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# United States v. Textron: The Right Answer to a Billion-Dollar Question

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# *United States v. Textron*: The Right Answer to a Billion-Dollar Question

Ned Hillenbrand*

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## *I. Introduction*

Despite the general understanding that paying taxes is fundamental to a functioning democracy,[1] Americans continue to debate who should in fact pay them, and how much.[2] Passionate debate concerning what the law

1. *See* IRS OVERSIGHT BOARD, 2010 Taxpayer Attitude Survey 5 (Jan. 2011), *available at* http://www.treasury.gov/irsob/reports/2011/IRSOB%202010%20Taxpayer%20Attitude%20Survey.pdf (providing statistically, in 2010, that 97% of Americans agree it is every American's civic duty to pay their fair share of taxes, and that 96% of Americans agree everyone who cheats on their taxes should be held accountable).

2. *See, e.g.*, J. Aaron Ball, *The Sea Clammers Doctrine: Reeling in Private Employment Tax Claims in Worker Misclassification Cases*, 1 DEPAUL BUS. & COM. L.J. 215, 249 n.226 (2003) ("Whether a tax or a method of taxation is 'fair' is a never-ending debate since there is no definitive standard of fairness."); *see also* William G. Gale, Book Note, *Tax Reform in the Real World*, 15 YALE J. ON REG. 387, 387 (1998) (reviewing MICHAEL GRAETZ, THE DECLINE (AND FALL?) OF THE INCOME TAX (1997)) ("[T]ax policy debates are a never-ending source of amusement and frustration . . . . [B]ashing the tax system (and the IRS) is often good politics regardless of the actual merit of the proposed reforms."); Marjorie E. Kornheuser, *The Morality of Money: American Attitudes Towards Wealth and the Income Tax*, 70 IND. L.J. 119, 212 (1994) ("Throughout its history, the income tax laws and the debates surrounding them have reflected, to varying degrees, American society's contradictory attitudes about earned income and wealth.").

should be is a healthy aspect of democratic society.[3] But noncompliance with established tax law challenges the legitimacy of our government.[4] The unwillingness of both citizens and corporations to pay their taxes in full and on time is cause for concern.[5]

In February 2006, the Internal Revenue Service (IRS) reported that the deficit tax gap in 2001 was approximately $350 billion, which reflected a compliance rate of 83.7%.[6] Over 15% of U.S. taxpayers failed to pay their taxes in full, which "creates public cynicism in the fairness and effectiveness of our voluntary compliance system."[7] Despite declarations of Congress to remedy the problem,[8] the tax gap in America remains an unresolved issue.[9]

The American taxpayer may fear being audited by the Internal Revenue Service (IRS), but in reality less than 1% of tax returns are audited

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3. *See* President Barack Obama, First Presidential Press Conference (Feb. 9, 2009) ("The strongest democracies flourish from frequent and lively debate, but they endure when people of every background and belief find a way to set aside smaller differences in service of a greater purpose.").

4. *See* Marjorie E. Kornhauser, *Legitimacy and the Right of Revolution: The Role of Tax Protests and the Anti-Tax Rhetoric in America*, 50 BUFF. L. REV. 819, 823–24 (2002) (discussing how antitax rhetoric has the potential to increase noncompliance, encourage antigovernment sentiment, threaten the legitimacy of government, and "endanger the existence of the state by strangling its means of support").

5. *See id.* at 873 ("Fair collection means that everyone pays the appropriate amount of tax that the law assesses. . . . The perceived or actual failure of large numbers of taxpayers to pay their taxes 'adversely' affects voluntary compliance by the rest . . . because of their diminished faith in the fairness of the tax."). *See generally* Dennis J. Ventry, Jr., *Cooperative Tax Regulation*, 41 CONN. L. REV. 431 (2008) (discussing the lack of tax compliance in the United States and providing potential solutions such as the creation of a more cooperative than adversarial tax system).

6. *See* Brett Wells, *Voluntary Compliance: "This Return Might Be Correct But Probably Isn't,"* 29 VA. TAX REV. 645, 647 (2010) ("The 'tax gap' refers to the difference between what taxpayers own on their return and the amount that they voluntarily pay in a timely manner. For 2001, the IRS estimates that the tax gap was $345 billion. This represents a compliance gap of 16.3% for that year." (citations omitted)); *see also* Ventry, *Cooperative Tax Regulation*, *supra* note 5, at 433 (stating that in February 2006, the IRS announced a 2001 tax gap of as much as $353 billion and a compliance rate of 83.7%).

7. Wells, *supra* note 6, at 648–49.

8. *See* Ventry, *Cooperative Tax Regulation, supra* note 5, at 433 (providing Senator Max Baucus's response to the tax gap statistic, in which Baucus stated, "When people and companies . . . don't pay their taxes, the burden for paying this country's expense falls even more heavily on Americans who do their duty every April 15").

9. *See* Wells, *supra* note 6, at 647–48 ("Congress has called for more aggressive efforts to reduce the tax gap. To achieve this objective, Congress, the U.S. Treasury Department, and respected tax scholars have offered numerous solutions. And yet, the reality is that the tax gap has remained largely unchanged since 1973.").

on an annual basis.[10] Regardless of its efforts to enforce tax compliance, the IRS will continue to rely on individuals and entities to engage in their "'civic duty to participate in defraying the costs of government.'"[11] As a result, taxpayers can risk underpaying their tax obligations and realistically avoid any adjustments or penalties. The potential for corporate taxpayers to underpay by millions, if not billions, of dollars casts serious doubt on the IRS's ability to collect the appropriate revenues.[12]

U.C. Davis School of Law Professor Dennis Ventry, Jr. blames the IRS's failure to better enforce tax compliance on the disclosure gap: "IRS enforcement is so severely handicapped by informational deficiencies that taxpayers can engage in abusive tax planning and accurately report transactions associated with that planning on appropriate disclosure forms, yet still provide no indication of abusive behavior."[13] The disclosure gap is at its greatest with respect to large public corporations, which produce highly complex tax returns—often containing thousands of pages[14]—that require greater manpower and resources than the average individual taxpayer's return.[15]

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10. *See* INTERNAL REVENUE SERV. DATA BOOK, 2009, PUBLICATION 55, at 22, *available at* http://www.irs.gov/pub/irs-soi/09databk.pdf (stating that the percentage of returns examined in the 2009 fiscal year was roughly 0.9%). This statistic may be misleading because the IRS uses other methods to collect revenues. *See* W. PATRICK CANTRELL, FEDERAL TAX PROCEDURE FOR ATTORNEYS 20–21 (2008) (providing that the IRS uses other methods such as the Financial Status Audit and Form 4822). Additionally, large corporations are commonly audited more frequently than the average individual taxpayer. *See* Dennis J. Ventry, Jr. *A Primer on Tax Work Product for Federal Courts*, 123 TAX NOTES 875, 881 (2009) (stating that corporate taxpayers are subject to contiguous audit cycles).

11. Wells, *supra* note 6, at 650 (quoting COMM'R'S EXEC. TASK FORCE ON CIVIL PENALTIES, INTERNAL REVENUE SERV., REPORT ON CIVIL TAX PENALTIES, 89 TNT 45-36 (Feb. 21, 1989)); *see also* Comm'r of Internal Revenue v. Lane-Wells Co., 321 U.S. 219, 223 (1944) (stating that the correct self-assessment of the American taxpayer will continue to be "the basis of our American scheme of income taxation").

12. *See* Wells, *supra* note 6, at 660 (providing that, in a 2007 research report that reviewed 361 of the S&P 500 companies, sixty-two companies claimed over $500 million of tax benefits from unsustainable tax positions, and thirty-six of those companies claimed over $1 billion of tax benefits from unsustainable tax positions).

13. Dennis J. Ventry, Jr., *Protecting Abusive Tax Avoidance*, 120 TAX NOTES 857, 877 (2008).

14. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 31 (1st Cir. 2009) (en banc) (stating that Textron's tax return at issue in this case consisted of more than 4,000 pages).

15. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 871 ("The tax returns and accompanying disclosure statements for these taxpayers are exceedingly complex, run thousands of pages in length, and reflect the form rather than the substance of the taxpayer's transactional history."); *see also* Ventry, *A Primer on Tax Work Product for*

Along with producing eye-opening tax gap statistics, 2001 also marked the beginning of a growing public concern about the accuracy of public corporations' financial statements.[16] Scandals involving Enron, WorldCom, and Tyco revealed the nation's corporate fraud problem, which included deceptive accounting practices and misleading financial statements.[17] The failure to "adequately disclose to the user of the financial statements the nature of the risks that were imminent" led to a sharp decline in public confidence and served as a catalyst for congressional and regulatory action.[18]

Both Congress and government agencies enacted reforms to promote the transparency of financial statements and greater tax compliance by public corporations.[19] Public sentiment continues to support increased regulation and enforcement of corporations' proper reporting and payment of tax obligations.[20] Not surprisingly, compliance with these new laws and

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*Federal Courts*, *supra* note 10, at 881 ("Although corporate taxpayers are subject to annual audit through contiguous audit cycles, the IRS may never be able to identify a particular transaction to challenge, let alone litigate. Corporate returns are exceedingly complex.").

16. *See* Wells, *supra* note 6, at 651 ("In the fall of 2001, Congress and the regulatory agencies faced a crisis in public confidence with respect to the financial reporting of public companies.").

17. *See* Chris Jung, Note, Textron: *The False Choice Between Financial Transparency and Litigant Confidentiality*, 7 N.Y.U. J. LAW & BUS. 393, 393 (2010) (providing examples of major corporate fraud within the past ten years, including Enron, WorldCom, Tyco, and Bernie Madoff's Ponzi scheme).

18. Wells, *supra* note 6, at 651; *see also* HAROLD S. BLOOMENTHAL, SARBANES-OXLEY ACT IN PERSPECTIVE 5 (Kristin A. Fischer et al. eds., 2010) (stating that this action focused on "the regulation of public accountants, the formulation of accounting standards, accelerating corporate disclosure, assuring reliability of corporate disclosure, [and] corporate governance").

19. *See, e.g.*, The Sarbanes-Oxley Act of 2002 § 302, 15 U.S.C. § 7241 (2006) (requiring the principal executive officer and the principal financial officer to certify the reliability of the company's financial statements and its internal control procedures under penalties of perjury); Fin. Accounting Standards Bd., *FASB Interpretation No. 48*: *Accounting for Uncertainty in Income Taxes*, *in* 281-B FINANCIAL ACCOUNTING SERIES 3 (June 2006) (stating that evaluating a company's tax position requires (1) determining if the tax position is more likely than not to be sustained upon examination, and, if so, (2) a recognition on the company's financial statement of the largest amount benefit that has a greater than 50% likelihood of being realized); Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers Before the Internal Revenue Service, 31 C.F.R. § 10.35 (2011) (providing a general set of standards applicable to all tax advice, and heightened level of requirements for tax advice constituting a "covered opinion").

20. *See* IRS OVERSIGHT BOARD, 2010 TAXPAYER ATTITUDE SURVEY 5, *available at* http://www.treasury.gov/irsob/reports/2011/IRSOB%202010%20Taxpayer%20Attitude%20Survey.pdf (providing statistically that the majority of Americans (98%) feel that it is more

regulations revealed significant underpayments by public corporations on their tax returns—ranging in the hundreds of millions to billions of dollars.[21] Despite the efforts to increase transparency, public corporations continue to claim positions on their tax returns that they do not believe to be sustainable.[22]

This Note discusses the use of a public corporation's tax accrual workpapers to (1) shrink the IRS-taxpayer disclosure gap and (2) hold those corporations accountable for knowingly taking unsustainable positions on their tax returns. Further, this Note addresses criticisms and concerns regarding the use of these materials as a resource during an IRS audit investigation.[23]

On May 24, 2010 the U.S. Supreme Court declined to review *United States v. Textron Inc. and Subsidiaries*,[24] in which the First Circuit Court of Appeals determined that Textron Inc.'s tax accrual workpapers were not protected from an IRS summons under the work product doctrine.[25] The Court's decision to not review *Textron* raised concerns about how the decision will affect future business practices and the work product doctrine's scope.[26] The discussion includes criticisms of the majority

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important to ensure that corporations are reporting and paying taxes correctly than high-income taxpayers, small businesses, and low-income taxpayers).

21. *See supra* note 12 and accompanying text (discussing a 2007 research report).

22. *See* Wells, *supra* note 6, at 660–61 (discussing how companies continue to claim tax positions in their tax returns even though it is determined that such tax positions are incorrect).

23. *See* OFFICE OF CHIEF COUNSEL, INTERNAL REVENUE SERV., NOTICE CC-2004-010: REQUESTS FOR TAX ACCRUAL WORKPAPERS (2004), *available at* http://www.unclefed.com/ForTaxProfs/irs-ccdm/2004/cc-2004-010.pdf ("The term 'tax accrual workpapers' means those audit workpapers relating to the tax reserve for current, deferred and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to footnotes disclosing those tax liabilities appearing on audited financial statements.").

24. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 31–32 (1st Cir. 2009) (en banc) (holding that the work product doctrine does not shield tax accrual workpapers from an IRS summons).

25. *See* Textron & Subsidiaries v. United States, 130 S. Ct. 3320, 3320 (2010) ("Petition for writ of Certiorari to the United States Court of Appeals for the First Circuit denied.").

26. *See* Noah P. Barsky et al., *Protecting a Client's Confidences: Recent Developments in Privileged Communications Between Attorneys and Accountants*, 28 J.L. & COM. 211, 232–36 (2010) (providing a summary of the case, recommendations for how practitioners should maintain privilege protections over client information, and a discussion of the unresolved issues of privilege law in relation to complex tax transactions); Wells, *supra* note 6, at 688–91 (discussing the underlying reasons for creating tax accrual workpapers, the *Textron* decision, and why the court's decision was correct); Jacob A. Kling, Comment, *Tax Cases Make Bad Work Product Law: The Discoverability of*

opinion's lack of clarity, as well as concerns that the First Circuit established a new test to determine whether the work product doctrine should apply to certain documents or materials.[27] This Note will demonstrate that the controversy surrounding the First Circuit's analysis of whether the work product doctrine should protect a public corporation's tax accrual workpapers is unfounded and inconsistent with the work product doctrine as stated in Federal Rule of Civil Procedure 26, public policy, and reform efforts to promote greater transparency of financial statements and tax compliance.[28]

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*Litigation Risk Assessments After* United States v. Textron, 119 YALE L.J. 1715, 1715 (2010) ("[The decision] may deter companies, public and nonpublic, from voluntarily preparing litigation risk assessments that estimate the company's contingent liabilities for the benefit of third parties . . . ."); Sarah S. Mallet, Case Note, *Work Product Doctrine—The First Circuit Further Confuses an Existing Circuit Split in* United States v. Textron Inc., 63 SMU L. REV. 251, 257 (2010) ("The problem with the First Circuit's opinion in *United States v. Textron Inc.* is not in its holding, but rather its flawed, incomplete, and misguided reasoning."); Ryan D. Houck & Virginia Sorrell, Recent Development, Textron *and the Work Product Doctrine: Maintaining Attorney Independence for Non-Adversarial Advising*, 23 GEO. J. LEGAL ETHICS 649, 666 (2010) (stating that "*Textron* may increase existing systematic and situational pressures on attorneys to favor their role as zealous advocates over their role as officers of the court").

27. *See* United States v. Deloitte LLP, 610 F.3d 129, 138 (D.C. Cir. 2010) ("Judge Torruella's dissenting opinion in *Textron* makes a strong argument that while the court said it was applying the 'because of' test, it actually asked whether the documents were 'prepared for use in possible litigation,' a much more exacting standard."); *see also* Cosme Caballero, *Curbing Corporate Abuse from Jurisprudential Off-Sites: Problematic Paradigms in* United States v. Textron Inc., 65 U. MIAMI L. REV. 645, 666 (2011) ("The majority's new work product inquiry, which calls upon courts to ask if documents are prepared for use in litigation, overly narrows the scope of work product protection."); Tracy Hamilton, *Work Product Privilege: The Future of Tax Accrual Work Paper Discovery in the Eleventh Circuit After* Textron, 27 GA. ST. U. L. REV. 729, 734–35 (2011) (accusing the First Circuit of ignoring the adopted "because of" test and creating a new "for use in litigation" test, which narrowed the historical scope of work product protection); Jung, *supra* note 17, at 395 (stating that the First Circuit created a new standard for work product protection, under which only documents created "for use" in litigation are shielded from discovery); Mallet, *supra* note 26, at 251 (stating that the First Circuit "overlooked the widespread consequences of further fragmenting an already divided interpretation of the phrase 'in anticipation of litigation'"); Stacey Roberts, Note, *Work Product Protection, Tax Accrual Documents, and* United States v. Textron, Inc.*: Why the First Circuit Got It Right for the Wrong Reasons*, 16 SUFFOLK J. TRIAL & APP. ADVOC. 53, 78 (2011) (stating the possibility that the First Circuit created a new test even though it affirmed the "because of" test as precedent); Lindsay Sullivan, Note, *Tax Accrual Work Papers &* Textron*: When Litigation Strategy Is Not Protected?*, 105 NW. U. L. REV. (forthcoming 2011) (arguing that although the opinion affirmed the "because of" test, it "actually created a new 'for use' standard without explicitly stating its reasons for such a change").

28. *See infra* Part VI.D (arguing that public policy evidence in Supreme Court decisions and regulations supports denial of work product protection to tax accrual workpapers when requested by the IRS).

Part II of this Note will explain why public corporations create tax accrual workpapers, what they entail, and when it is the IRS's policy to request these materials during an audit investigation.

Part III will discuss the evolution and codification of the work product doctrine. It will focus on the judicial interpretations of the phrase "in anticipation of litigation" under Federal Rule of Civil Procedure 26(b)(3),[29] its temporal and motivational components,[30] and the existing circuit split over the appropriate test to use when determining whether documents or materials are protected by the work product doctrine.[31]

Part IV will summarize the facts leading up to *Textron*, as well as both the majority and dissenting opinions. It will clarify the analysis and arguments relied upon by the majority in its decision to not extend work product protection to Textron's tax accrual workpapers.[32] It will address the dissent's counterarguments and concerns as well.

