Ethical Issues When Representing the

Accountant in an IRS Investigation

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1. Introduction

This panel is a modification of a similar panel first presented in December 2019 at the American Bar Association’s 36th Annual National Institute on Criminal Tax Fraud/Ninth Annual National Institute on Tax Controversy in Las Vegas, Nevada. The audience for that presentation consisted primarily of attorneys. Accordingly, the written materials that follow are directed at attorneys. We believe that these materials are still useful for non-attorneys in that they provide insight into the thought processes that will guide attorneys when representing the accountants who are the stars of the various scenarios, and a non-attorney reviewing these materials should be able to glean guidance as to the factors that should influence their choices if they are confronted with the situations described below.

These materials do not constitute legal advice. The unique facts of a particular situation are critical to determining the appropriate course of conduct. For that reason any practitioner facing the situations described below would be well-advised to seek legal counsel.

Most, if not all, of the scenarios to be discussed by this panel require an analysis of the various rules and regulations that govern the behavior of accountants in discharging their ethical responsibilities. So what are the implications, from a *legal* ethics standpoint, for an attorney representing an accountant who finds himself/herself involved in a tax investigation of the accountant’s client?

*See* Model Rule of Professional Conduct 1.1 (“lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation”). So, when representing an accountant, the lawyer’s ethical responsibilities include knowing, understanding, analyzing and applying the accountant’s ethical responsibilities. *Cf. Padilla v. Kentucky*, 559 U.S. 356 (2010).

1. Representing the Accountant in an Audit or Investigation of the Accountant’s Client
2. Scenario 1: No formal request (e.g., summons or subpoena), but IRS agents stop by to (1) interview accountant about his/her client’s tax return, and (2) ask if accountant will share with the agents documents from the accountant’s file.
3. Is the accountant being asked to disclose confidential client information in violation of section 1.700.001.01 of the AICPA’s Code of Professional Conduct?

[Note: AICPA rules might govern accountant’s conduct even if the accountant is not a member of the AICPA. *See*, *e.g.*, 20 Missouri Code of State Regulations 2010-3.010 (compliance with AICPA rules is a requirement for licensed accountants in Missouri)]; 68 Illinois Administrative Code § 1420.200(b); Utah Admin. Code R156-26a-501(2).

*But see* section 1.700.001.02 (client confidentiality rule does not prohibit a member from disclosing information in the process of responding to an inquiry questioning the member’s ethics); section 1.700.070 (rule does not prohibit a member “from disclosing information necessary to initiate, pursue, or defend the member in an actual or a threatened lawsuit or alternative dispute resolution proceeding”).

