only to the substance of matters communicated to an attorney in professional confidence. 160

The court went on to conclude that a number of matters concerning which the attorneys had refused to testify, such as the years during which the attorney-client relationship existed, remuneration received and the nature of legal services rendered, were not confidential communications and thus not protected by the privilege. As to the workpapers and documents involved, the court affirmed the holding of the district court that:

[The attorney could] withhold any particular confidential papers which were “specifically prepared by the client for the purpose of consultation with his attorney” and any of the firm’s memoranda and worksheets “to the extent of any unpublished expression made by an attorney therein of confidences which had passed between him and his clients.” 161

In the court’s view, however, a blanket refusal to produce anything was unjustified; if the documents were to be protected by the attorney-client privilege, it was incumbent upon the attorney to establish that they were confidential in nature. 162

To the extent that the court required the attorney to establish that the documents in his possession were confidential in nature and to respond to questions concerning the nature of services rendered, it has been criticized for placing a “serious and unjustified” limitation on the privilege. 163 It would seem equally unjustified, however, to allow an attorney’s blanket claim of privilege for everything in his custody to stand unchallenged. Since the documents remain in the attorney’s possession, the government would be without practical avenues to rebut such a claim unless some inquiry is permitted. The same critic states that the Colton decision “appears to sanction inquiry into the statements of the client leading up to the disclosure of items appearing on the face of the return.” 164 While the opinion is

160. Id. at 637.
161. Id. at 639.
162. Id.
164. Lofts, supra note 143, at 422.
not clear on this point, to the extent it does approve such inquiry the court is probably incorrect. Invariably there will be many occasions where the attorney and client will discuss matters which are of a confidential nature and yet some aspect of that discussion will eventually appear on a federal tax return. Surely the appearance of this one item should not remove the cloak of protection from the client's entire communication. Irrespective of the relative merits of this interpretation of Colton, however, subsequent decisions appear to have received the case in a different light.\footnote{165}

In Threlkeld v. United States\footnote{166} an attorney who also happened to be a certified public accountant sought to assert the attorney-client privilege in refusing to answer certain questions or produce certain documents in connection with an estate tax return he had prepared. As to the effect of the attorney's status as a certified public accountant, the court noted that he held himself out only as a lawyer and not as a practicing accountant and therefore was entitled to claim the privilege to the extent of its applicability to the communications and documents involved.\footnote{167} On the question of which communications and documents were protected by the privilege, the court, relying in part on Colton, stated:

Any communication by the client with the understanding that the information would be inserted in the return must be divulged. . . . The reason is that, with such an understanding, it could not be intended to be confidential.

Information communicated by the client with the direction that it not be inserted in the return or with the direction that it be, or not be, so inserted in the discretion and judgment of the attorney need not be divulged. . . .\footnote{168}


\footnote{166. 241 F. Supp. 324 (W.D. Tenn. 1965).}

\footnote{167. Id. at 326. The court seemingly handled this problem correctly. The mere fact that a practicing attorney also happens to be a certified public accountant as in Threlkeld should not deprive his client of the privilege, no more than the fact that a practicing accountant also happens to be an attorney as in Olender should bestow on his clients the protection of the attorney-client privilege. Cf. How to Handle Tax Audits, Requests for Rulings, Fraud Cases, and Other Procedures Before the I.R.S. 129 (I. Schreiber ed. 1967). But see United States v. Higgins, 266 F. Supp. 593 (S.D. W. Va. 1966). In Higgins an attorney-certified public accountant, who was apparently practicing as an attorney, was allowed to claim his client's attorney-client privilege with respect to some schedules and workpapers incident to the preparation of a federal tax return, but others were found to be "primarily of an accounting nature" and were held not protected.}

\footnote{168. 241 F. Supp. at 326.}
This application of Colton would appear to adequately protect the status of the attorney-client privilege doctrine since any communication which was made by the client in confidence would be inviolable.\(^{169}\)

The most troublesome decision in this area is that handed down recently by the Eighth Circuit in Canaday v. United States.\(^{170}\) An attorney practicing as such prepared tax returns for a client under investigation by the Internal Revenue Service. The taxpayer sought the protection of the attorney-client privilege to prevent the government from compelling the attorney to testify or to produce documents and workpapers in his custody. The court affirmed the holding of the district court that the privilege was inapplicable since the attorney "had acted not as a lawyer, but merely as a scrivener for [the] defendant."\(^{171}\) While the court did not clarify the nature of the work actually done by the attorney, it is difficult to conceive of circumstances where an attorney who is retained to prepare an income tax return would act as a mere "scrivener." Certainly a taxpayer's purpose in retaining an attorney for such a task is his belief that the attorney will employ his professional skill and judgment to minimize taxes and to prepare an accurate return.\(^{172}\) In addition, the two cases cited by the court in support of its ruling\(^{173}\) are either inapposite or directly contradict the decision. Falsone v. United States\(^{174}\) did not involve an attorney, but an accountant who unsuccessfully attempted to gain recognition of

\(^{169}\) A second application of Colton reaching a similar result is found in United States v. Higgins, 266 F. Supp. 593 (S.D. W. Va. 1966). Involved again was an attorney-certified public accountant, apparently practicing as a lawyer, who had prepared federal income tax returns for various clients. The court, quoting extensively from Colton, held that the schedules and workpapers involved, except those which were primarily of an accounting nature, were protected by the attorney-client privilege.