Part V will argue that the dissent failed to raise any legitimate concerns in response to the majority's holding, incorrectly applied the "because of" test to determine whether work product immunity applies to a public corporation's tax accrual workpapers, and erroneously concluded that related caselaw was "fatal" to the majority's holding.[33] It will also argue that although the majority's analysis welcomed speculation that it applied a new "for use" test,[34] the majority ultimately applied the correct test to determine whether work product protection applies to a public corporation's tax accrual workpapers and correctly concluded that they do not deserve work product protection under the "because of" test.

Part VI will argue that regardless of the test applied by the court in its determination, a public corporation's tax accrual workpapers do not deserve work product protection and should be discoverable under an IRS summons. The stated arguments for this conclusion are: (1) tax accrual workpapers fall under the "ordinary course of business" exception; (2) the

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29. *See* FED. R. CIV. P. 26(b)(3)(A) ("[A] party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial . . . .").

30. *See infra* Part III.A (providing the elements of both components).

31. *See infra* Part III.B (discussing the preexisting circuit split and accusations that the majority in *Textron* added further uncertainty).

32. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 26 (1st Cir. 2009) (en banc) ("[T]he Textron work papers were independently required by statutory and audit requirements and . . . the work product privilege does not apply.").

33. *See id.* at 33 (Torruella, J., dissenting) ("*Adlman*'s articulation of the 'because of' test is fatal to the majority's position.").

34. *See supra* note 27 and accompanying text (providing examples of the allegations surrounding *Textron* that accuse the First Circuit of creating a new "for use" test).

potential for litigation at the time of their creation is too remote to be considered "in anticipation of litigation"; (3) an IRS audit and subsequent administrative proceedings do not constitute "litigation" for work product doctrine purposes; (4) public policy favors erring on the side of more disclosure to the government when it involves tax-compliance and preventing tax-sheltering practices; and (5) the IRS has a substantial need for the information provided in a public corporation's tax accrual workpapers.

Part VII will provide concluding remarks.

## *II. What Are Tax Accrual Workpapers?*

Public corporations are required by law to provide public financial statements—certified by an independent auditor—and file them with the Securities and Exchange Commission (SEC).[35] In preparing these financial statements, corporations calculate reserves to enter into the company books for contingent tax liabilities, which include estimates of potential liability if the IRS challenges the corporation's tax positions.[36] The independent auditor examines the corporation's books to determine whether they comply with Generally Accepted Accounting Principles (GAAP), and then issues an opinion as to "whether the financial statements, taken as a whole, fairly present the financial position and operations of the corporation for the relevant period."[37] The auditor's analysis includes a determination of the adequacy and reasonableness of the corporation's reserves for contingent tax liabilities.[38] In its determination of the potential cost of each liability and the probability of additional liability, the auditor relies on a variety of

35. *See* Securities Act of 1934, 15 U.S.C. §§ 78(*l*), 78(m) (2006) (providing the general requirement for registering securities and the reporting responsibilities of an issuer of a security, and citing "public interest" and the "the protection of investors" as factors for the Securities Exchange Commission to consider); *see also* United States. v. Arthur Young & Co., 465 U.S. 805, 810–11 (1984) ("In an effort to control the accuracy of the financial data available to investors . . . various provisions of the federal securities laws require public corporations to file their financial statements with the [SEC]. . . . [T]hese financial reports must be audited by an independent certified public accountant.").

36. *See Textron*, 577 F.3d at 22–23 (outlining the legal requirements of Textron relating to the creation of tax accrual workpapers).

37. *Arthur Young*, 465 U.S. at 811 (citations omitted).

38. *See id.* at 812 ("The presence of a reserve account for such contingent tax liabilities reflects the corporation's awareness of, and preparedness for, the possibility of an assessment of additional taxes.").

sources.[39] One of these resources is the corporation's tax accrual workpapers.

Tax accrual workpapers contain information that identifies questionable tax positions taken by a corporation on its tax return and reflect the validity of those positions.[40] They provide valuable information that assists IRS efforts to assess what further taxes, if any, a public corporation owes.[41] For example, the workpapers at issue in *Textron* contained a spreadsheet listing each questionable tax item, and included the dollar amount at issue and the probability of liability for each item identified.[42] They help to "pinpoint the 'soft spots' on a corporation's tax return by highlighting those areas in which the corporate taxpayer has taken a position that may, at some later date, require the payment of additional taxes."[43] Because a corporation's financial statements usually do not identify the specific liabilities, but rather present a total reserve figure, the tax accrual workpapers are a helpful resource to the IRS during an audit investigation.[44] Despite the obvious advantages of having access to tax accrual workpapers, the IRS has shown restraint in its requests for workpapers under 26 U.S.C. § 7602.[45] Typically, the IRS limits

39. *See id.* at 812–13 (discussing the requirements of an independent auditor and what sources it utilizes, including "the corporation's books, records, and tax returns" as well as "interviews with corporate personnel, judgments on questions of potential tax liability, and suggestions for alternative treatments of certain transactions for tax purposes").

40. *See id.* at 808 (defining tax accrual workpapers as documents or memoranda relating to the evaluation of a company's contingent tax liabilities, which can contain information regarding a (1) company's financial transactions, (2) questionable positions it may have taken on its tax returns, and (3) a company's explanation for those positions).

41. *See id.* at 815 ("It is the responsibility of the IRS to determine whether the corporate taxpayer in completing its return has stretched a particular tax concept beyond what is allowed. Records that illuminate any aspect of the return . . . are therefore highly relevant to a legitimate IRS inquiry.").

42. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 23 (1st Cir. 2009) (en banc) (describing the contents of Textron's tax accrual workpapers).

43. United States v. Arthur Young & Co., 465 U.S. 805, 813 (1984).

44. *See Textron*, 577 F.3d at 23 ("A company's published financial statements do not normally indentify the specific tax items on the return that may be debatable, but incorporate or reflect only the total reserve figure.").

45. *See* 26 U.S.C. § 7602(a) (2006) (stating that "[f]or the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person . . . in respect of any internal revenue tax, or collecting any such liability" the IRS is authorized to examine and summon certain materials); *see also* OFFICE OF CHIEF COUNSEL, INTERNAL REVENUE SERV., NOTICE CC-2004-010 (2004): REQUESTS FOR TAX ACCRUAL WORKPAPERS (2004), *available at* http://www.unclefed.com/ForTaxProfs/irs-ccdm/2004/cc-2004-010.pdf ("Because of the sensitive nature of requests for tax accrual workpapers, field attorneys are to work with the operating divisions in preparing any

workpapers requests to taxpayer returns listing a transaction "that is the same as or substantially similar to one of the types of transactions that the [IRS] has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction."[46]

The IRS announced this "listed transaction" policy in 2002 and explained that it was necessary "to allow the [IRS] to fulfill its obligation to the public to curb abusive tax avoidance transactions and to ensure that taxpayers are in compliance with the tax laws."[47] Although it loosened the traditional policy for requesting tax accrual workpapers during an audit, it is consistent with the trend toward greater transparency and accountability.[48] It provided that the IRS may request tax accrual workpapers for any return that claims a tax benefit arising out of a transaction, or substantially similar transaction, that the IRS identified as a potential tax-sheltering or abusive transaction.[49] If the listed transaction is disclosed, then the request usually is for workpapers pertaining to that listed transaction.[50] If the listed transaction is not disclosed, or if the IRS determines there are multiple listed transactions, regardless of disclosure, then the request is for all tax accrual workpapers for that year's return.[51]

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requests for tax accrual workpapers and will review proposed summonses for tax accrual workpapers.").

46. 26 C.F.R. § 1.6011-4(b)(2) (2010).

47. *Request for Tax Accrual and Other Financial Audit Workpapers: Announcement 2002-63*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), July 8, 2002, at 72, *available at* http://www.irs.gov/pub/irs-irbs/irb02-27.pdf.

48. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 880 ("The most notable substantive change in the policy [of restraint] over the last [twenty] years has involved responding to the proliferation of abusive tax shelters.").

49. *Id.*; *Internal Revenue Serv., Recognized Abusive and Listed Transactions-LB&I Tier I Issues*, http://www.irs.gov/businesses/corporations/article/0,,id= 204155,00.html (last visited Nov. 22, 2011) (listing the approximately forty potential tax-sheltering or abusive transactions in alphabetical order) (on file with the Washington and Lee Law Review). This list includes sale-in, lease-out (SILO) transactions, which were the transactions at issue in *Textron*. *See Textron*, 577 F.3d at 24 (stating that a Textron subsidiary engaged in nine SILO transactions in which the subsidiary purchased equipment from a foreign utility or transit operator and leased it back to the seller on the same day).

50. *See Request for Tax Accrual and Other Financial Audit Workpapers: Announcement 2002-63*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), July 8, 2002, at 72, *available at* http://www.irs.gov/pub/irs-irbs/irb02-27.pdf (outlining the new policy for workpapers requests).

51. *See id.* (providing when requests will be made for all tax accrual workpapers and not just those related to the listed transaction at issue). This was the request made in *Textron*. *See Textron*, 577 F.3d at 24 ("[W]here (as in Textron's case) the taxpayer claims benefits from multiple listed transactions, the IRS seeks all of the workpapers for the tax

In its announcement, the IRS cited the Supreme Court's approval of the right to obtain tax accrual workpapers under the IRS's summons power. They stated that workpapers are not privileged communications because they are not "generated in connection with seeking legal or tax advice, but are developed to evaluate a taxpayer's deferred or contingent tax liabilities in connection with a taxpayer's disclosure to third parties."[52] However, the IRS emphasized that the request for tax accrual workpapers is not a "standard examination technique."[53] It makes such requests only in "unusual circumstances" and exercises its authority to do so with restraint.[54]

### *III. The Work Product Doctrine*

There are several privileges, doctrines, or immunities used by litigants to protect sensitive materials, maintain confidentiality, and prevent other parties from gaining advantages that are discouraged by the legal community.[55] The particular protection addressed in this Note is the work product doctrine, as stated in Rule 26(b)(3) of the Federal Rules of Civil Procedure.[56] Disagreement over whether the work product doctrine should apply to a public corporation's tax accrual workpapers is the root of the controversy with respect to the majority's decision in *Textron*.[57]

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year in question.").

52. *Request for Tax Accrual and Other Financial Audit Workpapers: Announcement 2002-63*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), July 8, 2002, at 72, *available at* http://www.irs.gov/pub/irs-irbs/irb02-27.pdf.

53. *Id.*

54. *Id.*

55. *See, e.g.*, Catherine C. Stern, Note, *Don't Tell Mom the Babysitter's Dead: Arguments for a Federal Parent-Child Privilege and a Proposal to Amend Article V*, 99 GEO. L.J. 605, 612 (2011) ("Currently, the Federal Rules of Evidence recognize several privileges, including the attorney-client privilege, the spousal privilege, and a psychotherapist-patient privilege."). Several other examples are the work product doctrine, doctor-patient privilege, and common interest privilege.

56. *See* FED. R. CIV. P. 26(b)(3)(A) ("Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent)."). Note that the Federal Rules of Civil Procedure govern enforcement proceedings for an IRS summons. *See* 26 U.S.C. § 7604(a) (2010) ("If any person is summoned under the internal revenue laws to . . . produce books, papers, records, or other data, the United States district court for the district in which the person resides or is found shall have jurisdiction by appropriate process to compel such attendance . . . .").

57. *Compare* Kling, *supra* note 26, at 1726 ("The court's holding will likely chill the socially valuable preparation of such analyses in connection with business transactions and may reduce the accuracy of public companies' financial statements."), *with* Henry J. Lischer,

The objective of the work product doctrine is to "establish a 'zone of privacy for strategic litigation planning' and to prevent one party from piggybacking on another party's preparation."[58] A popular treatise on the topic notes that "the protection given to 'work product' arises from a common assumption—that an attorney cannot provide full and adequate representation unless certain matters are kept beyond the knowledge of adversaries."[59] Litigants use the doctrine to protect documents, materials, and legal opinions that are prepared in anticipation of litigation or for actual trial.[60] In recent applications of the work product doctrine, courts have indicated a trend toward greater transparency and a narrowing of the protection's applicability.[61] However, courts and attorneys continue to struggle with the doctrine's scope and its applicability to specific materials and contexts.[62]

Although legal scholars, judges, and attorneys often associate the attorney-client privilege with the work product doctrine, the current "work product doctrine actually differs dramatically from the [attorney-client privilege] in nearly every respect."[63] The work product doctrine provides broader protection than the attorney-client privilege because it protects materials created by both lawyers and non-lawyers that can be shared

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Jr., *Work Product Immunity for Attorney-Created Tax Accrual Workpapers?: The Aftermath of* United States v. Textron, 10 FLA. TAX REV. 503, 563 (2011) ("If the courts were to hold that attorney-created tax accrual workpapers are protected by work product immunity, work product immunity would be wandering far from its roots of protecting the litigation process, and arguably the immunity would provide protection to a vast class of documents that relate to compliance . . . .").

58. Barsky et al., *supra* note 26, at 217–18 (quoting United States v. Adlman, 68 F.3d 1495, 1501 (2d Cir. 1995)).

59. 2 EDNA S. EPSTEIN, THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE 791 (5th ed. 2007).

60. *See* Wells, *supra* note 6, at 688 (providing background information about the work product doctrine and its objectives). The work product doctrine also protects an attorney's mental impressions relating to the litigation, which are defined as opinion work product under the Federal Rules of Civil Procedure. *See* FED. R. CIV. P. 26(b)(3)(B) ("[The court] must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation.").

61. *See* THE ATTORNEY-CLIENT PRIVILEGE IN CIVIL LITIGATION: PROTECTING AND DEFENDING CONFIDENTIALITY 102 (Vincent S. Walkowiak, ed., 4th ed. 2008) (discussing how societal changes have driven courts to narrow the scope of the attorney-client privilege and work product doctrine to promote greater disclosure in corporate settings).

62. *See* Colin P. Marks, *The Anticipation Misconception*, 99 KY. L.J. 9, 14 (2010) ("[The] variance in the stringency of what qualifies as work product . . . has created a lack of uniformity across judicial districts . . . .").

63. 2 THOMAS E. SPAHN, THE ATTORNEY CLIENT PRIVILEGE AND THE WORK PRODUCT DOCTRINE: A PRACTITIONER'S GUIDE 423 (2007).

without constituting a waiver of the protection.[64] However, the work product doctrine provides less protection than the attorney-client privilege's absolute immunity because it is rebuttable by a showing of "substantial need" for disclosure.[65] Whereas the attorney-client privilege lasts beyond death, the work product doctrine "has a more limited temporal scope."[66] It arises only during litigation and when litigation is reasonably anticipated.[67] The distinction between the work product doctrine and attorney-client privilege is important because one may cover materials that are unprotected by the other, and litigants often attempt to extend the scope of one's protection when the other fails to provide any.[68] When the attorney-client privilege is not applicable—as in *Textron*[69]—the work product doctrine may still be applicable.

Prior to the creation of the doctrine, the common law recognized the need to protect client-created materials for use in pending litigation.[70] The U.S. Supreme Court first articulated this concept as the attorney work product doctrine in *Hickman v. Taylor*.[71] In 1970, the common-law work

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64. *See id.* at 433 ("The work product doctrine provides a broader protection than the attorney-client privilege in several respects. The work product doctrine (i) protects materials created by non-lawyers as well as lawyers and (ii) can be shared without necessarily causing a waiver.").

65. *See id.* at 431 ("Most courts describe the work product doctrine as providing only a qualified or limited protection. Although a few courts provide absolute protection to opinion work product, all or nearly all of a litigant's work product might be available to the other side if it can provide a sufficient justification."); *see also* FED. R. CIV. P. 26(b)(3)(A)(ii) (stating that documents or materials subject to work product protection may be discoverable if "the party shows that it has a substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means").

66. SPAHN, *supra* note 63, at 431.

67. *Id.* at 433 (discussing how in some respects the work product doctrine provides a narrower protection than the attorney-client privilege).

68. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 883 (stating that courts should be "wary of expanding the work product doctrine so far that it transforms [work product protection] into a 'backstop' for other privileges" and immunities).

69. *See Textron*, 577 F.3d at 25 (stating that by disclosing its workpapers to Ernst & Young, Textron waived the attorney-client privilege).

70. *See* SPAHN, *supra* note 63, at 423 (providing the history of the work product doctrine prior to its codification, and stating that it was considered an aspect of the attorney-client privilege).

71. *See* Hickman v. Taylor, 329 U.S. 495, 513 (1947) (holding that the petitioner gave insufficient reasons for the disclosure of the opposing party's materials, and affirming the Court of Appeals denial); *id.* at 511 ("This work is reflected, of course, in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways—aptly though roughly termed by the Circuit Court of Appeals in this case . . . as the 'Work product of the lawyer.'" (quoting Hickman v.

product doctrine was codified under Rule 26(b)(3).[72] Courts continue to rely on *Hickman* to determine whether the work product doctrine should apply to certain materials.[73] In *Hickman*, the Court established three propositions: (1) material collected by counsel in the course of preparation for possible litigation is protected from discovery; (2) an adversary may obtain discovery by showing sufficient need for the material; and (3) an attorney's opinion work, including theories, analysis, mental impressions, and beliefs, receives the highest level of protection.[74] These propositions are useful to consider when interpreting the codified version of the work product doctrine under Rule 26(b)(3) and play an important role in analyzing whether workpapers should receive work product immunity.[75]

### *A. The Meaning of "in Anticipation of Litigation"*

The phrase "in anticipation of litigation" under Rule 26(b)(3), and what determines whether documents or materials are prepared in anticipation of litigation, is the crux of the issue addressed in *Textron*.[76]

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Taylor, 153 F.2d 212 (3d Cir. 1946), *aff'd*, 329 U.S. 495 (1947))); SPAHN, *supra* note 63, at 423 (stating that despite its refusal to adopt a 1946 amendment by the Federal Rules Advisory Committee that would provide protection for "any writing" prepared "in anticipation of litigation or in preparation for trial," a year later the Court first articulated the attorney work product doctrine in *Hickman v. Taylor*).