1. Is there a state rule of confidentiality beyond the AICPA rules? *See*, *e.g.*, Mo.Rev.Stat. §326.322 (client confidentiality statute). FL Stat. § 90.5055 (2016) But state privilege rules generally don’t apply in federal proceedings. *Couch v. U.S.*, 409 U.S. 322, 335 (1973); *Trump v. Mazars USA,* LLP, 940 F.3d 710, 724 (D.C. Cir. 2019) (quoting *Couch*).
2. 26 U.S.C. §§ 6713(a) (civil penalty) and 7216 (criminal penalty) for preparers who disclose clients’ tax return information. *But see* 26 CFR §301.7216-2(b) (permissible to disclose tax return information to officers or employees of the IRS).
3. *See* Circular 230 §10.20(a) (“practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged”).
4. *See also* Rule No. 4 of the Rules of Professional Conduct of the National Association of Enrolled Agents (Members and Associates should disclose “confidential information only when authorized or legally obligated to do so”).
5. Scenario 2: Accountant is served with an IRS Summons or Grand Jury Subpoena to provide information and documents about the client.
6. Ethical rules would seem to allow accountant to provide information and documents in response to the summons on subpoena. *See* AICPA Code of Professional Conduct at section 1.700.001.02 (rule against disclosing confidential client communications “shall not be construed . . . to affect in any way the member’s obligation to comply with a validly issued and enforceable subpoena or summons”), section 1.700.100.01.
7. Can/should/must the accountant tell the client that he or she has been served with a summons or subpoena?
8. If it is an IRS summons, sometimes the client will be advised. *See generally* 26 U.S.C. §7602(c) (notice to taxpayer of IRS contacts with third persons). *But see id.* at §7602(c)(3)(C) (notice not required during criminal investigations. *See also id.* at §7609 (procedures to give notice to taxpayer of summons served on third parties, but procedures don’t apply when summons is served as part of a criminal investigation).
9. If it is a grand jury subpoena, sometimes the subpoena will have language on its face, or in an accompanying letter, pursuant to which the United States Attorney’s office asks the recipient not to disclose to anyone (including (especially?) the target of the investigation) that he or she has been served with a subpoena.
10. Some case law exists that suggests that it is improper for the Government to include such language on a grand jury subpoena. *See* *In re Grand Jury Proceedings,*  814 F.2d 61 (1st Cir. 1987).
11. But do you or your client want to risk the fight? The language typically warns (threatens?) that disclosing the existence of the subpoena could obstruct or interfere with the investigation, not-so-subtly raising the specter of an obstruction of justice charge.
12. In some cases there are statutes that make it a crime to disclose the existence of a grand jury subpoena. *See*, *e.g.*, 18 U.S.C. §1510(b)(1) (felony for an officer of a financial institution, to notify anyone about the existence or contents of a subpoena for records of that financial institution, or records that have been provided in response to the subpoena, if officer acts “with the intent to obstruct a judicial proceeding”); 18 U.S.C. 1510(b)(2) (misdemeanor for an officer of a financial institution to notify a customer of the financial institution who records have been subpoenaed, or anyone else named in the subpoena, of the existence or contents of the subpoena, regardless of whether or not the officer acted with any intent to obstruct a judicial proceeding).
13. AICPA Code of Professional Conduct at section 1.700.100.02 (“[w]hen complying with a subpoena or summons, the member is not required to notify the client that its records have been subpoenaed or that a summons related to the client’s records has been issued”). State rules may vary from this approach.

*Compare* ABA Model Rule of Professional Conduct 1.4 (“lawyer shall . . . keep the client reasonably informed about the status of the matter”).

1. Can/should the accountant assert any privileges in response to the summons or subpoena?
2. 26 U.S.C. §7525 -- The (extremely limited) tax practitioner’s privilege
3. State law privileges won’t apply to a federal summons or subpoena. *In re Zuniga,* 714 F.2d 632, 642 (6th Cir. 1983); *In re Grand Jury Subpoena American Broadcasting companies, Inc.*, 947 F. Supp. 1314, 1321 (E.D. Ark. 1996).
4. “With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.” 26 U.S.C. §7525(a)(1).
5. Note the words “with respect to tax advice”. This section does not apply to communications about tax return preparation. *U.S. v. BDO Seidman*, 337 F.3d 802, at 810 (7th Cir. 2003); *U.S. v. Frederick,* 182 F.3d 496, 502 (7th Cir. 1999); *U.S. v. KPMG LLP*, 237 F.Supp.2d 35, 39 (D.D.C. 2002). Indeed, communications between an attorney and a taxpayer are not privileged to the extent those communications occur in the context of the attorney acting as a tax return preparer, since tax return preparation is not considered to be the rendering of legal services. *In re Grand Jury Investigation*, 842 F.2d 1223, 1224-25 (11th Cir. 1987); *Meade v. General Motors, LLC*, 250 F.Supp.3d. 1387, 1393 (N.D. Ga. 2017).
6. The privilege does not apply in criminal tax matters. 26 U.S.C. §7525(a)(2) (privilege may only be asserted in “any noncriminal tax matter before the Internal Revenue Service” or “any noncriminal tax proceeding in Federal court brought by or against the United States”).
7. The privilege does not apply to communications regarding tax shelters. 26 U.S.C. §7525(b).
8. Attorney/Client privilege: Perhaps some of the information in the accountant’s possession is subject to an attorney/client privilege held by the accountant’s client.
9. Doubtful, unless the accountant is a *Kovel* accountant. (*See* Part III below)
10. But, still, it might be in the accountant’s best interest to at least enable the client to assert the privilege
11. If accountant’s client knows about the summons or the subpoena, then the client could bring an appropriate action to modify or quash the summons or subpoena.
12. In some cases, the accountant might be able to work out (through counsel) an agreement with a reasonable AUSA to withhold arguably privileged materials for subsequent determination as to whether a privilege applies.
13. What if the accountant’s client (or counsel for the accountant’s client) tries to direct the accountant not to turn over information or documents?

