

Reliance On Counsel Defense Waives Work Product And Attorney-Client Privilege Protection

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In litigation, the work-product doctrine and the attorney-client privilege protect materials and communications from discovery by an adversary in litigation. The work-product doctrine excludes from discovery materials prepared in anticipation of litigation because discovery of such materials would hamper the orderly prosecution and defense of legal claims in adversary proceedings. The attorney-client privilege extends to communication between a taxpayer and a “federally authorized tax practitioner” with respect to tax advice, to the extent the communication would be privileged if it were between a taxpayer and an attorney.

Many tax penalties will not apply if the taxpayer had reasonable cause for its tax position. At times, reliance on the advice of counsel in adopting a tax position constitutes reasonable cause.

Reliance on counsel, the work-product doctrine, and the attorney-client privilege, do not play well together, as Salem Financial, Inc. learned in a recent Court of Claims case. Salem is a successor to Branch Investments LLC, a subsidiary of BB&T. In tax litigation, Salem raised reliance on counsel to defend itself against asserted penalties. The Government used that defense to claim access to documents and communications that would otherwise have been protected under the work-product doctrine and attorney-client privilege. The Claims Court sided with the Government, and authorized the release of the contested items since they related to the reliance on counsel defense.

The reliance on counsel defense has saved many a taxpayer from penalties. It is unknown if the taxpayer in this case knew that by using that defense it would be forfeiting the above evidence protections – perhaps the benefits of the defense outweighed the negatives relating to the disclosure of the subject items and thus was intentional.

WHERE’S THE VALUE HERE? A reminder to litigating taxpayers that a reliance on counsel “reasonable cause” defense may result in a waiver of protections otherwise available under the work-product doctrine and the attorney-client privilege.

SALEM FINANCIAL, INC v. U.S., 109 AFTR 2d 2012-XXXX, (Ct Fed Cl 01/18/2012)

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