72. *See* SPAHN, *supra* note 63, at 423, 427 (stating that after rejecting attempts by the Federal Rules Advisory Committee in both 1946 and 1955 to codify the doctrine, the Supreme Court eventually did so).

73. *See* EPSTEIN, *supra* note 59, at 793 ("*Hickman* continues to be the standard by which courts interpret [Federal Rule of Civil Procedure 26(b)(3)] and protect work product when those provisions do not apply.").

74. *See id.* at 793–95 (summarizing *Hickman* and the important propositions established in the Court's decision).

75. *See* FED. R. CIV. P. 26(b)(3)(A) ("Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent)."). Rule 26, not *Hickman*, expanded the attorney work product doctrine to protect the work of non-attorneys as well. The doctrine is now referred to as the work product doctrine as well as the attorney work product doctrine. *See* SPAHN, *supra* note 63, at 429 ("Using the term 'attorney' when describing the doctrine is not so much incorrect as it is incomplete, because non-lawyers may also create protected work product. . . . [T]he term 'attorney-work product' identifies [only] a subset of protected work product." (emphasis omitted)).

76. *See Textron*, 577 F.3d at 22 (framing the issue as whether "the attorney work product doctrine shields from an IRS summons 'tax accrual work papers' prepared by lawyers and others in Textron's Tax Department to support Textron's calculation of tax reserves for audited corporate financial statements").

This is not an unusual occurrence, however, because this phrase has been the subject of many disputes.[77] "Because the phrase 'in anticipation of litigation' 'eludes precise definition,' there are 'a variety of approaches and conflicting decisions in the case law.'"[78] Although the Federal Rules of Civil Procedure do not provide much guidance,[79] the general consensus is that whether work product was produced in anticipation of litigation requires an inquiry into (1) the temporality of the threatened litigation and (2) the motivation behind the creation of the documents or materials.[80] These are commonly referred to as the temporal and motivational components of "in anticipation of litigation."[81]

### *1. The Temporal Component*

The temporal component determines when the document was created, mainly whether it was created before or during litigation. Courts generally accept that "[t]o receive work product protection for a document, an applicant must demonstrate not only a subjective belief that litigation was likely at the time of the document's creation, but also that the belief was objectively reasonable."[82] However, courts have varied interpretations of what constitutes "litigation"[83] and what constitutes "anticipation of

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77. Proposed Amendments to the Federal Rules of Civil Procedure Relating to Discovery, Advisory Committee's Note to Rule 26, 48 F.R.D. 487, 499 (1970) ("Some of the most controversial and vexing problems to emerge from the discovery rules have arisen out of requests for the production of documents or things prepared in anticipation of litigation or for trial.").

78. Pac. Gas & Elec. Co. v. United States, 69 Fed. Cl. 784, 790 (2006) (quoting Harper v. Auto-Owners Ins. Co., 138 F.R.D. 655, 659 (S.D. Ind. 1991)).

79. Proposed Amendments to the Federal Rules of Civil Procedure Relating to Discovery, Advisory Committee's Note to Rule 26, 48 F.R.D. 487, 499 (1970) ("The existing rules make no explicit provision for [materials prepared in anticipation of litigation].").

80. *See* Marks, *supra* note 62, at 14 (referring to the dual inquiry generally applied by courts to determine whether work product is prepared in anticipation of litigation).

81. *See* EPSTEIN, *supra* note 59, at 836 (discussing the temporal and motivational concepts of "in anticipation of litigation").

82. Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 880.

83. *See* SPAHN, *supra* note 63, at 459–66 (providing a list of what constitutes "litigation" for purposes of the work product doctrine, including judicial as well non-judicial proceedings, such as adversarial administrative hearings). Spahn also addresses the complex debate over whether government investigations are litigation. *See id.* at 465–66. Although a government investigation alone may not qualify as litigation, knowledge of or the commencement of a government investigation can justify a corporation to reasonably anticipate later litigation. *See id*. (providing what triggers a reasonable belief that litigation

litigation."[84] More specifically, courts have both accepted and rejected the argument that notice of an IRS audit is a triggering event for anticipating litigation.[85] These varied opinions expose the complexities of applying the work product doctrine to situations involving an IRS audit and the common misconceptions about what an IRS audit entails.[86] The temporal component was a secondary issue in *Textron*,[87] but it is important to consider when determining whether litigation is actually anticipated at the creation of a company's tax accrual workpapers.[88] However, the motivational component—whether that document or material was prepared for litigation and not some other purpose[89]—and what test should be applied to determine whether the motivational component is satisfied[90] are at issue in *Textron*.[91]

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is anticipated in a government investigation context).

84. *See id.* at 468–70 (providing a list of the different interpretations of "anticipation of litigation," including "litigation is imminent" and "there is a substantial and significant threat of litigation"); Marks, *supra* note 62, at 14 ("Courts . . . vary on the level of temporality they will require, with some courts requiring a very high level of imminence while others seem content with a much lesser degree.").

85. *See, e.g.*, United States v. Ackert, 76 F. Supp. 2d 222, 227 (D. Conn. 1999) (stating that although the notice of an IRS audit would justify the anticipation of litigation, the conversation at issue was not protected by the work product doctrine because it occurred in connection with a proposed investment, not a potential lawsuit); *see also* United States v. Tel. & Data Sys., Inc., 02-C-0030-C, 2002 U.S. Dist. LEXIS 15510, at *9–10 (W.D. Wis. 2002) (stating that documents prepared in response to an IRS audit are not protected by the work product doctrine, because they are prepared for a potential IRS administrative proceeding, not litigation).

86. *See infra* Part VI.C (arguing why an IRS audit and subsequent administrative proceedings are not litigation for purposes of the work product doctrine).

87. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 29 (1st Cir. 2009) (en banc) (referencing the temporality requirement, vaguely, in the majority's analysis).

88. *See infra* Part VI.B (arguing that tax accrual workpapers fail to satisfy the temporal component of "in anticipation of litigation").

89. *See* EPSTEIN, *supra* note 59, at 793–95 (discussing both the temporal and motivational components of "anticipation of litigation").

90. *See infra* Part III.B (providing the tests applied in the respective federal circuit courts to determine whether the motivational prong is satisfied).

91. *See Textron*, 577 F.3d at 30 (discussing the different tests applied by circuits to determine whether the motivational component is satisfied); *see also* Lischer, *supra* note 57, at 547 n.168 (stating that the temporal and motivational components are separate yet interrelated tests, but the motivational component determines whether the work product doctrine will apply).

### 2. The Motivational Component

The motivational component of "in anticipation of litigation" asks whether a document's creation is motivated by litigation.[92] Documents or materials have the potential to be created for multiple purposes, which causes uncertainty about when the motivational component is satisfied.[93] A court must make a two-pronged inquiry: (1) whether the document is created for litigation purposes, and (2) whether the document's creation is driven by dual or multiple purposes.[94] Depending on what test is applied by the court, the work product doctrine's protection of dual-purpose documents may vary.[95] However, it is universally accepted that materials created in the ordinary course of business—that would otherwise have been created in "essentially similar form irrespective of litigation"—are not protected.[96]

## B. The Motivational Component Circuit Split

The potential for documents and materials to serve multiple purposes has led to a circuit split over which test should be applied to determine whether a document is created "in anticipation of litigation."[97] The Fifth Circuit applies the "primary purpose" test,[98] but the overwhelming majority

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92. *See* SPAHN, *supra* note 63, at 484–85 (introducing the motivational element and describing its meaning).

93. *See id.* at 485 ("Courts have debated whether a document must have been created exclusively because of the litigation or whether the doctrine can also protect documents created for multiple purposes.").

94. *See id.* at 486–89 (discussing the varying scopes of the work product doctrine applied by courts who differ in opinion as to whether documents or materials at issue must be created in anticipation litigation exclusively, primarily, or to some other degree).

95. *See infra* Part III.B (discussing the test applied by circuit courts to determine whether a document is prepared "in anticipation of litigation"); *see also* Sullivan, *supra* note 27 ("Dual-purpose documents . . . which may be prepared because of litigation but also serve a business purpose, may be treated differently depending on which test the court applies.").

96. Maine v. U.S. Dep't. of the Interior, 298 F.3d 60, 70 (1st Cir. 2002); *see also* Proposed Amendments to the Federal Rules of Civil Procedure Relating to Discovery, Advisory Committee's Note to Rule 26, 48 F.R.D. 487, 501 (1970) ("Materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes are not under the qualified immunity provided by [Rule 26(b)(3)].").

97. *See* Marks, *supra* note 62, at 16 (discussing the circuit split over what degree of the motivation to create a document or materials constitutes in anticipation of litigation).

98. *See* United States v. El Paso Co., 682 F.2d 530, 542 (5th Cir. 1982) (applying the primary motivating purpose test to determine whether El Paso's tax pool analysis is

of the remaining circuits—including the First Circuit[99]—apply the "because of" test.[100] Much of the controversy surrounding *Textron* concerns whether the First Circuit applied the "because of" test or established a new "for use" test without overruling precedent.[101] For purposes of determining what test the First Circuit applied in *Textron*, it is important to understand how the "primary purpose" and "because of" tests are applied by courts in cases similar to *Textron*.

### *1. The "Primary Purpose Test" and* El Paso

The primary purpose test requires a court to determine the primary motivating purpose behind the creation of a document.[102] "If the primary

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protected by the work product doctrine).

99. *See Maine*, 298 F.3d at 73 (stating that the Department of Interior failed to establish that either the work product doctrine or the attorney-client privilege applied to the documents, and that the district court did not abuse its discretion by granting their disclosure).

100. *See* United States v. Torf (*In re* Grand Jury Subpoena), 357 F.3d 900, 907 (9th Cir. 2003) ("We join a growing number of our sister circuits in employing the formulation of the 'because of' standard articulated in the Wright & Miller Federal Practice Treatise."); PepsiCo, Inc. v. Baird, Kurtz & Dobson LLP, 305 F.3d 813, 817 (8th Cir. 2002) ("In order to protect work product, the party seeking protection must show that the materials were prepared in anticipation of litigation, i.e., because of the prospect of litigation." (citing Binks Mfg. Co. v. Nat'l Presto Indus., Inc., 709 F.2d 1109, 1118–19 (7th Cir. 1983)); *Maine*, 298 F.3d at 68 (adopting the use of the "because of" test); Montgomery Cnty. v. MicroVote Corp., 175 F.3d 296, 305 (3d Cir. 1999) (stating that the Third Circuit defines documents as being prepared "in anticipation of litigation" when "the document can be fairly said to have been prepared or obtained because of the prospect of litigation" (quoting *In re* Grand Jury Proceedings, 604 F.2d 798, 803 (3d Cir. 1979))); Equal Emp't Opportunity Comm'n v. Lutheran Soc. Servs., 186 F.3d 959, 968 (D.C. Cir. 1999) (providing that the test to determine whether the work product doctrine applies is the "because of" test); United States v. Adlman, 134 F.3d 1194, 1198 (2d Cir. 1998) (stating that the "because of" test is more consistent with the literal terms and the proposes of Rule 26 and adopting it over the "primary purpose" test); Logan v. Commercial Union Ins. Co., 96 F.3d 971, 976–77 (7th Cir. 1996) (stating that the "because of" test is applied in the Seventh Circuit).

101. *See Textron*, 577 F.3d at 43 (Torruella, J., dissenting) (arguing that the majority affirms that the "because of" test is the correct test to apply in the First Circuit, but applies a newly created "for use" test).

102. *See, e.g.*, United States v. Gulf Oil Corp., 760 F.2d 292, 296 (Temp. Emer. Ct. App. 1985) (applying the primary purpose test to determine whether documents, which were financial reports prepared by company auditors to satisfy federal securities laws, are protected by the work product doctrine); *see also* United States v. Davis, 636 F.2d 1028, 1040 (5th Cir. 1981) ("We conclude that litigation need not necessarily be imminent, as some courts have suggested . . . as long as the primary motivating purpose behind the creation of the document was to aid in possible future litigation." (citations omitted)).

motivating purpose behind the creation of the document is not to assist in pending or impending litigation, then a finding that the document enjoys work product immunity is not mandated."[103] Most courts, when applying this test, primarily consider what motivated the document's creation.[104] Others apply the test narrowly by looking at how the document is used.[105] Under both interpretations, materials created in the ordinary course of business or for other nonlitigation purposes are not protected.[106] Most circuits have rejected this test and adopted the broader "because of" test, but it remains the applicable test in the Fifth Circuit.[107] The Fifth Circuit addressed whether a corporation's tax accrual workpapers deserve work product protection under the "primary purpose" test in *United States v. El Paso Co*.[108]

In *El Paso*, the IRS petitioned the district court to enforce a summons against El Paso Natural Gas Company after El Paso refused a document request made during a routine audit of the company's 1976–1978 tax cycles.[109] After the district court ruled that El Paso must comply with the IRS summons, the Fifth Circuit granted the company's stay motion to review the case.[110] The court referred to the documents at issue as "the tax pool analysis" but states in its opinion that such a term is synonymous to tax accrual workpapers.[111] After holding that El Paso breached the

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103. *Gulf Oil Corp*., 760 F.2d at 296.

104. *See* SPAHN, *supra* note 63, at 489 (stating that the primary motivating purpose test can be used to determine "what motivated the document's creation, regardless of how the document will be used").

105. *See id.* (stating that courts may also apply the test in a narrower sense by looking at whether the document will be used in litigation).

106. Proposed Amendments to the Federal Rules of Civil Procedure Relating to Discovery, Advisory Committee's Note to Rule 26, 48 F.R.D. 487, 501 (1970) ("Materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes are not under the qualified immunity provided by [Rule 26(b)(3)].").

107. *See* United States v. El Paso Co., 682 F.2d 530, 543 (5th Cir. 1982) (stating that the applicable test in the Fifth Circuit is the "primary purpose" test).

108. *See id.* at 545 (concluding that the El Paso's tax pool analysis documents and supporting memoranda are not shielded by the attorney-client privilege or work product doctrine, that public policy reflected in security laws did not demand denial of the summons, and affirming the lower court's enforcement of the IRS summons).

109. *Id.* at 533.

110. *Id.*

111. *See id.* ("This appeal is centrally concerned with documents known to the accounting profession under various names—the noncurrent tax account, the tax accrual work papers, and the tax pool analysis. . . . No matter what alias is used, however, the documents are of similar nature.").

confidentiality required to apply the attorney-client privilege, the court then addressed the applicability of the work product doctrine.[112]

The court concluded that even if El Paso's tax pool analysis otherwise qualified for work product protection, it would still not qualify under the "in anticipation of litigation" requirement.[113] Applying the "primary purpose" test, the court concluded that the tax pool analysis was intended to bring its financial books into compliance with GAAP and securities laws.[114] "[T]he primary motivation is to anticipate, for financial purposes, what the impact of litigation might be on the company's tax liability. El Paso thus creates the tax pool analysis with an eye on its business needs, and not its legal ones."[115] The court also noted that no evidence corroborated the use of the tax pool analysis documents by either outside counsel or El Paso's attorneys to prepare for litigation.[116] The documents were used only to "concoct[] theories about the result of possible litigation" and "back up a figure on a balance sheet," which made them carry "much more the aura of daily business" than "courtroom combat."[117]

El Paso argued that the IRS summons should not be permitted on public policy grounds, claiming that it would discourage companies from providing the full and frank disclosure of financial information sought by securities laws.[118] The court responded by stating, "We are unwilling to make inroads in the plainly announced congressional policy to allow the IRS broad access to relevant, nonprivileged documents on the basis of El Paso's claim of a conflict with the policies underlying the securities laws."[119] The court did not share El Paso's concern that disclosure of these documents would discourage compliance with securities laws, pointing out that accountants would be legally obligated to deny certification of a

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112. *Id.* at 542.

113. *See id.* (conceding that determining whether a document is prepared in anticipation of litigation is a "slippery task," but concluding that El Paso's tax pool analysis was not protected).

114. *See id.* at 543 (arguing that the purpose of the tax pool analysis documents was primarily for conformity with GAAP and the desire to please accountants was compelled by securities laws).

115. *Id.*

116. *See id.* (stating that "[t]here is no evidence in the record that the tax pool analysis or underlying memoranda are referred to outside counsel or used by El Paso's attorneys to prepare for trial").

117. *Id.* at 544.

118. *See id.* ("The main premise of El Paso's argument is that the accuracy of financial reports will suffer if companies must divulge their tax pool analyses to the IRS.").

119. *Id.*

company's financial records without the necessary information.[120] "By upholding the IRS'[s] authority to reach the tax pool analysis, we do not unleash the inquisition. The tax pool analysis may be useful to the IRS as a 'roadmap' through the company's tax return; it is not, however, an admission of guilt."[121]

Although the *El Paso* court applied a different test than the test(s) at issue in *Textron*, it offers arguments similar to the majority in *Textron*. The Fifth Circuit concluded that the workpapers were created in the ordinary course of business, primarily used for business purposes, and contained analysis that is "only a means to a business end."[122] The court emphasized that the IRS only makes the request for workpapers in limited circumstances, due to the sensitivities of making such requests, and that Congress's grant of broad summons powers to the IRS supports their disclosure.[123] These arguments resurface in the *Textron* opinion and are persuasive—even when applying the broader "because of" test.[124] *El Paso*, along with *Textron*, supports the assertion that regardless of the test applied by courts, a public corporation's tax accrual workpapers should not be protected under the work product doctrine from an IRS summons.[125]

### 2. *The "Because of" Test and* Adlman

The "because of" test considers documents to be prepared in anticipation of litigation if "in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained because of the prospect of litigation."[126] It is a broader interpretation of the work product doctrine's scope than the "primary purpose" test, and it extends work product protection to materials created for dual purposes.[127] Although it is a broader test than the "primary

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120. *See id.* (stating that El Paso's theory of noncompliance is speculative and presumes that "corporations will dishonor their legal obligations by discontinuing the preparation of tax pool analysis").