\(^{170}\) 354 F.2d 849 (8th Cir. 1966). This case is the subject of a critical Comment in 33 Mo. L. Rev. 122 (1968).

\(^{171}\) 354 F.2d at 857. The lower court had stated that:

\[1\]t is patently clear that the function performed by [the attorney] for the defendant in filling out defendant's tax returns was the function of a scrivener, and that the documents received by [the attorney] from the defendant and the documents prepared by [the attorney] for the defendant were not of such a nature as to be the subject of the attorney-client privilege.

\[I\]d. at 857 n.7.

\(^{172}\) See Comment, 33 Mo. L. Rev. 122, 126 (1968).


ATTORNEY-CLIENT PRIVILEGE

a state-created accountant-client privilege before the Internal Revenue Service. Colton v. United States,175 it will be recalled, did involve a tax attorney's claim of his client's attorney-client privilege, but the court specifically recognized that tax return preparation was "sufficiently within the professional competence of an attorney to make [it] prima facie subject to the attorney-client privilege."176 Thus, based on either logic or precedent, the decision in Canaday designating income tax return preparation as the work of a "scrivener" is difficult to support and should not be followed.

The obvious confusion which exists in this area appears to be the result of a failure on the part of the courts to follow a systematic analysis of the factual situations involved.177 If an attorney-accountant seeks to assert the attorney-client privilege for his client, the court should first inquire as to whether the professional holds himself out and actually practices as an attorney or an accountant.178 If he is an employee of a public accounting firm or generally holds himself out to the public as an accountant the privilege should be presumed inapplicable.179 If he practices as an attorney and holds himself out as such, then the privilege should be considered as attaching to communications by the client to the extent the services provided are within the attorney's professional legal competence. For reasons discussed earlier, tax return preparation should fall within this category,180 while performing a year end audit of the financial records, for example, would not.181

176. Id. at 637.
178. Id.
179. The presumption could not be a conclusive one, however, since consideration must be given to that rare situation where an attorney-accountant who holds himself out to the public and practices as an accountant, for unknown reasons, decides to provide services of a uniquely legal nature, such as litigating a case for a client. While such conduct would likely violate the canons of ethics of both the legal and accounting professions, this would not justify penalizing the client by depriving him of the protection afforded by the attorney-client privilege.
180. An exception would, of course, exist with respect to communications which are made with the understanding that they shall be disclosed on the return, since the element of confidentiality is lacking. As to these communications the privilege would not apply.
181. See In re Fisher, 51 F.2d 424 (S.D.N.Y. 1931). The fact that communications to an accountant would not be privileged while communications to an attorney performing similar services would be is not a basis for criticism of the scope of the attorney-client privilege. This is the natural result of the circumstance that an attorney-client privi-
V. CONCLUSION

It has been suggested that many of the problems surrounding the attorney-client privilege in the tax fraud area could be eliminated by the recognition of an accountant-client privilege.\textsuperscript{182} Certainly it must be conceded that a substantial portion of the litigation concerning the availability of the attorney-client privilege in tax investigations relates to accounting and involves accountants' workpapers, documents originally transferred to accountants or services having both legal and accounting aspects. Nevertheless, before the recognition of an accountant-client privilege can be advocated, the need for such recognition merits close scrutiny, keeping in mind Professor Wigmore's admonition that the doctrine of privilege should be "strictly confined within the narrowest possible limits."\textsuperscript{183}

Initially it seems clear that the application of state law and state-created privileges is not a proper vehicle for gaining recognition of an accountant-client privilege in Internal Revenue Service investigations. The spectrum of problems which would be created by such action has been noted previously,\textsuperscript{184} and it should suffice to say here that the inequities and lack of uniformity which would result make this alternative clearly inadvisable.

The broader question of whether an accountant-client privilege should be created by federal law must also be answered in the negative. While it is quite clear that information often intended to be confidential when communicated to an accountant is presently subject to discovery by the Internal Revenue Service, it seems equally clear that the mere fact that a client intends a communication to be confidential does not justify cloaking it with the protection of a privilege. Before a privilege against disclosure of communications should be recognized, it is also essential that the injury to the client and the relation caused by disclosure is greater than the benefit gained by having the information available in litigation.\textsuperscript{185} Recognition of an accountant-client privilege would clearly result in the withdrawal of the privilege is recognized by the federal common law while none exists for the accountant's client.

\textsuperscript{182} Cf. 8 J. WIGMORE, EVIDENCE § 2292 (McNaughton rev. ed. 1961); Fahey, Testimonial Privilege of Accountants in Federal Tax Fraud Investigations, 17 TAX L. REV. 491, 509 (1962); Lofts, supra note 143, at 434.

\textsuperscript{183} 8 J. WIGMORE, supra note 182, § 2291.

\textsuperscript{184} See notes 72-81 supra, and accompanying text.

\textsuperscript{185} See J. WIGMORE, supra note 182, § 2285.
holding of substantially more information from the Internal Revenue Service and other administrative agencies and thus hamper them in carrying out their law enforcement responsibilities. The corresponding benefits which would result from recognition simply do not justify this curtailment. While past experience indicates that a taxpayer's case often appears to be unjustly damaged by discovery of a confidential communication made to an accountant, it is submitted that adequate protection can in most cases be afforded if the accountant will recognize that when his client becomes the subject of a tax investigation, the accountant should insist on the immediate retention of an attorney.