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THE TAX LAWYER

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Before Filing Your Taxes With IRS, Consider This

As you start preparing to file your tax return this year, consider what will happen if you are audited. Most audits are via correspondence, so you'll have time to consider what to provide. When the IRS asks for substantiation, provide receipts and other supporting information. Invoices, cancelled checks, bank statements, etc., can all be relevant.

But what if you have memos and letters from tax advisers? They might address whether you qualify for a deduction, your audit risk, or potential tax litigation. You want to support your case and to *help* your tax position, not make it worse. So try to avoid handing the IRS a road map of arguments to make *against* you.



Internal Revenue Service headquarters building in Washington. (AP Photo/J. David Ake, File)

What should you do if the IRS asks for *all* of your documents about a particular deduction, income item, or tax year? As part of vetting a particular tax position, you and your tax advisers may have discussed what tax arguments the IRS could make. You might talk about audit risk and tax authorities pro and con. Traditionally, documents to be used in tax litigation and relating to the strength or weakness of a tax position are covered by work-product privilege so the IRS generally cannot get them.

You can withhold documents that are protected by attorney client privilege and those that are covered by work-product protection. The latter covers documents created in anticipation of litigation. This protection has wide application, not just to tax litigation. If the IRS issues an Information Document Request or subpoena, you may be able to legitimately refuse.

Work-product protection is different from attorney-client privilege. Attorney-client privilege protects communications between clients and their *lawyers*, whether or not those communications deal with anticipated litigation. Discussions with tax lawyers are privileged, but discussions with accountants are not, unless the accountants are subcontractors of the tax lawyers.

Having lawyers hire accountants can bootstrap attorney-client privilege to accountant communications, allowing [attorney-client privilege from an accountant](#). That makes sense where tax litigation is imminent or might involve an IRS criminal matter. Work product protection is much narrower than attorney client privilege.

For example, in *U.S. v. Textron, Inc.*, the First Circuit gave the IRS access to all documents not protected by attorney-client privilege. Textron had memos and calculations dealt with the extent to which its tax reporting would pass muster in an IRS audit. The court found the documents were not prepared *specifically* for use in litigation so were fair game. Consider taking precautions.

It may help if your notes and documents are legended at the time they are created with “work-product” protections. It may help if you can show they are for the specific use of anticipated litigation.

If you solely deal with your tax lawyer, not your accountant, this should not apply. Having your tax lawyer act as the liaison for all communications can import attorney-client privilege.

Keep legal opinions and memos on tax matters in a separate file. Don't just have a “tax” file. If you have a big tax issue (say a lawsuit recovery, a casualty loss or conservation easement), keep *that* file separate.

Segregate tax issues. Keep a file on each and don't comingle them. That way if you turn over a file you've limited the disclosure to the pertinent topic.

If you maintain tax accrual work papers, limit them to numerical analyses. Keep tax memos in a legal file, preferably with your lawyer. Think of tax documents as tax returns and spreadsheets only, numbers rather than words.

Keep legal issues associated with taxes (discussion of case law, IRS rulings, etc.) in a legal file.

In a company, keep legal opinions and tax memos with the general counsel's office. Keep legal opinions and tax memoranda in a file separate from accounting and financial statements.

Work-product protection is more clear-cut *after* your return is filed. If you know you have a dispute, you have a much better argument you are preparing documents for the *specific* purpose of litigation.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.