121. *Id.* at 545.

122. *Id.* at 543.

123. *See id.* at 544–45 (addressing the public policy issues raised by El Paso).

124. *See infra* Part IV.A (providing that majority's analysis in *Textron*).

125. *See infra* Part VI (arguing that regardless of the test applied by a court, a public corporation's tax accrual work papers should not receive work product protection).

126. 8 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, FEDERAL PRACTICE & PROCEDURE § 2024 (2010).

127. *See* SPAHN, *supra* note 63, at 499 ("Some courts take a narrow view of the work

purpose" test, it does not extend to materials prepared in the ordinary course of business or that would have been created in a similar fashion irrespective of the potential for litigation.[128]

Whether the work product doctrine will protect a public corporation's tax accrual workpapers under the "because of" test has been addressed only by the First Circuit.[129] However, the Second Circuit applied the "because of" test in *United States v. Adlman*.[130] The dissenting opinion in *Textron* referenced *Adlman*'s application of the "because of" test as support, and considered its articulation "fatal" to the majority opinion's analysis.[131]

In *Adlman*, Sequa Corporation contemplated merging two of its subsidiaries, which would produce a significant loss and a tax refund that the IRS would likely challenge.[132] At the request of Sequa, an employee of Arthur Anderson & Co. produced a fifty-eight-page memorandum, which included (1) an analysis of likely IRS challenges to the restructuring and tax refund, (2) a discussion of the applicable laws and prior judicial and IRS rulings, (3) suggested legal theories, strategies, and methods of structuring the transaction, and (4) predictions about the likely outcome of litigation.[133] Sequa completed the merger, reported a loss on the restructuring, and subsequently sued the IRS for a refund.[134] The IRS then audited Sequa for its 1986–1989 tax returns and issued a summons for the memorandum, which Sequa claimed to be protected work product.[135]

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product doctrine and protect only those documents that will be used in the litigation. The 'because of' test is a dramatically different and broader interpretation of Rule 26(b)(3)."); *id.* at 501–02 (stating that the "because of" test has been interpreted by courts to cover materials serving dual purposes or motivations).

128. *See* United States v. Adlman, 134 F.3d 1194, 1202 (2d Cir. 1998) (discussing the scope and applicability of the "because of" test).

129. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 30 (1st Cir. 2009) (en banc) (stating that only two circuits have addressed work product protection for tax accrual workpapers, citing *El Paso* as the only other case squarely addressing the issue, which applied the "primary purpose" test).

130. *See Adlman*, 134 F.3d at 1204–05 (finding that the district court's enforcement of an IRS summons is vacated and remanded for consideration of the documents at issue under the "because of" test).

131. *See Textron*, 577 F.3d at 31–36 (Torruella, J., dissenting) (referencing the court's analysis in *Adlman* to support its contention of the majority opinion).

132. *Adlman*, 134 F.3d at 1195.

133. *Id.*

134. *See id.* ("The reorganization resulted in a $289 million loss. Sequa claimed the loss on it 1989 return and carried it back to offset 1986 capital gain, thereby generating a claim for a refund of $35 million.").

135. *Id.* at 1195–96.

The IRS brought a claim in district court to enforce the subpoena.[136] The court rejected Sequa's claims of attorney-client privilege and work product privilege, and granted the IRS petition to enforce the summons.[137] On Sequa's initial appeal, the Second Circuit vacated the district court's judgment for applying the wrong standard and remanded the case.[138] In response, the district court again concluded that the memorandum was not prepared in anticipation of litigation.[139] On second appeal, the Second Circuit phrased the issue as "whether Rule 26(b)(3) is inapplicable to a litigation analysis prepared by a party or its representative in order to inform a business decision which turns on the party's assessment of the likely outcome of litigation expected to result from the transaction."[140]

The Second Circuit discussed the application of both the "primary purpose" test and the "because of" test.[141] It denied adoption of the "primary purpose" test, arguing that "[n]owhere does Rule 26(b)(3) state that a document must have been prepared *to aid* in the conduct of litigation in order to constitute work product, much less *primarily or exclusively* to aid in litigation."[142] Fearing that a company would have to either decline preparing such material—and make ill-informed decisions in the process—or suffer prejudice to its litigation prospects, the court reasoned that the result of applying the "primary purpose" test was inconsistent with the doctrine's purpose.[143] Adopting the "because of" test, the court stated that "[w]here a document is created because of the prospect of litigation, analyzing the likely outcome of that litigation, it does not lose protection under this formulation merely because it is created in order to assist with a

136. *Id.* at 1196.

137. *Id.*

138. *See* United States v. Adlman, 68 F.3d 1495, 1501 (2d Cir. 1995), *abrogated by* United States v. Adlman, 134 F.3d 1194 (2d Cir. 1998) ("[T]here is no rule that bars application of work product protection to documents created prior to the vent giving rise to litigation. . . . In many instances, the expected litigation is quite concrete, notwithstanding that the events giving rise to it have not yet occurred."); *id.* at 1502 ("We conclude that the district court barred work-product protection on the basis of the incorrect standard. We must therefore remand for a determination whether the protection of Rule 26(b)(3) should apply.").

139. United States v. Adlman, 134 F.3d 1194, 1196 (2d Cir. 1998).

140. *Id.* at 1197.

141. *Id.* at 1197–1203.

142. *Id.* at 1198.

143. *Id.* at 1200 ("We perceive nothing in the policies underlying the work-product doctrine or the text of [Rule 26(b)(3)] itself that would justify subjecting a litigant to this array of undesirable choices.").

business decision."[144] The court noted, as support for its decision, that the Third, Fourth, Seventh, Eighth, and D.C. Circuits already adopted the "because of" test.[145]

The court vacated the district court's enforcement of the IRS summons and remanded the case to be determined under the "because of" test.[146] The appellate court concluded that the outcome will depend on whether it "would have been prepared irrespective of the anticipated litigation and therefore was not prepared because of it."[147] It provided a strong inclination on how the case should be decided: "Where a document is created because of the prospect of litigation, analyzing the likely outcome of that litigation, it does not lose protection under this formulation merely because it is created in order to assist a business decision."[148]

Besides the dissent's reliance on *Adlman* in *Textron*, the case is relevant to *Textron* because the First Circuit cited it when adopting the "because of" test and establishing it as precedent in *Maine v. U.S. Dept. of the Interior*.[149] The underlying facts and judgment in *Maine* are not relevant to this discussion.[150] However, the First Circuit emphasized in *Maine* that the "because of" test does not protect documents "'prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of litigation' . . . even if the documents aid in the preparation of litigation."[151]

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144. *Id.* at 1202.

145. *Id.* at 1203.

146. *See id.* at 1205 (providing the holding of the court).

147. *Id.*

148. *Id.* at 1202.

149. *See* Maine v. U.S. Dep't. of the Interior, 298 F.3d 60, 68 (1st Cir. 2002) (finding that the Department of Interior failed to establish that either the work product doctrine or the attorney-client privilege applied to the documents, and that the district court did not abuse its discretion by granting their disclosure); *id.* (stating that the First Circuit agrees with the formulation of the work product doctrine adopted by the Second Circuit and five other circuit courts); *id* .at 73 ("The district court's standard that a document may not be exempt under the attorney work-product privilege unless the prospect of litigation 'served as the primary motivating factor' must be rejected.").

150. *See id.* 63–66 (providing that Maine made a series of Freedom of Information Act requests to the Department of Interior regarding the decision to list the Atlantic Salmon in eight Maine rivers as an endangered species, and that the Department of Interior withheld hundreds of documents by claiming both attorney-client and work product privileges).

151. *Id.* at 70 (citations omitted).

### 3. *The Alleged "For Use" Test and* Textron

Critics of *Textron*, including the dissenting judges,[152] accused the majority of creating a new "for use" test and failing to apply precedent without overruling it.[153] Under the alleged "for use" test, documents or materials only receive work product protection if they are prepared for use in litigation.[154] It narrows the work product doctrine's scope significantly more than the "because of" and "primary purpose" tests, and its alleged application in *Textron* raised concerns about the doctrine's stability among the circuits.[155] In fact, whether the First Circuit applied the correct test was the key issue presented to the Supreme Court on writ of certiorari.[156] To better understand the *Textron* outcome and why it is correct, it is important to discuss the reasoning and analysis provided by both the majority and dissenting opinions in *Textron*.[157] Doing so will demonstrate that (1) the dissent raised unlikely concerns, incorrectly applied precedent, and failed to distinguish *Adlman* from *Textron*, and (2) although the majority opinion admittedly invites these accusations and related criticisms, it ultimately applied the "because of" test in its analysis—not a narrower "for use" test—and arrived at the correct outcome under established precedent.[158]

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152. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 32 (1st Cir. 2009) (en banc) (Torruella, J., dissenting) ("[T]he majority abandons our 'because of' of test . . . . The majority purports to follow this test, but never even cites it. Rather, in its place, the majority imposes a 'prepared for' test . . . ." (citations omitted)).

153. *See supra* note 27 and accompanying text (providing examples of the accusation that the First Circuit applied a new "for use" test even though it affirmed its prior adoption of the "because of" test).

154. *See* Kling, *supra* note 26, at 1718 ("[T]he opinion must be read as an attempt to eliminate work product protection for documents that are prepared in order to analyze a company's litigation prospects for a business purpose rather than for use at trial.").

155. *See supra* Part III.B.1–2 (discussing the preexisting circuit split over the meaning of "anticipation of litigation").

156. *See* Brief for Petitioner at 1, United States v. Textron Inc. & Subsidiaries, 577 F.3d 21 (1st Cir. 2009) (en banc) (No. 09-750), 2009 WL 5115221, at *1 (stating that the question presented is "[w]hether the work-product privilege in Federal Rule of Civil Procedure 26(b)(3), which protects documents that are 'prepared in anticipation of litigation or for trial,' is limited to documents that are prepared for use in litigation").

157. *See* Textron Inc. & Subsidiaries v. United States, 130 S. Ct. 3320, 3320 (2010) ("Petition for writ of Certiorari to the United States Court of Appeals for the First Circuit denied.").

158. *See infra* Part V.B (arguing that although the majority's argument is partially flawed, it did apply the correct test and decided the case appropriately under that test).

## *IV.* United States v. Textron

In *Textron*, the IRS audited the corporation for its tax liability during the tax years 1998–2001.[159] Textron, a major aerospace and defense conglomerate that is commonly audited by the IRS,[160] listed nine transactions in its 2001 return that the IRS believed to be "sale-in, lease out" (SILO) transactions.[161] SILO transactions are included on the list of tax avoidance transactions referred to under 26 C.F.R. § 1.6011-4(b)(2).[162] The IRS requested Textron's tax accrual workpapers for years 1998–2001,[163] which consisted of (1) a spreadsheet containing items that may be challenged by the IRS, the likelihood of liability if audited, and dollar amounts measuring the appropriate tax reserve for each item, and (2) backup workpapers consisting of earlier drafts of the spreadsheet, as well as notes and legal opinions written by Textron's in-house counsel.[164] For some items, the probability of having to pay additional taxes was listed as 100%.[165] Textron provided the final spreadsheet to Ernst & Young, its outside audit accountant, to corroborate the adequacy and reasonableness of the corporation's financial statements.[166]

Textron refused to disclose the tax accrual workpapers, presumably because revealing them would make the corporation vulnerable to the IRS's

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159. United States v. Textron Inc. & Subsidiaries, 507 F. Supp. 2d 138, 141 (D.R.I. 2007), *rev'd*, 577 F.3d 21 (1st Cir. 2009) (en banc).

160. S*ee id.* ("Textron, Inc. is a publicly traded conglomerate with approximately 190 subsidiaries. . . . Like other large corporations, Textron's federal tax returns are audited periodically at which time the IRS examines the returns for the tax years that are part of the audit cycle.").

161. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 23 (1st Cir. 2009) (en banc) ("In each of the nine instances, Textron Financial had purchased equipment from a foreign utility or transit operator and leased it back to the seller on the same day.").

162. *See* Internal Revenue Serv., *Notice 2005-13: Tax-Exempt Leasing Involving Defeasance*, http://www.irs.gov/businesses/article/0,,id=135286,00.html (last visited Nov. 22, 2011) ("This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code.") (on file with the Washington and Lee Law Review).

163. United States v. Textron Inc. & Subsidiaries, 507 F. Supp. 2d 138, 142 (D.R.I. 2007), *rev'd*, 577 F.3d 21 (1st Cir. 2009) (en banc).

164. United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 25 (1st Cir. 2009) (en banc).

165. *Id.*

166. *See id.* at 24.

requests for additional taxes.[167] In response to Textron's refusal, the IRS issued an administrative summons under 26 U.S.C. § 7602.[168] The summons requested all of Textron's tax accrual workpapers for the tax years in question.[169] When Textron again refused, the IRS brought an enforcement action against Textron under 26 U.S.C. § 2604 in district court.[170]

Textron argued that the IRS summons was not issued for a legitimate purpose and that tax accrual workpapers are privileged materials.[171] Textron alleged that the purpose for preparing the workpapers was to confirm that it was "adequately reserved with respect to any potential disputes or litigation that would happen in the future."[172] The district court first concluded that ascertaining the correctness of the tax returns filed by the taxpayer was a prima facie showing of a legitimate purpose and that Textron provided insufficient evidence to show bad faith.[173] The district

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167. *See* Barsky et al., *supra* note 26, at 232 ("Revelation of these documents presented a significant concern for Textron. . . . [T]he IRS would be able to immediately identify Textron's vulnerabilities and the specific amounts Textron should be willing to pay to settle each tax matter.").

168. *See* 26 U.S.C. § 7602 (2006) ("The Secretary is authorized (1) [t]o examine any books, papers, records, or other data which may be relevant material to such inquiry . . . ."); *see also* United States v. Arthur Young & Co., 465 U.S. 805, 816 (1984) ("In order to encourage effective tax investigations, Congress has endowed the IRS with expansive information gathering authority; § 7602 is the centerpiece of that congressional design.").

169. *See Textron*, 577 F.3d at 24 ("[W]here [as in Textron's case] the taxpayer claims benefits from multiple listed transactions, the IRS seeks all of the workpapers for the tax year in question." (citations omitted)); *see also Request for Tax Accrual and Other Financial Audit Workpapers: Announcement 2002-63*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), July 8, 2002, at 72, *available at* http://www.irs.gov/pub/irs-irbs/irb02-27.pdf ("[I]f the Service determines that tax benefits from multiple investments in Listed Transactions are claimed on a return, regardless of whether the Listed Transactions were disclosed, the Service, as a discretionary matter, will request all Tax Accrual Workpapers.").

170. *See* 26 U.S.C. § 7604(a) (2006) ("If any person is summoned under the internal revenue laws to . . . produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such . . . production . . . ."); *see also* United States v. Powell, 379 U.S. 48, 57–58 (1964) (declaring that the IRS "must show that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed . . . .").

171. United States v. Textron Inc. & Subsidiaries, 507 F. Supp. 2d 138, 142–43 (D.R.I. 2007), *rev'd*, 577 F.3d 21 (1st Cir. 2009) (en banc).

172. *Id.* at 143.

173. *See id.* at 144–45 (discussing whether the IRS summons of Textron's tax accrual workpapers served a legitimate purpose, and concluding that the IRS satisfied its burden of proof).

court then addressed each of Textron's privilege claims, including the attorney-client privilege, the tax practitioner-client privilege under 26 U.S.C. § 7525,[174] and the work product doctrine.[175]

The district court stated that the attorney-client privilege and the tax practitioner-client privilege could apply to Textron's tax accrual workpapers, but Textron's disclosure of the workpapers to Ernst & Young waived its entitlement to either privilege.[176] With respect to the work product doctrine, the district court acknowledged the circuit split over determining whether a document was prepared in "anticipation of litigation."[177] It asserted that (1) the opinions of Textron's counsel and accountants regarding items that may be challenged by the IRS would not have been prepared but for the fact that "Textron anticipated the possibility of litigation with the IRS,"[178] (2) Textron's disclosure to Ernst & Young did not waive work product protection because it did not "substantially increase the opportunity for potential adversaries to obtain the information,"[179] and (3) the IRS failed to show a "substantial need"[180] for the tax accrual workpapers.[181] Finally, it concluded that the work product doctrine applied to Textron's tax accrual workpapers and denied the IRS's petition of enforcement.[182]

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174. *See* 26 U.S.C. § 7525 (2006) ("[T]he 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 . . . .").

175. United States v. Textron Inc. & Subsidiaries, 507 F. Supp. 2d 138, 141, 148–50 (D.R.I. 2007), *rev'd*, 577 F.3d 21 (1st Cir. 2009) (en banc).

176. *See id.* at 146–48, 151–52 (discussing the application of both the attorney-client privilege and the tax practitioner-client privilege, and the waiver of both privileges by disclosing the information to an independent accountant).

177. *See id.* at 149–50 (acknowledging the existence of both the "because of" test and the "primary purpose" test, and establishing that the standard within the First Circuit is the "because of" test).

178. *Id.* at 150.

179. *Id.* at 152.

180. *See* FED. R. CIV. P. 26(b)(3)(A) ("[M]aterials may be discovered if . . . the party shows that is has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.").

181. *See* United States v. Textron Inc. & Subsidiaries, 507 F. Supp. 2d 138, 154 (D.R.I. 2007), *rev'd*, 577 F.3d 21 (1st Cir. 2009) (en banc) ("[T]he IRS has failed to carry the burden of demonstrating a 'substantial need' for ordinary work product, let alone the heightened burden applicable to Textron's tax accrual workpapers, which constitute opinion work product.").

