

Why Did That IRS Attorney Interrogate My Client?

The New Paradigm

Historically, Internal Revenue Service chief counsel typically became involved in a civil tax case only after the investigative stage was completed at the examination level, and the controversy had moved on to the appeals division or to the tax court. In the investigative stage of fraud cases, IRS attorneys would be involved behind the scenes giving direction and advice to special agents conducting the criminal investigation.

IRS attorneys' involvement in examinations has drastically changed—one consequence of the recently completed first major reorganization of the IRS since the Eisenhower era. For large- and medium-sized business audits, it is not uncommon for an IRS attorney to be (1) present at the first meeting, (2) drafting Information Document Requests (the tax audit's version of interrogatories and requests for production of documents), and (3) attending meetings at which he or she is actively involved in questioning the taxpayer. Would a commercial litigator allow the other side's attorney to be present and conduct what, in effect, amounts to a deposition in a prelitigation stage without the client's attorney present?

The IRS has gone "back to the basics" and has greatly increased its resources involved in investigating criminal tax fraud by individuals and closely held businesses. In cases where fraud is perhaps suspected, but the matter is not yet "referred" by the civil examination function to criminal investigation, it is not uncommon for the government attorney to accompany a revenue agent to a meeting. In tactical terms, this is giving the other side the advantage of an experienced fraud attorney having a "free shot" at one's client, perhaps without one's presence. Any compromising statements or documents produced by the client will, undoubtedly, later be used against the taxpayer consistent with long-

standing treasury policy.

Obviously this change has resulted in the interjection of the taxpayer's counsel at far earlier stages of proceedings than historically has been the case. Because the government has its tax attorneys involved at that stage, clients are making the obvious response.

Privilege Lost

The early involvement of IRS attorneys has raised some privilege issues. For many years, the IRS has successfully argued that the attorney-client privilege did not apply to communications among attorneys either because of their status or the type of work involved. For example,

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if a certified public accountant is also an attorney but practices as a CPA (i.e., a "dualie"), the judiciary treats that professional as a CPA for attorney-client privilege purposes. There is a limited statutory privilege that does apply to accountants according to IRC 7525. However, that does not, by definition, apply in any fraud cases and is otherwise far more limited than the attorney-client privilege, even in civil settings. In separate October 2002 decisions involving two national accounting firms, the IRC 7525 privilege was very narrowly construed, and the accounting firms were required to turn over lists of tax shelter investors and other sensitive information to the IRS.¹ One should fully expect that the government will aggressively

seek to limit the narrow scope of the statutory accountant's privilege. When an individual's attorney is working for an investment banking house or preparing tax returns, there exists another example where the attorney-client privilege may not apply.

Given this well-developed body of case law on limitations to the attorney-client privilege, the question becomes the following: What about the communications, such as memos and other internal communications, etc., to revenue agents and criminal investigation division agents made by an IRS attorney who is de facto acting as an investigator? This will certainly make for interesting litigation. It will not be confined just to documents. Why, for example, can an IRS attorney involved as an active participant at a meeting not be called to testify about what he or she said or did at a meeting? Are statements that attorney subsequently made to other IRS employees privileged?

Conclusion

Taxpayers, business attorneys, and accountants need to be aware of the sea change in how the IRS is choosing to employ its legal resources and take appropriate offensive and defensive steps.

NOTES

1. See *United States v BDO Seidman, LLP*, 2002 US Dist Lexis 19369 and *United States v KPMG, LLP* (No 02-2925), 2002 Tax Notes 194-29 (US District Court, DC).



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