VERY DANGEROUS for the accountant to take direction from the accountant’s client or the attorney for the accountant’s client. Such action raises the prospect of obstruction of justice or conspiracy.

.C. Scenario 3: The accountant’s client is the subject of a criminal tax investigation or prosecution. To what extent do you let your client, the accountant, cooperate with or interact with the target?

1. VERY DANGEROUS to allow the target and the accountant to have unmonitored communications.
2. If request is from the target’s attorney, through the accountant’s attorney, the situation is better, but still must proceed with caution.
3. Some requests may be very appropriate. For example, the attorney for the target may ask to sit in on interview between government agent and accountant. Sometimes the interview can be recorded. *Cf.* 26 U.S.C. 7521 (procedures for recording interviews between IRS personnel and the taxpayer); I.R.M. 4.10.3.3.6.

. D. Scenario 4: What if you believe, or learn, that your client, the accountant,

is or may become a target of the investigation?

1. Background: What are some of the areas that investigators might be looking at with respect to the accountant?
2. Possible criminal violations: 26 USC § 7206(2) (aiding and assisting the presentation of a false document to the IRS); 26 USC § 7212(a) (corruptly endeavoring to impede the due administration of the internal revenue code); 18 USC $§ 371 \left(conspiracy\right)$
3. Preparer/Promoter Penalties Under the Internal Revenue Code (26 USC §§ 6694(a) (understatement due to unreasonable positions); 6694(b) (understatement due to willful or reckless conduct); 6695 (laundry list of various penalties could be asserted against preparers, such as failure to furnish copy of the return to the taxpayer, failure to sign the return, and others); 6700 (promoting abusive tax shelters); 6701 (aiding and abetting the understatement of tax liability); 6713 (improper disclosure of tax return information)
4. Ethical/Licensure Proceedings: IRS Office of Professional Responsibility; state licensing boards
5. Good argument that, in terms of the accountant’s ethical obligations to the client, when the accountant himself or herself is under investigation, all bets are off; that is, the accountant’s need to defend himself/herself from such accusation overrides whatever obligations the accountant may otherwise have to the client. *See* AICPA Code of Professional Conduct at section 1.700.001.02 (client confidentiality rule does not prohibit a member from disclosing information in the process of responding to an inquiry questioning the member’s ethics); *id.* at section 1.700.070 (rule does not prohibit a member “from disclosing information necessary to initiate, pursue, or defend the member in an actual or a threatened lawsuit or alternative dispute resolution proceeding”).
6. Of course, as the attorney for the accountant in this situation, it is crucial to keep in mind that your duty of loyalty runs to your accountant-client. You will need to advise your accountant-client based upon what is in the best interests of that client, and that may mean taking a course of action (e.g., disclosing information to the government) even if doing so would be adverse to the interests of the taxpayer (i.e., the client of your accountant-client). *See* Comment 1 to ABA Model Rules of Professional Conduct 1.7 (“[l]oyalty and independent judgment are essential elements in the lawyer’s relationship to a client”).
7. If you are representing a *taxpayer* during a criminal tax investigation or audit, and you have reason to believe that your client’s accountant may have exposure, that knowledge may trigger certain duties on your part with respect to your dealings with the accountant. *See*, *e.g.*, ABA Model Rules of Professional Conduct Rule 4.3 (governing the attorney’s interactions with unrepresented persons (in this case, the accountant; attorney may have obligation to clarify to the accountant that the attorney represents the taxpayer and does not represent the accountant; attorney may not give the accountant legal advice other than to recommend that the accountant might wish to secure counsel for himself/herself); *id.* at Rule 4.4 (entitled “Respect for Rights of Third Persons”)
8. The *Kovel* Accountant
9. Introduction: Sometimes, when representing a client in a tax matter (such as an audit or other government investigation), the attorney for the taxpayer will hire an accountant to assist the attorney with the representation. Under appropriate circumstances, communications between the taxpayer and this accountant, communications that might ordinarily not be protected from disclosure to the Government by any privilege, will be privileged if the accountant constitutes a *Kovel* accountant, as described below.