182. *See id.* at 155.

On appeal, a divided First Circuit panel initially upheld the district court's decision,[183] but the en banc court vacated that decision and granted the government's petition for rehearing.[184]

### *A. The Majority Opinion*

Judge Boudin delivered the majority opinion for the en banc First Circuit and framed the issue as "whether the attorney work product doctrine shields from an IRS summons 'tax accrual work papers' prepared by lawyers and others in Textron's Tax Department to support Textron's calculation of tax reserves for its audited corporate financial statements."[185] The en banc court concluded, while affirming precedent established in *Maine*, that the workpapers at issue were prepared to satisfy regulatory laws and therefore not protected under the work product doctrine.[186] The court agreed with the IRS that the "immediate motive of Textron in preparing the tax accrual workpapers was to fix the amount of the tax reserve on Textron's books and to obtain a clean financial opinion from its auditor."[187] It concluded that the subject matter of the workpapers related to a subject that might potentially be litigated but that the potential for litigation was too remote to qualify for work product protection.[188]

The majority briefly discussed public policy concerns underlying its decision: "Underpaying taxes threatens the essential public interest in revenue collection. . . . It is because the collection of revenues is essential to government that administrative discovery, along with many other comparative tools, are furnished to the IRS."[189] The opinion also noted that the IRS made the request after finding specific "listed transactions" and

183. *See* Barsky et al., *supra* note 26, at 232 ("On an appeal, the district court's decision was upheld by a divided panel . . . .").

184. *See* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21, 26 (1st Cir. 2009) (en banc).

185. *Id.* at 22.

186. *See id.* at 26 ("We now conclude that under our own prior *Maine* precedent—which we reaffirm *en banc*—the Textron work papers were independently required by statutory and audit requirements and that the work product privilege does not apply.").

187. *Id.* at 27.

188. *See id.* at 29 (arguing that the workpapers lacked a connection to potential litigation).

189. *Id.* at 31.

reinforced the notion that the IRS is sensitive to making such requests and does so only when it deems necessary.[190]

In summation, the court concluded that (1) the work product doctrine is aimed at protecting work done for litigation and not financial statements, (2) the workpapers were prepared to gain approval of their financial filings and established regulations will discourage companies from providing less information despite knowing that it is not privileged, and (3) the IRS's access to such information serves a "legitimate, and important, function of detecting and disallowing abusive tax shelters."[191] Applying *Maine* to the facts, the court concluded that the workpapers were prepared in the ordinary course of business and therefore not entitled to work product protection.[192]

If the *Textron* decision provided only those arguments—without any further rationale—it would have avoided much of the criticism and confusion it currently faces.[193] In response to Textron's argument that the workpapers would be useful to the company if litigation did occur, the court argued that "there is no evidence in this case that the work papers were prepared for such a use or would in fact serve any useful purpose."[194] The majority further stated that "the focus of work product protection has been on materials prepared *for use* in litigation, whether the litigation was underway or merely anticipated."[195] It also provided earlier in the opinion that the district court's decision to extend work product protection to tax accrual workpapers did not include a finding that the they were *for use* in possible litigation—only that the reserves listed would cover liabilities that could potentially be litigated.[196]

### *B. The Dissenting Opinion*

Judge Torruella's impassioned dissent argued that the majority (1) quietly rejected circuit precedent, (2) announced a bad rule, and (3) would have found that the workpapers are protected by the work

190. *See id.* at 24 (stating that the request was made only after specifically identifying potential tax-sheltering and abusive transactions).

191. *See id.* at 31–32 (summarizing the courts findings).

192. *See id.* at 30 (stating that *Maine* supports the IRS position in the case).

193. *See supra* notes 26–27 and accompanying text (presenting some of the criticisms and concerns concerning the majority opinion's clarity and accuracy).

194. *Textron*, 577 F.3d at 30.

195. *Id.* at 29 (emphasis added).

196. *Id.* at 27.

product doctrine if it applied the proper "because of" test.[197] The dissent argued not only that the majority created a "prepared for" or "for use" test, but that such a test is narrower in scope than even the "primary purpose" test.[198] Relying heavily on *Adlman* in its reasoning, it stressed that Rule 26(b)(3) does not state that a document must be prepared to aid in conducting litigation to constitute work product and the "rationales underlying the work-product doctrine apply to documents prepared in anticipation of litigation, even if they are not for use at trial."[199]

The dissent provided many of the criticisms raised by business and legal scholars regarding the consequences of such a rule on the future transparency of companies regarding tax compliance.[200] First, it accused the majority of ignoring the consequences of permitting discovery of dual-purpose documents, in order to support the case-specific needs of the IRS and its reviewing of Textron's dense, complicated return.[201] It argued that forcing companies to reveal such legal rationale and impressions would implicate free-riding conduct that the work product doctrine seeks to remedy and allow the IRS to immediately identify what Textron is willing to spend in settlement.[202] Second, it argued that the rule will open the door for discovery of information beyond the basic numbers provided in the workpapers and could compel the disclosure of legal rationale and impressions—which runs contrary to the purpose of the work product doctrine.[203] Third, it expressed fears that the decision will have "chilling"

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197. *See id.* at 32–43 (Torruella, J., dissenting) (outlining the sections of the dissenting opinion by argument).

198. See *id.* at 32 (comparing the scopes of the pre-existing tests to the alleged, majority-created test).

199. *Id.* at 34, 36.

200. *See supra* note 26 and accompanying text (providing concerns that *Textron* further adds to the uncertain application of the work product doctrine at the circuit court level); *see also* Jung, *supra* note 17, at 395 ("Thus, while *Textron* appears to promote transparency—by giving litigants access to information traditionally protected by the work product doctrine—the decision actually discourages transparency by disincentivizing companies from communicating freely with their independent auditors."); Kling, *supra* note 26, at 1726 ("The court's holding [in *Textron*] will likely chill the socially valuable preparation of such [legal] analyses in connection with business transactions and may reduce the accuracy of public companies' financial statements."); Sullivan, *supra* note 27 ("The vast majority of in-house counsel finds that work product protection facilitates their work and believes that disclosure would cause employees to hesitate to assist them in preparing for litigation.").

201. *See Textron*, 577 F.3d at 36 (Torruella, J., dissenting) (criticizing the majority for making a results-oriented decision).

202. *See id.* (claiming that the majority opinion fails to properly consider the negative effect of disclosing such materials).

203. *See id.* (expressing concerns about the disclosure of opinion work product).

consequences that the majority failed to consider and, counter-intuitively, promotes less transparency and disclosure by public companies.[204]

The dissent provided its opinion of how the "because of" test should be applied with respect to the tax accrual workpapers. It criticized the majority for failing to acknowledge that an IRS audit can be litigation because although the initial stages of a tax audit may not be adversarial, "the disputes themselves are essentially adversarial" and "the subject of these disputes will become the subject of litigation unless the dispute is resolved."[205] It restated the district court's argument that there would be no need to estimate the account reserve for tax contingent liabilities without anticipation of litigation.[206] In response to the "ordinary course of business" exception provided in Rule 26's Advisory Committee Notes,[207] the dissent attempted to show that the workpapers were dual-purpose documents.[208] It claimed that "the best reading of the advisory committee's notes is simply that preparation for business or for public requirements is preparation for a nonlitigation purpose. . . . [B]ut [it] does not suggest that the presence of such a purpose should somehow override a litigation purpose, should one exist."[209]

To support its assertions, the dissent framed the workpapers' characteristics as materials that anticipate the likelihood that litigation over specific tax items will result in Textron having to pay the IRS additional taxes.[210] "That Textron will not ultimately litigate each position does not change the fact that when it prepared the documents, Textron was acting to anticipate and analyze the consequences of possible litigation . . . ."[211] It finally concluded that the documents would not be the same "at all" but for

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204. *See id.* at 37–38 ("[T]he majority's new rule will have ramifications that will affect the form and detail of documents attorneys prepare when working to convince auditors of the soundness of a corporation's reserves. . . . Nearly every major business decision by a public company has a legal dimension that will require such analysis.").

205. *Id.* at 40.

206. *See id.* at 40–41 (providing arguments for how the "because of" test should apply to the workpapers at issue).

207. *See supra* note 96 and accompanying text (stating the "ordinary course of business" exception to the work product doctrine).

208. *See Textron*, 577 F.3d at 42 (Torruella, J., dissenting) (discussing the "ordinary course of business" exception and arguing that it should not apply to Textron's tax accrual workpapers).

209. *Id.*

210. *See id.* (agreeing with Textron's interpretation of its tax accrual workpapers).

211. *Id.*

the anticipated litigation and were not prepared regardless of the prospect of litigation.[212]

## *V. Analysis of the* Textron *Opinion*

### *A. The Dissent Reached the Wrong Decision*

#### *1. The Dissent Failed to Raise Legitimate Concerns*

The criticisms and concerns raised by the dissent and echoed by *Textron*'s critics carry little weight. First, the court's decision to deny work product protection does not implicate free-riding conduct.[213] The request for workpapers is made only in extraordinary circumstances.[214] They are considered to be outside the scope of a standard examination and are not requested absent unusual circumstances.[215] The IRS has acknowledged the sensitivity of workpapers requests and exercises its authority to request them with considerable restraint.[216] In *Textron*, the request was made only after finding multiple potential tax-sheltering transactions[217] in Textron's

212. *Id.*

213. *See supra* note 200 and accompanying text (providing the arguments raised by the dissent and critics of the *Textron* decision).

214. *See Request for Tax Accrual and Other Financial Audit Workpapers: Announcement 2002-63*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), July 8, 2002, at 72, *available at* http://www.irs.gov/pub/irs-irbs/irb02-27.pdf ("The Service will continue in its current policy of requesting Tax Accrual Workpapers only in unusual circumstances . . . .").

215. *See* Claudine Pease-Wingenter, *The Application of the Attorney-Client Privilege to Tax Accrual Workpapers: The Real Legacy of Textron*, 8 HOUS. BUS. & TAX J. 337, 341 (2008) (emphasizing that the request for tax accrual workpapers is unique).

216. *See Request for Tax Accrual and Other Financial Audit Workpapers: Announcement 2002-63*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), July 8, 2002, at 72, *available at* http://www.irs.gov/pub/irs-irbs/irb02-27.pdf ("Despite the broad scope of authority recognized by the Supreme Court, the Service has historically acted with restraint, declining to request Tax Accrual Workpapers as a standard examination technique.").

217. See Internal Revenue Serv., Recognized Abusive and Listed Transactions—LB&I Tier I Issues in Alphabetical Order, http://www.irs.gov/businesses/corporations/article/0,,id=204155,00.html (last visited Nov. 22, 2011) (listing tax-sheltering transactions in alphabetical order) (on file with the Washington and Lee Law Review). The list of transactions that the IRS has determined to be tax avoidance transactions is limited to roughly forty types of transactions, which places further restraint on the request for a corporation's tax accrual workpapers. *Id.*

return—which is stated as grounds for such a request.[218] The IRS recognizes the potential detriment such requests could have on the auditor-client relationship and continues to follow its policy of restraint.[219] Such requests are made to shorten the disclosure gap and aid "the Service in focusing its examination resources on returns that contain specific uncertain tax positions that are of particular interest or of sufficient magnitude to warrant Service inquiry, as well as allowing examination teams to identify all of the issues underlying the tax returns more quickly and efficiently."[220] It is doubtful that the request and use of workpapers—in limited circumstances to collect appropriate taxes from corporations—qualifies as free-riding conduct that the work product doctrine seeks to prevent.

Second, the potential for disclosure of legal rationale and impressions related to the production of tax accrual workpapers is possible, but it is unlikely to reveal any protected information under the work product doctrine.[221] Although the district court asserted that the workpapers were in fact opinion work product,[222] that argument was not raised by the First

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218. *See Textron*, 577 F.3d at 23 (stating that the IRS determined Textron engaged in nine SILO transactions, that are listed as potential tax-sheltering tactics and often evidence taxpayer abuse); *see also Request for Tax Accrual and Other Financial Audit Workpapers: Announcement 2002-63*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), July 8, 2002, at 72, *available at* http://www.irs.gov/pub/irs-irbs/irb02-27.pdf ("[I]f the Service determines that tax benefits from multiple investments in Listed Transactions are claimed on a return, regardless of whether the Listed Transactions are claimed on a return, regardless of whether the Listed Transactions were disclosed, the Service, as a discretionary matter, will request all Tax Accrual Workpapers.").

219. *See* Pease-Wingenter, *supra* note 215, at 341 (discussing the policy history of IRS requests for tax accrual workpapers); *see also* Prepared Remarks of IRS Commissioner Doug Shulman to New York Bar Association Taxation Section, Annual Meeting in New York City, Jan. 26, 2010 (stating that although the IRS is promoting greater transparency to ensure certainty, consistency, and efficiency, it would still abide by its longstanding policy of restraint in making tax accrual workpapers requests); *Uncertain Tax Positions—Policy of Restraint: Announcement 2010-09*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), Feb. 16, 2010, at 409, *available at* http://www.irs.gov/pub/irs-irbs/irb10-07.pdf ("[T]he Service intends to retain the existing policy of restraint for requesting tax accrual workpapers during the course of examinations . . . . The Service will continue to review the policy and to consider additional modifications . . . to ensure it obtains complete and accurate information regarding a taxpayer's uncertain tax positions . . . .").

220. *Uncertain Tax Positions—Policy of Restraint: Announcement 2010-09*, INTERNAL REVENUE BULL. (Internal Revenue Serv., Wash., D.C.), Feb. 16, 2010, at 409, *available at* http://www.irs.gov/pub/irs-irbs/irb10-07.pdf.

221. *See supra* notes 204 and accompanying text (providing the arguments that disclosure of tax accrual workpapers will lead to the discovery of legal rationale and impressions otherwise protected by the work product doctrine).

222. *See* United States v. Textron Inc. & Subsidiaries, 507 F. Supp. 2d 138, 154 (D.R.I. 2007), *rev'd*, 577 F.3d 21 (1st Cir. 2009) (stating that Textron's tax accrual workpapers

Circuit in either the majority or dissent.[223] It remains to be seen whether the *Textron* ruling permitted the disclosure of legal rationale or impressions, or potentially opens the door for their disclosure in the future. Assuming that *Textron* leads to disclosure of legal rationale and impressions related to the workpapers, it is unlikely that those impressions would fall within the scope of opinion work product. Federal Rule of Civil Procedure 26(b)(3)(B) protects legal rationale and impressions under opinion work product, but only if they concern litigation.[224] The workpapers themselves are not prepared in "anticipation of litigation,"[225] so any related legal rationale or impressions are therefore unlikely to concern litigation.[226] Thus, the disclosure of these legal rationale or impressions falls outside the scope of opinion work product protection.

Third, the potential for chilling disclosure and transparency is unlikely[227] given the role and obligations of independent auditors to certify a company's financial statements.[228] The main independent auditors, including Ernst & Young, are sophisticated entities that have legal obligations of their own to follow when certifying financial statements.[229] If *Textron* did chill public corporations' willingness to disclose relevant information, that effect would merely place a greater burden on auditors to ferret out the details of a company's financial statements. Such a burden shift is not cause for concern.[230] The Supreme Court has stated the

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constituted opinion work product, and therefore were subject to a higher standard of protection under the work product doctrine).

223. *See generally* United States v. Textron Inc. & Subsidiaries, 577 F.3d 21 (1st Cir. 2009) (en banc).

224. *See* FED. R. CIV. P. 26(b)(3)(B) ("If the court orders discovery of those materials [prepared in anticipation of litigation or for trial], it must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation.").

225. *See infra* Part VI.B–C (arguing why a public corporation's tax accrual workpapers are not prepared "in anticipation of litigation").

226. *See* Lischer, *supra* note 57, at 555 (stating that the opinion information related to the tax accrual workpapers cannot concern litigation if the workpapers were not prepared in anticipation of litigation).

227. *See supra* notes 204 and accompanying text (arguing that discovery of tax accrual workpapers will have a chilling effect on transparency and disclosure by public corporations).

228. *See* Lischer, *supra* note 57, at 541 (noting that independent auditors will not certify a taxpayer's financial statements if the taxpayer provides insufficient information).

229. *See* United States v. Arthur Young, 465 U.S. 805, 818–19 (1984) (stating that auditors are obligated to acquire all relevant information prior to certifying a company's financial statements).

230. *See* Lischer, *supra* note 57, at 540 ("Accordingly, tension—probably a healthy

importance of the independent auditor's role in certifying a public company's financial statements:

> By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. . . . This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust. . . . [T]he independent certified public accountant cannot be content with the corporation's representations that its tax accrual reserves are adequate; the auditor is ethically and professionally obligated to ascertain for himself as far as possible whether the corporation's contingent tax liabilities have been accurately stated. If the auditor were convinced that the scope of the examination had been limited by management's reluctance to disclose matters relating to the tax accrual reserves, the auditor would be unable to issue an unqualified opinion as to the accuracy of the corporation's financial statements. Instead the auditor would be required to issue a qualified opinion, an adverse opinion, or a disclaimer of opinion, thereby notifying the investing public of possible potential problems inherent in the corporation's financial reports.[231]

Even if the reaction to *Textron* was a trend towards revealing as little information as possible to an auditor to receive certification, the auditor would still, in its gatekeeping role, be obligated to demand enough information to provide a qualified opinion.[232] If enough information were not provided, the auditor has ample incentive to either demand more or refuse to certify the company's financial statements.[233] Either way, the risk

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tension—would exist between the tax payer and [the certified public accountant] because of the [certified public accountant's] obligation of independence . . . ."). There is the possibility that the relationship between an outside auditor and the taxpayer crosses the adversarial threshold, and this disclosure of documents to the outside accountant is waiver. *See* United States v. Deloitte LLP, 610 F.3d 129, 139 (D.C. Cir. 2010) (addressing whether disclosure to an independent auditor constitutes waiver of work product protection). "Among the district courts that have addressed this issue, most have found no waiver." *Id.* However, that trend may change depending on how courts view the evolving auditor-taxpayer relationship.

231. *Arthur Young*, 465 U.S. at 818–19 (citations omitted).

232. *See* Lischer, *supra* note 57, at 541 ("Because the [certified public accountant] has obligations independent of its obligations in favor of its client the taxpayer, the [certified public accountant] will require adequate-to-the-task disclosure in the tax accrual workpapers.").

233. *See* The Sarbanes-Oxley Act of 2002 § 101, 15 U.S.C. § 7211 (2002) (establishing the Public Company Accounting Oversight Board (PCAOB) to regulate auditors of public companies and conduct necessary investigations and disciplinary proceedings); Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 879 ("[I]f a public corporation failed to generate tax accrual workpapers in any given year, its auditors would be unable to issue it a bill of financial health . . . , the corporation could be delisted by its

of chilling disclosure is minimal and does not pose the threat raised by the dissent and other critics of the *Textron* opinion.[234]

### 2. *The Dissent Incorrectly Applied the "Because of" Test*

The dissent accused the majority of "straining to craft a rule favorable to the IRS" when the dissent itself strains to apply the law favorably to public corporations.[235] First, the dissent acknowledged that there are several steps between an IRS audit notice and settling a disputed tax return through litigation, but argued that the potential for unresolved disputes to become adversarial justifies qualifying the workpapers as prepared "in anticipation of litigation."[236] If that is correct, without anything more to substantiate the likelihood of litigation, then the work product doctrine would extend indefinitely, regardless of the remoteness of the potential litigation.[237] That leaves the possibility that anything related in subject matter to the litigation and prepared prior to that litigation is prepared in anticipation of that litigation and, therefore, qualifies for work product protection.[238] This reasoning stretches the work product doctrine to

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exchange, and it would cease to exist as a publicly traded entity.").

234. *See* Lyman P.Q. Johnson & Mark A. Sides, *The Sarbanes-Oxley Act and Fiduciary Duties*, 30 WM. MITCHELL L. REV. 1149, 1155–58 (2004) (providing that an Audit Committee of a public company is required to be independent and is responsible for the appointment, compensation, and oversight of the company's auditors). Proponents of the "chilling" argument also overlook the internal controls provided by a public corporation's audit committee. The audit committee has a written charter describing its duties and responsibilities, which at a minimum must include: (1) obtaining and reviewing a report by the independent auditor describing the firm's internal controls, material issues raised by a variety of sources, steps taken to deal with those issues, and the potential for conflicting relationships between the independent auditor and the company; and (2) discussing the company's annual audited financial statements and quarterly financial statements with management and the independent auditor. *See id.* at 1163–66 (offering guidelines set out in the Sarbanes-Oxley Act for a public company's audit committee, and its minimal requirements). A public corporation's audit committee will further discourage a decision to disclose less information to the independent auditor, and serves as another deterrent against providing insufficient or misleading information to corroborate the company's financial statements.

235. *Textron*, 577 F.3d at 43 (Torruella, J., dissenting).

236. *See id.* at 40 ("Though the initial stages of a tax audit may not be adversarial, the disputes themselves are essentially adversarial; the subject of these disputes will become the subject of litigation unless the dispute is resolved.").

237. *See supra* Part III.A.1 (discussing the temporal limitations placed on the scope of the work product doctrine).

238. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 880 (stating that under this theory, the work product doctrine could extend to any advice,

illogical lengths and fails to consider the temporal limitations on its scope.[239]

Second, the dissent made a strenuous effort to refute the "ordinary course of business" exception by claiming (1) that the workpapers were dual-purpose documents, and (2) that documents having a litigation purpose irrespective of a regulatory or business purpose fall outside the scope of this exception.[240] The major flaw in this argument is that the workpapers are not dual-purpose documents. They serve no litigation purpose.[241] They are not prepared to assess the likelihood of litigation, but to assess the likelihood of having to pay further taxes due to positions taken by a public corporation on its tax return.[242] The sole purpose for their preparation, as the majority stated, is to receive approval of its financial statement from an independent auditor.[243] They only contain content related to the remote possibility of anticipated litigation.[244] The regulatory requirement to have an auditor certify a company's financial statements is unrelated to litigation, the regulatory requirement to pay taxes is several steps removed from potential litigation, and the workpapers were proven to serve no useful litigation purposes by the majority.[245] Under the current language of Rule 26 as interpreted by the Advisory Committee, Textron's tax accrual workpapers fall under the "ordinary course of business exception" and do not deserve work product protection.[246]

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legal or otherwise, regarding potential litigation, regardless of the likelihood of litigation).

239. *See supra* Part III.A.1 (discussing the limitations placed on work product doctrine by the temporal component of "in anticipation of litigation").

240. *See Textron*, 577 F.3d at 41–43 (Torruella, J., dissenting) (addressing and dismissing the "ordinary course of business" exception).

241. *See supra* notes 186–88, 193 and accompanying text (discussing the majority opinion's argument that the workpapers serve no purpose in litigation).

242. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 880 ("[The workpapers] may discuss the prospect of litigation, and they may contain analyses that might one day become the subject of litigation, but the documents themselves are not created for litigation purposes.").

243. *See supra* Part IV.A (providing the majority opinion's arguments).

244. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 879–80 ("[W]orkpapers contain percentage determinations on the likelihood of success of prevailing on the merits of specific tax positions. Those determinations themselves are not prepared in anticipation of litigation, but to evaluate the likelihood of litigation as required by federal securities law and [Generally Accepted Accounting Principles].").

245. *See id.* at 880 ("Indeed, without independent financial reporting obligations, most corporate taxpayers would never create tax accrual workpapers, certainly not for litigation reasons.").

246. *See supra* note 96 and accompanying text (presenting the "ordinary course of business" exception to work product doctrine protection).

Third, the dissent's assertion that the documents would not have been prepared in the same way irrespective of the anticipated litigation is incorrect.[247] A public corporation is required by law to have its financial statements certified by an outside accountant.[248] To do so, it must provide an explanation for why it has reserve accounts for tax contingent liabilities.[249] Even when a company does not create a reserve account for its contingent tax liabilities, it must provide an explanation for the absence of a reserve account on its financial statement.[250] In either situation, the financial statement and explanatory documents provided to the independent auditor are prepared irrespective of litigation.[251] The workpapers discuss matters that may be litigated, but that does not support the assertion that the makeup of the workpapers depends on the existence of anticipated litigation. Their preparation is solely driven by regulatory requirements and will occur irrespective of litigation involving the listed items. Therefore, the dissent erroneously found that Textron's tax accrual workpapers deserve work product protection under the "because of" test.

### 3. *The Dissent Erroneously Concluded that* Adlman *Is "Fatal" to the Majority Opinion*

The dissent relied heavily on *Adlman*'s articulation of the "because of" test in its analysis and claimed the articulation to be "fatal" to the majority's analysis.[252] It framed the issue addressed in *Adlman* as "whether the work-product doctrine applies where a dual purpose exists for preparing the legal analysis, that is, where the dual purpose of anticipating litigation and a

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247. *See supra* notes 206–12 and accompanying text (summarizing the dissent's application of the "because of" test).

248. *See supra* note 35 and accompanying text (describing the requirements of public companies to have their annual financial statements audited by an independent accountant).

249. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 879 (stating that the workpapers are an important part of the reporting process because they help to explain the amount on reserve due to the potential future liability for additional taxes owed by the company "in the event of an adverse administrative or judicial determination over tax return positions").

250. *See id.* ("Public corporations produce tax accrual workpapers even if they do not anticipate having to set aside a tax reserve. That is because they must justify to their auditors the absence of a contingent tax reserve.").

251. *See id.* ("[T]ax accrual workpapers are generated every year in a public corporation's ordinary course of business, and they are generated whether or not the company anticipated specific or potential litigation.").

252. *Textron*, 577 F.3d at 33 (Torruella, J., dissenting).

business purpose coexist."[253] It then argued that the tax accrual workpapers in *Textron*, like the memorandum in *Adlman*, qualified as dual-purpose documents that fall under work product protection when applying the "because of" test.[254]

The dissent neglected to recognize that the document at issue in *Adlman* is distinguishable from the tax accrual workpapers at issue in *Textron*. There is a clear distinction between documents prepared to make an informed business decision with respect to potential litigation—the memorandum at issue in *Adlman*—and documents prepared in the ordinary course of business to comply with legal or statutory requirements—the tax accrual workpapers at issue in *Textron*.[255] Sequa identified a specific transaction, anticipated that it might lead to litigation with the IRS, and requested a memorandum about it.[256] Therefore, the memorandum was made for both litigation and business purposes, and qualifies as a dual-purpose document. Conversely, the purpose of creating Textron's workpapers was to receive certification of its financial statement from an outside auditor without any regard to potential litigation.[257] Thus, under the Second Circuit's articulation of the "because of" test, a public corporation's tax accrual workpapers are unprotected by the work product doctrine because they would have been prepared "irrespective of the anticipated litigation and therefore [were] not prepared because of it."[258]

The dissent also provided one of the examples the *Adlman* court cited for choosing to apply the "because of" test rather than the "primary purpose" test:

> [T]he policies underlying the work-product doctrine suggest strongly that work-product protection should not be denied to a document that analyzes expected litigation merely because it is prepared to assist an

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253. *Id.*

254. *See id.* at 38–43 (accusing the majority opinion of ignoring the dual purposes (litigation and business) underlying the creation of the corporation's tax accrual workpapers).

255. *Compare* United States v. Adlman, 134 F.3d, 1194, 1195–96 (2d Cir. 1998) (describing the reasons for creating the memorandum), *with Textron*, 577 F.3d at 22–23 (describing the reasons for creating tax accrual workpapers); *see also infra* Part VI.A (arguing that tax accrual workpapers fall under the "ordinary course of business" exception).

256. *See* Lischer, *supra* note 57, at 527–28 ("The report in controversy in *Adlman* was not required for financial accounting purposes, and the report (a 'litigation analysis') was prepared because litigation with the IRS was expected").

257. *See Textron*, 577 F.3d at 22–23 (providing the reasons for creating tax accrual workpapers, which does not include any consideration of current or potential litigation).

258. United States v. Adlman, 134 F.3d 1194, 1205 (2d Cir. 1998).

> business decision. . . . The problem is aptly illustrated by several hypothetical fact situations likely to recur: . . . (iii) A business entity prepares financial statements to assist its executives, stockholders, prospective investors, business partners, and others in evaluating future courses of action. Financial statements include reserves for projected litigation. The company's independent auditor requests a memorandum prepared by the company's attorneys estimating the likelihood of success in litigation and an accompanying analysis of the company's legal strategies and options to assist in estimating what should be reserved for litigation losses. . . . [T]he company involved would require legal analysis that falls squarely within *Hickman*'s area of primary concern—analysis that candidly discusses the attorney's litigation strategies, appraisal of likelihood of success, and perhaps the feasibility of reasonable settlement.[259]

The dissent argued that "[t]he majority offers no response to this sound policy analysis" and instead permits the disclosure of "such dual-purpose documents, which contain confidential assessments of litigation strategies and chances."[260]

The dissent neglected to recognize the distinction between reserves for litigation liabilities and reserves for tax contingency liabilities. The example in *Adlman* does not address tax contingent liabilities—only memoranda related to litigation liabilities. Although the hypothetical is similar to the production and use of the tax accrual workpapers, the probabilities of tax liability are too remote from prospective litigation to be considered "a document that analyzes expected litigation."[261] Whereas, the *Adlman* memorandum is prepared with the existence of both a subjective and objectively reasonable belief that litigation is likely,[262] the tax accrual workpapers at issue in *Textron* fail to satisfy the temporal component of "in anticipation of litigation."[263] Thus, the example fails to directly implicate the tax accrual workpapers at issue in *Textron*, and the dissent's use of the example evidences its failure to recognize this distinction.

The dissent's discussion of *Adlman* and its articulation of the "because of" test can hardly be presented as inconsistent with the majority opinion in *Textron*, let alone "fatal" to it. However, the dissent is correct that the

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259. *See id.* at 1199–1200.

260. *Textron*, 577 F.3d at 36 (Torruella, J., dissenting).

261. *See Adlman*, 134 F.3d at 1199.

262. *See supra* Part III.A.1 (providing the elements of the temporal component of "in anticipation of litigation").

263. *See infra* Parts VI.B–C (arguing that tax accrual workpapers fail to qualify as documents prepared "in anticipation of litigation").

*Adlman* decision dispels the notion that the "because of" test is limited to documents prepared "for use" in litigation.[264] Admittedly, the "because of" test does not require documents or materials to be used in litigation to receive work product protection, and the majority opinion has deservingly received criticism with respect to this element of its analysis.[265] However, this element is not a key component of the majority's argument or holding, and it does not corrupt the majority's otherwise correct application of the "because of" test.[266] Despite the majority opinion's erroneous assertion that documents must be prepared "for use" in litigation to receive work product protection, it ultimately arrived at the right decision under the "because of" test.[267]

### *B. The Majority Ultimately Reached the Right Decision*

#### *1. The Majority's Analysis Welcomed Criticism and "For Use" Test Speculation*

The majority in *Textron* admittedly welcomed much of the criticism and speculation that it created a new "for use" test.[268] It first emphasized that the district court failed to make a finding that the tax accrual workpapers were prepared "for use" in possible litigation.[269] It then referenced testimony that claimed the tax accrual workpapers were unlikely to be useful in litigation over any of the positions taken.[270] The majority

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264. *See Textron*, 577 F.3d at 34 (stating that "[n]owhere does Rule 26(b)(3) state that a document must have been prepared *to aid* in the conduct of litigation in order to constitute work product" (quoting United States v. Adlman, 134 F.3d 1194, 1198–99 (2d Cir. 1998))).

265. *See id.* at 32 ("[T]he majority imposes a 'prepared for' test, asking if the documents were 'prepared for use in possible litigation.'. . . In adopting its test, the majority ignores a tome of precedents from the circuit courts and contravenes much of the principles underlying work product doctrine.").

266. *See infra* Part IV.B (arguing that the majority's opinion was erroneous in some respects, but ultimately applied the "because of" test correctly, and arrived at the right decision under the "because of" test).

267. *See Textron*, 577 F.3d at 29 ("From the outset, the focus of work product protection has been on materials prepared for use in litigation, whether the litigation was underway or merely anticipated.").

268. *See supra* Part IV.A (discussing the majority opinion in *Textron*, and noting the derivation of "for use" test speculation).

269. *See Textron*, 577 F.3d at 27 (stating that such a finding would have been erroneous).

270. *See id.* at 28 ("To complete the story, we note *one* suggestion by one Textron witness that, if litigation did occur, the work papers could be useful to Textron in that

further stated, "From the outset, the focus of work product protection has been on materials prepared for use in litigation, whether the litigation was underway or merely anticipated."[271] The multiple "for use" references in the opinion welcomed speculation that the majority did not apply the "because of" test despite affirming it as precedent.[272] Thus, the majority's discussion of the workpapers' usefulness in litigation was the catalyst for accusations that it created a new "for use" test.[273]

Despite speculation that the court applied a new test in its analysis, there is a more likely explanation for the court's "for use" argument. As stated, the "because of" test extends work product protection to dual-purpose documents—documents that serve both a litigation and non-litigation purpose.[274] By focusing correctly on the functionality of Textron's tax accrual workpapers, the "for use" language is more likely a poorly worded argument that the workpapers were not actually dual-purpose documents.[275] The majority acknowledged that Textron witnesses made an effort to use the word "litigation" as often as possible, and one witness even argued that the workpapers would be useful to litigation.[276] These references to litigation did not convince the majority that the workpapers served any purpose other than to "make book entries, prepare financial statements and obtain a clean audit."[277] In response to Textron's focus on the content of the workpapers and its relation to potential litigation, the court emphasized that "it is not enough to trigger work product protection that the *subject matter* of a document relates to a subject

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litigation. This assertion was not supported by any detailed explanation, was *not* adopted by the district judge and is more than dubious . . . ." (citations omitted)).

271. *Id.* at 29.

272. *See id.* at 26 (citing the "because of" language in *Maine* and then concluding that "under our own prior *Maine* precedent—which we reaffirm *en banc*—the Textron work papers were independently required by statutory and audit requirements and that the work product privilege does not apply").

273. *See supra* note 27 and accompanying test (providing arguments made that accuse the majority of applying a narrower "for use" test).

274. *See supra* Part III.B.2 (establishing the scope and applicability of the "because of" test to dual-purpose documents).

275. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 871 ("The key question is, *why* were the documents created? The *context* of document preparation, not the *content* of the documents themselves, is what matters. And the *context* surrounding the preparation of tax documents, including tax accrual workpapers, has nothing to do with anticipating litigation.").

276. *See Textron*, 577 F.3d at 27–28 (discussing the testimony of Textron witnesses).

277. *Id.* at 27.

that might conceivably be litigated."[278] It concluded this section of its argument by stating that "a set of tax reserve figures, calculated for purpose of accurately stating a company's financial figures, has in ordinary parlance only that purpose: [T]o support a financial statement and the independent audit of it."

Although the majority opinion used poor terminology and unclear logic in the "for use" section of its analysis, it is unlikely that the court intended to narrow work product protection to documents used in litigation.[279] It was more likely a badly worded attempt to show that the workpapers served no functional litigation purpose. Interpreting "for use" more broadly to mean that the workpapers served no litigation purpose—and therefore are not dual-purpose documents deserving of work product protection under the "because of" test—is less speculative than the theory that the First Circuit created a new test. That interpretation reconciles the "for use" section of the majority's argument with the affirmation of *Maine* and the remainder of the majority opinion, which is otherwise consistent with the correct application of the "because of" test.