10. The *Kovel* Case (*United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961)
11. Facts: A law firm specializing in tax law employed Kovel, an accountant and former IRS agent. In a federal investigation of a client of the law firm, Kovel received a subpoena to appear and testify before the grand jury. Kovel refused to answer certain questions asked by the Assistant US Attorney and claimed the information requested was protected by attorney-client privilege.
12. District Court: Held Kovel in contempt and sentenced him to imprisonment of 1 year.
13. Court of Appeals: Vacated the judgment of contempt and remanded for consideration consistent with the opinion. Although disclosure of information to a third-party generally destroys attorney-client privilege, an attorney representing a client often may need to enlist third-party assistance. Indeed, the court mentions file clerks, secretaries, telephone operators, messengers, and law clerks as the types of individuals to whom an attorney or the attorney’s client may impart privileged information. Accordingly, agents of the attorney must be included when considering privilege. The court then analogizes accounting concepts to a foreign language, and notes that if an attorney hired an interpreter to interview a client and then translate the interview into notes, the communications between the client and interpreter would certainly be privileged. However, in determining whether a communication to an accountant is privileged, it is “vital to the privilege that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer.” If only accounting advice is being sought, or if the advice is being sought from the accountant rather than the lawyer, then there is no privilege.
14. The General Principle: Communications by an attorney’s client to an accountant hired by the attorney to assist the attorney in understanding the client’s financial information are covered by the attorney-client privilege. (Some cases suggest that the privilege can still apply, even where the client hires the accountant, if the client hired the accountant for the purpose of assisting the lawyer in providing legal services to the client. *See Cavallaro v. United States*, 284 F.3d 236, 247 (1st Cir. 2002)).
15. CAUTION: In many, many situations, the involvement of both an attorney and an accountant in representation of a client with respect to a tax matter will not result in communications between the accountant and the client being privileged under *Kovel*. *See*, *e.g.*, *Cavallaro* (no privilege because accountants were not hired to provide assistance to law firm; key facts included the engagement letter between the accountants and the client, which stated that the engagement was solely for the benefit of the client and its shareholders and not for anyone else’s benefit, as well as pre-existing relationship between accountants and client prior to the hiring of counsel); *United States v. Adlman*, 68 F.3d 1495 (2d Cir. 1995) (memorandum prepared by accountants for in-house attorney of corporation not privileged; court finds that accountants had been hired in the past by the corporation to provide tax advice, auditing, accounting and advisory services, and evidence did not establish that in preparing the memorandum the accountants were working under a separate arrangement to assist the in-house counsel in providing legal advice to the company); *United States v. Chevron Texaco Corp.*, 241 F.Supp.2d 1065 (N.D.Calif. 2002) (communications between corporation and/or its attorneys on the one hand and the corporation’s accountant on the other hand were not privileged because accountants were not engaged to assist corporation’s attorneys but were instead engaged to provide accountants’ own tax advice to the corporation). *See also United States v. Richey*, 632 F.3d 559 (9th Cir. 2011) (court used *Kovel*-type analysis to evaluate whether privilege applied to protect from disclosure the file of an appraiser hired by taxpayers’ attorneys to value a conservation easement granted by the taxpayers; court of appeals held that communications related to the preparation and drafting of the appraisal prepared by the appraiser and filed with the taxpayers’ tax return were not made for the purpose of providing legal advice but for the purpose of determining the value of the easement, so appraiser’s file not privileged).