### *2. The Majority Correctly Applied the "Because of" Test*

The primary issue in the petition for writ of certiorari was whether the First Circuit created a new "for use" test and added another test to the pre-existing circuit split.[280] Some feel that the decision to deny review creates uncertainty about what test the First Circuit will apply to determine whether documents and materials will fall within the scope of work product protection.[281] These concerns, although alleged to be supported by the court's rationale in the *Textron* opinion,[282] are unfounded.[283] The majority

278. *Id.* at 29.

279. *See id.* at 29–30 (interpreting "in anticipation of litigation or for trial" to not mean documents prepared for some purpose other than litigation, which is consistent with the dual-purpose element of the "because of" test).

280. *See* Brief for Petitioner at 1, United States v. Textron Inc. & Subsidiaries, 577 F.3d 21 (1st Cir. 2009) (en banc) (No. 09-750), 2009 WL 5115221, at *1 (stating that the question presented is "whether the work-product privilege in Federal Rule of Civil Procedure 26(b)(3), which protects documents that are 'prepared in anticipation of litigation or for trial,' is limited to documents that are prepared for use in litigation").

281. *See supra* note 26 and accompanying text (offering examples of concerns raised in response to the *Textron* opinion).

282. *See supra* Parts IV.A, V.B.1 (discussing the majority's "for use" argument).

283. *See supra* Part V.B.1 (reconciling the "for use" section of the majority's argument with its affirmation of *Maine* and the remainder of the opinion).

correctly applied the established "because of" test and did not engage in the creation of a new "for use" test.

The majority opinion acknowledged existing precedent by referencing the "because of" test language in the *Maine* opinion, as well as its rejection of the "primary purpose" test.[284] Before providing any analysis or reasoning for its holding, the court stated that it was reaffirming its prior *Maine* decision.[285] Although stating the established precedent and affirming its application in the case at issue does not confirm that the court did in fact apply the established test in its analysis, doing so would be inconsistent with the decision to overrule precedent and apply a new test.[286] It does, however, leave open the possibility that the court incorrectly applied precedent in its analysis. The First Circuit admittedly provided arguments that are unclear and irrelevant to its holding, but the bulk of its analysis and reasoning corroborate that the "because of" test was correctly applied in *Textron*.

The majority considered the workpapers not prepared for litigation, but acknowledged that they related to a subject that "might or might not occasion litigation."[287] Its discussion of both the purpose and intended use of the workpapers is admittedly misleading.[288] The best explanation for it is that the court intended to refute the alleged dual-purpose nature of the workpapers by arguing that they would not be of any use in the litigation and, therefore, they do not deserve work product protection under the "because of" test.[289] Thus, the workpapers cannot be argued to serve a litigation purpose—or qualify as dual-purpose documents—if they are of no use in litigation and are merely related to a subject matter that has the potential to be litigated, especially when the potential for litigation is remote at the time of their creation.[290]

The majority's primary arguments included that (1) the work product doctrine is aimed at protecting work done for litigation and not financial statements, (2) the workpapers were prepared to gain approval of their

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284. *See Textron*, 577 F.3d at 26 (rejecting the "primary purpose" test and affirming the "because of" test as applied in *Maine*).

285. *Id*.

286. *See supra* note 27 and accompanying text (suggesting that *Textron* did not apply the "because of" test despite affirming its adoption).

287. *Textron*, 577 F.3d at 26.

288. *See supra* Part V.B.1 (arguing that the majority opinion welcomed criticism).

289. *Textron*, 577 F.3d at 28.

290. *See id.* at 29 ("It is not enough to trigger work product protection that the *subject matter* of a document relates to a subject that might conceivably be litigated.").

financial filings, and established regulations will discourage companies from providing less information despite knowing that it is not privileged information, and (3) IRS access to such information serves a "legitimate, and important, function of detecting and disallowing abusive tax shelters."[291] The determining factor in the decision is proof not only that the majority followed precedent, but also that it reached the right outcome under the "because of" test:

> In *Maine*, we said that work product protection does not extend to "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of litigation." . . . *Maine* applies straightforwardly to Textron's tax audit workpapers—which were prepared in the ordinary course of business . . . .[292]

Regardless of whether a court applies the "primary purpose" or "because of" test in its analysis, there is a universal understanding that the documents produced in the ordinary course of business will not be protected by the work product doctrine.[293] This interpretation of the "because of" test is consistent with both *Maine* and *Adlman*.[294] Thus, the majority's discussion of documents and materials prepared in the ordinary course of business confirms that it properly applied the "because of" test and arrived at the right decision.[295]

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291. *See supra* Part IV.A (discussing the rationale behind the majority's holding).

292. *Textron*, 577 F.3d at 30 (citations omitted).

293. *See supra* note 96 and accompanying text (providing in the Advisory Notes of Rule 26 that materials produced in the ordinary course of business will not be protected).

294. *See Textron*, 577 F.3d at 30 (providing that the work product doctrine does not extend to documents or materials created in the ordinary course of business, regardless of whether they contain legal opinions); Maine v. U.S. Dep't. of the Interior, 298 F.3d 60, 70 (1st Cir. 2002) (stating that the "because of" test does not protect from disclosure documents that are prepared in the ordinary course of business or that would have been created "in essentially similar fashion regardless of the litigation"); United States v. Adlman, 134 F.3d 1194, 1202 (2d Cir. 1998) ("[I]t should be emphasized that the "because of" formulation that we adopt here withholds protection from documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation. . . ."). The *Adlman* court added, "Even if such documents might also help in preparation for litigation, they do not qualify for protection because it could not fairly be said that they were created 'because of' actual or impending litigation." *Id.* (citations omitted).

295. *See Textron*, 577 F.3d at 30 ("A set of tax reserve figures, calculated for purposes of accurately stating a company's financial figures, has in ordinary parlance only that purpose: [T]o support a financial statement and the independent audit of it.").

### *VI. Tax Accrual Workpapers Do Not Deserve Work Product Protection*

After *Textron*, the "because of" and "primary purpose" tests remain the only tests currently adopted by the circuit courts to determine whether documents or materials are prepared "in anticipation of litigation."[296] *El Paso* and *Textron* establish that, under either test, a public corporation's tax accrual workpapers should not receive work product protection from an IRS summons.[297]

Regardless of the test applied by courts, a public corporation's workpapers should not be protected from an IRS summons. The underlying reasons for this conclusion are: (1) tax accrual workpapers fall under the "ordinary course of business" exception, (2) the potential for litigation at the time of their creation is too remote to be considered "in anticipation of litigation," (3) an IRS audit and subsequent administrative proceedings do not constitute "litigation" for work product doctrine purposes, (4) public policy favors erring on the side of more disclosure to the government when it involves tax-compliance and preventing tax-sheltering practices, and (5) the IRS has a substantial need for the information provided in a public corporation's tax accrual workpapers.

#### *A. Tax Accrual Workpapers Are Produced in the Ordinary Course of Business*

Regardless of the test applied by the court, and even if a public corporation can show that the tax accrual workpapers are prepared in anticipation of litigation, the work product doctrine will not apply if they are prepared in the "ordinary course of business."[298] Documents or materials that would have been created "in essentially similar form irrespective of the litigation"—meaning they would have been created in the absence of pending or future litigation—fall under the exception and are not entitled to work product protection.[299] The exception also applies to

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296. *See supra* notes 98–100 and accompanying text (providing that the Fifth Circuit applies the "primary purpose" test and the vast majority of other circuits apply the "because of" test). Some circuits have not yet addressed what test to apply when determining whether documents or materials are prepared "in anticipation of litigation."

297. *See supra* Parts III.B.1, IV (providing the summary and conclusions of *El Paso* and *Textron*).

298. *See supra* note 96 and accompanying text (providing the "ordinary course of business" exception to work product protection).

299. Maine v. U.S. Dep't. of the Interior, 298 F.3d 60, 70 (1st Cir. 2002) (citations

dual-purpose documents meeting those characteristics, regardless of whether they serve a litigation purpose.[300]

The "ordinary course of business" exception to work product protection is derived from the Advisory Committee's explanatory statement of Rule 26.[301] The Rule 26 Notes identify three types of materials that are not protected: (1) materials assembled in the ordinary course of business, (2) materials assembled pursuant to public requirements unrelated to litigation, and (3) materials assembled for other nonlitigation purposes.[302] "Each of the three categories focuses on the purpose for creation of the materials, not on the substantive content of the materials . . . ."[303] One of the cases cited as support for this assertion involved materials produced in compliance with statutory requirements, which led that court to conclude that they did not deserve work product protection.[304] The advisors could not have predicted the vast expansion of the administrative state since 1970, but the notes and referenced caselaw indicate that they did consider materials created for compliance with statutory or regulatory requirements to fall under the scope of the "ordinary course of business" exception.[305]

The contents of a corporation's tax accrual workpapers are only relevant in the determination of the purpose for their creation.[306] The function of the workpapers—the purpose for which they are created—is what determines whether they were prepared in anticipation of litigation.[307]

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omitted).

300. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 867 (providing how the exception applies to dual-purpose documents); *see also* EPSTEIN, *supra* note 59, at 887 ("If a document is prepared for something that people do all the time then it should not be given work-product protection just because litigation is also a possibility.").

301. *See* Proposed Amendments to the Federal Rules of Civil Procedure Relating to Discovery, Advisory Committee's Note to Rule 26, 48 F.R.D. 487, 501 (1970) ("Materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes are not under the qualified immunity provided by this subdivision.").

302. *See supra* note 301 (providing language from the Advisory Committee's Notes).

303. Lischer, *supra* note 57, at 556–57.

304. *See* Goosman v. A Duie Pyle, Inc., 320 F.2d 45, 52 (4th Cir. 1963) ("[The accident reports] were made in the ordinary course of business under ICC regulations and do not represent the lawyer's work product . . . ." (citations omitted)).

305. *See supra* note 301 and accompanying text (discussing the exceptions provided in the Advisory Committee's Notes).

306. *See* Ventry, *Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 878 (stating that determining whether the work product doctrine applies requires a court to ask why the materials were created, and that the contents of the materials are only relevant for answering why the materials were created).

307. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 870 (stating that

Even if a court considered the workpapers to contain predictions of potential litigation outcomes over particular transactions, it may do so only in determining the reason for their creation.[308] As stated, tax accrual workpapers are created to comply with regulations requiring the certification of a public corporation's financial statements, which is separate and unrelated to litigation.[309] They are prepared (1) in the ordinary course of business, (2) pursuant to public requirements unrelated to litigation, and (3) for nonlitigation purposes.[310]

A public corporation's tax accrual workpapers fall under the "ordinary course of business exception." They are created to comply with statutory requirements, which is a specific example provided by the Advisory Committee to show when the exception applies. The workpapers are not dual-purpose documents because they fail to serve any litigation purpose.[311] Even if considered to be dual-purpose documents, Textron's workpapers would have been created in essentially similar fashion to provide Ernst & Young with sufficient information to certify its financial statements, regardless of the potential for litigation over any of the items listed.[312] The functionality of tax accrual workpapers—to provide a corporation's outside auditor with sufficient information to certify the corporation's financial

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tax preparation materials require courts to recognize the difference between content and function, and that courts that focus on the content of the materials disregard "the work product doctrine's primary concern with *why* a document was prepared, rather than what it includes").

308. *See* Lischer, *supra* note 57, at 557 ("The subject matter of the tax accrual workpapers . . . might eventually result in litigation, but the tax accrual workpapers clearly are not prepared for, and are not part of, the litigation process . . . .").

309. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 870 ("While the *content* of tax materials—including tax accrual workpapers—can include discussions of potential litigation success or failure for particular transactions, the *function* of the materials . . . is mandated by independent, superseding authority unrelated to potential litigation.").

310. *See* Lischer, *supra* note 57, at 557 (stating that the workpapers fall within each of the three exceptions to the scope of the work product doctrine established by the Advisory Committee).

311. *See supra* notes 287–90 and accompanying text (explaining why a public corporation's tax accrual workpapers do not qualify as dual-purpose documents).

312. *See supra* note 35 and accompanying text (discussing Textron's reasons for creating tax accrual workpapers); *see also* EPSTEIN, *supra* note 59, at 885–86 (explaining that courts will grant work product protection to dual-purpose documents provided that one of the purposes is motivated by litigation, "provided that the documents would *not* have been prepared in substantially identical form even had there been no litigation purpose" (emphasis added)).

statements—is separate and independent from litigation.[313] That the content of the workpapers may be related to matters potentially litigated is irrelevant. Tax accrual workpapers fall under not one, but all three of the exceptions provided by the Advisory Committee's Notes.[314] It is unlikely that a proponent of applying work product immunity to the workpapers could prove that none of the three exceptions apply.[315] Thus, a public corporation's tax accrual workpapers are produced in the ordinary course of business and do not deserve work product protection.

### *B. Litigation Is Too Remote to Be Reasonably Anticipated*

Although the majority in *Textron* relies primarily on analysis of the motivational component to arrive at its holding, it is important to point out that the temporal component of "in anticipation of litigation" cannot be satisfied by a public corporation's tax accrual workpapers.[316] To satisfy the temporal requirement, a party seeking work product protection must show not only a subjective belief that litigation is realistically possible, but it must show that belief to be objectively reasonable at the time the documents or materials are created as well.[317]

Tax accrual workpapers expert Dennis Ventry, Jr. elaborates on what satisfies these requirements: "The mere mention or fear of being sued is not enough, nor is the remote possibility of future litigation. Rather, for a court to grant work product immunity, the applicant must demonstrate a more immediate showing of anticipated litigation . . . ."[318] Federal courts have interpreted the temporal component of "anticipation of litigation" to mean "litigation is imminent," "litigation is impending," "there is more than an inchoate chance of litigation," and "there is more than a remote prospect of

313. *See Textron*, 577 F.3d at 23–24 (providing the purpose for preparing tax accrual workpapers).

314. *See supra* note 301 and accompanying text (providing the Advisory Committee's Notes).

315. *See* Lischer, *supra* note 57, at 557 (discussing the possibility for tax accrual workpapers to fall under all three exceptions to work product protection).

316. *See supra* Part III.A.1 (discussing the temporal component of "in anticipation of litigation").

317. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 880 (arguing that anticipating litigation is never reasonable with respect to the creation of tax accrual workpapers).

318. *Id.* at 877 (citations omitted).

litigation."[319] A popular treatise on the subject states that "for work-product protection from discovery to attach to a particular document, the probability of litigation must be substantial and the commencement of litigation must be imminent."[320]

It is unlikely that the creation of the workpapers could satisfy any of these standards.[321] The tax returns at issue in *Textron* were from 1998–2001, and notice of the IRS audit for this period was in 2003.[322] That means that, at the earliest, Textron could have an objectively reasonable belief that litigation was possible at least two years after the creation of the tax accrual workpapers at issue.[323] If documents created at least two years prior to having more than an inchoate possibility of litigation are considered to be "in anticipation of litigation," it is difficult to know what, if any, materials would actually fail to satisfy the temporal component.

If the First Circuit had extended work product protection to cover the tax accrual workpapers in *Textron*, then it would have vastly expanded the scope of the doctrine beyond what it was originally intended to cover.[324] Unless the temporal component of "anticipation of litigation" is disregarded altogether, a public corporation's tax accrual workpapers and the reasons for their creation are too remote from the possibility for potential litigation to be considered prepared in anticipation of litigation.[325]

### *C. An IRS Audit and Subsequent Proceedings Do Not Qualify as Litigation*

Despite common misconceptions about what an IRS audit entails, courts cannot correctly conclude that an IRS audit is litigation.[326] A

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319. SPAHN, *supra* note 63, at 468–70.

320. EPSTEIN, *supra* note 59, at 884.

321. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 880 ("The temporal connection between preparation of the documents and the commencement of litigation is too attenuated and fraught with uncertainty to support immunizing documents from discovery under the work product doctrine.").

322. *See Textron*, 577 F.3d at 23 (providing background facts of the case).

323. *See* Lischer, *supra* note 57, at 554 ("[A]ctual litigation is not imminent or even likely at the time of preparation of tax accrual workpapers.").

324. *See supra* notes 70–75 and accompanying text (providing the underlying reasons for the work product doctrine's creation in *Hickman*); *see also* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 882 (expressing concern about expanding the work product doctrine beyond its intended limitations).

325. *See* Lischer, *supra* notes 57, at 557 (stating that tax accrual workpapers are not prepared for litigation and are prepared out of business necessity).

326. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at

corporation may reasonably anticipate an annual IRS audit, but doing so does not mean that it can also reasonably anticipate litigation.[327] "The relationship between taxpayers and the government is *not* inherently adversarial, particularly as that term is used to describe litigation in the context of work product analysis. Planning a transaction, reporting a position on a return, or even undergoing an audit is far removed from the adversarial arena."[328]

Although there is the potential for tax disputes to be litigated between a taxpayer and the IRS, the administrative process of undergoing an audit does not constitute an adversarial proceeding.[329] An IRS audit has in fact been called the "antechamber to litigation," and is intended to be cooperative rather than adversarial.[330] A subsequent administrative challenge or proposed adjustment does not include an important element of litigation or an adversarial hearing—the ability to cross-examine witnesses.[331] The U.S. Supreme Court provides a useful summary of what a taxpayer can expect after receiving notice of an IRS audit:

> [The IRS] conducts examinations or audits of taxpayers' returns and affairs. If, after the conclusion of the audit and any internal administrative appeals, the IRS concludes that the taxpayer owes a deficiency, it issues a formal notice of deficiency . . . . Upon receiving notice of deficiency, the taxpayer has, broadly speaking, four options: (1) he can accept the IRS's ruling and pay the amount of the deficiency; (2) he can petition the Tax Court for a redetermination of the deficiency; (3) he can pay the amount of deficiency and, after exhausting an

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880 (stating that there is a demonstrated misunderstanding of tax dispute resolution procedures among the federal courts).

327. *See* Abel Inv. Co. v. United States, 53 F.R.D. 485, 490 (D. Neb. 1971) (stating that an IRS audit is not litigation).

328. Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 870–71 (citations omitted).

329. *See* 8 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, FEDERAL PRACTICE & PROCEDURE § 2024, at 502–03 (2010) ("[L]itigation should be understood generally to include proceedings before administrative tribunals *if they are of an adversarial nature*." (emphasis added)).

330. United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999).

331. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 880 (arguing that "tax administration does not amount to an adversarial proceeding" for purposes of the work product doctrine). Although the Federal Rules of Civil Procedure do not define "litigation," the Special Master's Guidelines for the Resolution of Privilege Claims define it as "a proceeding in court or administrative tribunal in which the parties have the right to cross-examine witnesses or to subject an opposing party's presentation of proof to equivalent disputation." Willingham v. Ashcroft, 228 F.R.D. 1, 4 (D.D.C. 2005) (citations omitted).

> administrative claim, bring suit for a refund in the Claims Court or in district court; or (4) he can do nothing and await steps by the IRS or the Government to collect the tax.[332]

The IRS has the ability to collect tax by nonjudicial means, and the potential for litigation does not refute that the IRS seeks to use materials in an "extrajudicial" assessment of a tax deficiency.[333] Additionally, the IRS provides ample alternatives to litigation that are used more frequently to resolve tax disputes; these include (1) claims processing, (2) negotiation procedures, and (3) settlement procedures.[334] Any disputed issue always has the potential to be litigated, so the fact that an IRS audit may lead to litigation over a disputed tax position is unpersuasive. An IRS audit and subsequent administrative hearings do not amount to litigation or give a taxpayer a reasonable belief that litigation is imminent.[335]

Textron's particular relationship with the IRS is further evidence that an IRS audit rarely leads to litigation.[336] During Textron's previous eight audit cycles dating back to 1959, among the thousands of proposed adjustments by the IRS, the parties litigated disputed issues only three times.[337] That amounts to less than 1% of the proposed adjustments, which corroborates that the likelihood of an IRS audit ever leading to litigation is minimal, if not nonexistent.[338] Even the litigation at issue in *Textron* arose out of the unusual request for a corporation's tax accrual workpapers, due

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332. United States v. Baggot, 463 U.S. 476, 478 (1983) (citations omitted).

333. *See id.* at 480–81 (arguing that the purpose of an IRS audit is not to prepare or conduct litigation but "to assess the amount of tax liability through administrative channels").

334. *See* MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 1.08[3] (2d rev. ed. 2005) (listing the informal administrative actions provided by the IRS, which account for the most frequent manner in which the IRS acts to carry out its statutory mandate).

335. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 882 ("The relationship between the parties may later become adversarial, but not before the taxpayer has exhausted all levels of administrative review, and not merely because the IRS seeks adjustment to the taxpayer's liability.").

336. *See Textron*, 577 F.3d at 24 ("Textron agreed that it usually settled disputes with the IRS through negotiation or concession or at worst through the formal IRS administrative process; but it testified that sometimes it had litigated disputed tax issues in federal court.").

337. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 882 (providing background information about Textron's relationship with the IRS).

338. *See id.* (stating that as a "matter of logic or mathematical probability" a corporation can never reasonably anticipate litigation with the IRS when creating its tax accrual workpapers). The Supreme Court has conceded, with respect to litigation being a remote contingency of an IRS audit, that "[t]here may conceivably be instances in which the chances of litigation are so low that it cannot be considered a realistic possibility . . . ." United States v. Baggot, 463 U.S. 476, 483 n.7 (1983).

to the IRS's inability to understand Textron's SILO transactions without more information to clarify ambiguities on its tax return.[339] Thus, only when the IRS manages to identify, investigate, and dispute a particular tax item on a corporation's return, and the corporation manages to exhaust all of its administrative avenues,[340] is litigation a possibility.[341] The potential for an IRS audit and subsequent administrative proceedings is not litigation for purposes of the work product doctrine. Therefore, a public corporation's tax accrual workpapers, at the time of their creation, are not prepared "in anticipation of litigation."

### *D. Public Policy Favors Compliance and the Exposure of Tax-Sheltering Activities*

The First Circuit in *Textron* acknowledged the public policy concerns related to enforcing the country's tax laws effectively and promoting the transparency of public corporations.[342] The tax returns of corporate taxpayers often involve a high volume of sophisticated transactions and typically run thousands of pages.[343] Requiring the disclosure of tax preparation materials, such as tax accrual workpapers, for public corporations will aid the IRS effort to (1) identify tax-sheltering transactions, (2) verify the accuracy of the taxpayer's return, and (3) evaluate the substance of the transaction—which are crucial to the effective enforcement of the nation's self-assessment system.[344] Some may

339. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 881 (providing background facts of *Textron*).

340. *See id.* at 881–82 (providing examples of administrative avenues available to a taxpayer, including (1) negotiations, (2) conferences with IRS audit managers, (3) accelerated resolution through fast-track settlement program, and (4) independent review by the IRS Office of Appeals).

341. *See id.* at 882 (arguing that litigation will occur in "exceedingly rare circumstances").

342. *See Textron*, 577 F.3d at 31 ("The practical problems confronting the IRS in discovering under-reporting of corporate taxes, which is likely endemic, are serious. . . . It is because the collection of revenues is essential to government that administrative discovery, along with many other comparatively useful tools, are furnished to the IRS.").

343. *See id.* ("Textron's return is massive—constituting more than 4,000 pages . . . .").

344. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 871 (stating that tax preparation materials would complement the IRS's regulatory functions); Lischer, *supra* note 57, at 534 ("The U.S. tax system relies to a significant extent on self-reporting by taxpayers, and enforcement of such a self-reporting system requires that the IRS be given appropriate investigatory tools to confirm that the self-reporting was correct.") (citations omitted).

argue that such disclosures are "unfair" to the taxpayer,[345] but permitting the IRS to use these materials "reinforces legislative and regulatory antishelter efforts emphasizing transparency rather than secrecy, more rather than less cooperation."[346]

The U.S. Supreme Court firmly established that public policy is in favor of more disclosure to the government with respect to a taxpayer's tax liability: "Our complex and comprehensive system of federal taxation, relying as it does upon self-assessment and reporting, demands that all taxpayers be forthright . . . . Without such disclosure, and the concomitant power of the Government to compel disclosure, our national tax burden would not be fairly and equitably distributed."[347] The Supreme Court's broad interpretation of the IRS summons power under 26 U.S.C. § 7602[348] favors disclosure even when a countervailing interest exists.[349] In this context, allowing the IRS to request a public corporation's tax accrual workpapers serves the substantial public interest of promoting fair and equal enforcement of the nation's tax laws, which significantly outweighs any countervailing interest underlying the "I want to keep this information hidden, but I have nothing to hide" argument.[350]

Recent laws and regulations that promote the transparency of public corporations also reflect the necessity to ensure tax compliance and expose tax-sheltering practices.[351] The Sarbanes-Oxley Act of

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345. *See Textron,* 577 F.3d at 31 ("Textron apparently thinks it is 'unfair' for the government to have access to its spreadsheets, but tax collection is not a game.").

346. Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 871.

347. United States v. Arthur Young, 465 U.S. 805, 815–16 (1984).

348. *See* 26 U.S.C. § 7602(a) (2006) (stating that "for the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax . . . or collecting any such liability" the IRS commissioner is authorized to examine and summon certain materials).

349. *See* United States v. Euge, 444 U.S. 707, 715–16 (1980) ("There is thus a formidable line of precedent construing congressional intent to uphold the claimed enforcement authority of the [IRS] if such authority is necessary for the effective enforcement of the revenue laws . . . ."); Lischer, *supra* note 57, at 534–36 (providing examples of the Supreme Court's interpretation of the IRS summons power and concluding that providing the IRS effective enforcement tools is a substantial public interest).

350. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 879 ("In the world of tax regulation, taxpayers and their advisors possess the information that tax regulators seek. The goal is to keep as much of the information from the IRS as possible, and taxpayers pay considerable sums of money to those advisors most skilled at concealment.").

351. *See supra* note 19 and accompanying text (discussing how the tax gap and drop in public confidence concerning the reliability of public companies' financial statements led to

2002[352] imposes broad-sweeping regulation on corporations, requires principal executive officers and principal financial officers to certify financial statements and internal controls under penalties of perjury, and mandates greater disclosure of information to regulators and investors.[353] The Financial Accounting Standards Board's Financial Interpretive Statement 48 (FIN 48)[354] establishes baseline "criteria for the recognition, derecognition, measurement, classification, and disclosure of the financial impact of a company's income tax positions."[355] FIN 48 requires public corporations to assess whether their tax positions are more-likely-than-not sustainable upon examination, and if a particular position does not meet that threshold then the corporation must provide adequate reserves to cover any related contingent liabilities.[356] Additionally, recent amendments to Circular 230[357] require practitioners to disclose to the taxpayer and the government tax positions that do not meet the more-likely-than-not standard for sustainability.[358] The amendments further specify that "disclosures failing to meet the [more-likely-than-not] standard must state the fact prominently" and "the opinion cannot be used by the taxpayer for purposes of avoiding underpayment penalties."[359] These are only a few

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sweeping reform to promote compliance, transparency, and disclosure).

352. *See* The Sarbanes-Oxley Act of 2002, Pub. L. No 107-204, 116 Stat. 745 (2002) (subjecting corporations to stricter disclosure rules and internal controls, and establishing the Public Company Accounting Oversight Board to regulate auditors of public companies).

353. *See* Jung, *supra* note 17, at 393–94 (stating that the Act was passed in response to the "growing flurry of scandals"); Wells, *supra* note 6, at 651–52 (describing the Sarbanes-Oxley Act's elements).

354. *See* Fin. Accounting Standards Bd., *FASB Interpretation No. 48: Accounting for Uncertainty in Income Taxes*, in 281-B FINANCIAL ACCOUNTING SERIES 3 (June 2006) (stating that evaluating a company's tax position requires (1) determining if the tax position is more-likely-than-not to be sustained upon examination, and, if so, (2) a recognition on the company's financial statement of the largest amount benefit that has a greater than 50% likelihood of being realized).

355. Wells, *supra* note 6, at 654.

356. *See id.* at 654–56 (discussing the requirements and effect of FIN 48); Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 883 (describing the elements of FIN 48, and how FIN 48 affects disclosures on financial statements of public corporations).

357. *See* Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service, 31 C.F.R. § 10 (2011) (establishing rules governing the recognition of attorneys, certified public accountants, enrolled agents, and other persons representing taxpayers before the IRS).

358. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 882 (describing the increased reporting requirement of tax practitioners under Circular 230).

359. *Id.*

examples of the effort to promote transparency and disclosure, which favors *Textron*'s refusal to extend work product protection to tax accrual workpapers.

It is apparent from Supreme Court opinions,[360] recent regulatory efforts,[361] and general public sentiment[362] that public policy favors the disclosure of tax accrual workpapers rather than supporting their protection under the work product doctrine.[363] Noncompliance and tax-sheltering practices are well-evidenced problems. Statistics show that large corporations have claimed tax benefits ranging in the hundreds of millions to billions of dollars, due mainly to their ability to underpay tax obligations and then take a wait-and-see-approach under the nation's self-assessment system.[364] This approach to paying taxes places "a significant burden on the IRS and increases the ongoing tax gap at a time when the country needs to motivate its taxpayers to pay their taxes in full in a timely way."[365] Thus, encouraging tax compliance and discouraging tax-sheltering practices are substantial public policy concerns that favor the disclosure of a public corporation's tax accrual workpapers in this context.[366]

### *E. The IRS Has a Substantial Need for Tax Accrual Workpapers*

Federal Rule of Civil Procedure 26 provides that even if documents or materials are prepared in anticipation of litigation or for trial, they can be discoverable if the party challenging work product protection "shows that it

360. *See supra* notes 347–50 and accompanying text (providing the Supreme Court's support for disclosure and enforcement).

361. *See supra* notes 351–59 and accompanying text (offering examples of the regulatory effort to require disclosure, transparency, and compliance).

362. *See supra* note 1 and accompanying text (providing statistically, in 2010, that 97% of Americans agree it is every American's civic duty to pay their fair share of taxes, and that 96% of Americans agree everyone who cheats on their taxes should be held accountable).

363. *See supra* note 20 and accompanying text (providing statistically that the majority of Americans (98%) feel that it is more important to ensure that corporations are reporting and paying taxes correctly than high-income taxpayers, small businesses, and low-income taxpayers).

364. *See supra* note 12 and accompanying text (providing 2007 statistics that reveal S&P 500 companies have claimed tax benefits ranging in the hundreds of millions to billions of dollars); Wells, *supra* note 6, at 692–93 (discussing the historical leniency of the self-assessment tax system and the potential to abuse it).

365. Wells, *supra* note 6, at 692.

366. *See id.* at 661 ("[I]t is now time to require taxpayers to only take tax positions that the taxpayer believes is correct and to not accept the notion that a taxpayer can purposely underpay the tax obligations that the taxpayer believes is due.").

has a substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means."[367] The Advisory Committee emphasized that courts, in determining whether a substantial need exists, should consider "the likelihood that the party, even if he obtains information by independent means, will not have the substantial equivalent of the documents the production of which he seeks."[368] Although this doctrine is commonly applied to situations where (1) a witness is not available, (2) the party has a substantial need for that witness's information, and (3) the party cannot otherwise receive it, the IRS can argue that it should be applied with respect to the discoverability of a public corporation's tax accrual workpapers.[369]

To compel discovery of documents or materials due to a substantial need, a party must show that (1) a substantial need for the information exists, (2) there is an inability to acquire the information or its substantial equivalent, and (3) the information or its substantial equivalent cannot be acquired by other means without undue hardship.[370] The district court, which incorrectly characterized Textron's workpapers as opinion work product, concluded that the IRS failed to show a substantial need sufficient for both ordinary work product—documents or materials—and opinion work product.[371] The court argued that the workpapers were not relevant to determining Textron's tax liability and that the IRS could acquire relevant facts through "information document requests" and other means.[372] However, the district court erroneously overlooked the importance of the information provided in a public corporation's workpapers and the IRS's inability to acquire that information or its substantial equivalent without undue hardship.[373]

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367. FED. R. CIV. P. 26(b)(3)(A)(ii).

368. Proposed Amendments to the Federal Rules of Civil Procedure Relating to Discovery, Advisory Committee's Note to Rule 26, 48 F.R.D. 487, 501 (1970).

369. *See* 8 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, FEDERAL PRACTICE & PROCEDURE § 2024 (2010) (discussing how parties generally use the substantial need exception to compel discovery).

370. *See* SPAHN, *supra* note 63, at 587–613 (providing what must be proven to show a substantial need for documents or materials).

371. *See* United States v. Textron Inc. & Subsidiaries, 507 F. Supp. 2d 138, 154 (D.R.I. 2007), *rev'd*, 577 F.3d 21 (1st Cir. 2009) ("[T]he IRS has failed to carry the burden of demonstrating a 'substantial need' for ordinary work product, let alone the heightened burden applicable to Textron's tax accrual workpapers, which constitute opinion work product.").

372. *See id.* at 155 (explaining why the IRS failed to prove a substantial need for Textron's workpapers).

373. *See* Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at

The IRS may raise several arguments to prove it has a substantial need for a public corporation's tax accrual workpapers. It can argue that (1) the IRS cannot perform its regulatory function of enforcing tax law effectively without this information, (2) failure to hold corporate taxpayers accountable will place a heavier burden on those taxpayers that do fulfill their tax obligations, and (3) allowing this information to remain privileged will encumber efforts to promote compliance and maintain the legitimacy of the country's self-assessment tax system.[374] The general understanding that it is important to pay taxes—along with the importance of enforcing established tax law, ensuring equality and fairness among taxpayers, and encouraging compliance in general—corroborates that the IRS has a substantial need for tax accrual workpapers.[375] Corporate tax returns are dense and complex, and are commonly thousands of pages long.[376] Without the information provided in tax accrual workpapers, there is a high probability that unsustainable tax positions will be overlooked due to the "volume of materials and the complexity of tax shelter transactions involved, combined with the funding and personnel deficiencies that continue to plague the IRS."[377] Even if the IRS manages to identify suspicious tax positions, it may still require more information about the transaction to make a proper determination.[378] These impediments against properly enforcing tax laws establish that there is a specified, substantial need for the information in a public corporation's tax accrual workpapers.

Reviewing a public corporation's tax return and financial statements does not provide the same or the substantial equivalent of the information contained within its tax accrual workpapers. As stated previously, corporate tax returns are highly complex, commonly thousands of pages long, and there is a high probability that many tax sheltering or abusive

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883 (stating that the district court failed to examine the documents Textron claimed to be privileged and based its findings on pleadings, affidavits submitted by parties, and evidence presented at hearing).

374. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 884 (providing examples of what may constitute a substantial need in this context).

375. *See* Roberts, *supra* note 27, at 76–77 (arguing that the public policy concerns raised in *Textron* and *El Paso* support granting the IRS access to tax accrual workpapers under the "substantial need" exception).

376. *See, e.g.*, *Textron*, 577 F.3d at 31 (noting that Textron's tax return was over 4,000 pages long).

377. Ventry, *A Primer on Tax Work Product for Federal Courts*, *supra* note 10, at 881 (citations omitted).

378. *See id.* (discussing the obstacles faced by the IRS in enforcing tax law).

transactions will go unnoticed during an IRS audit.[379] Even if identified, the information provided in tax accrual workpapers may still be required to determine what tax liability exists. Sifting through thousands of pages on an item-by-item basis is not the substantial equivalent of a spreadsheet listing each debatable tax item, its respective dollar amount subject to possible dispute, and the probability of liability for each item listed.[380] Similarly, a public corporation's financial statements "do not normally identify the specific tax items on the return that may be debatable but incorporate or reflect on a total reserve figure."[381] The aggregate amount on reserve for tax contingent liabilities provides minimal information about specific tax positions taken and is not the same as or the substantial equivalent of the specific, item-by-item information provided in a public corporation's tax accrual workpapers. Thus, a tax return or financial statement, or the combination of both, is not a substantial equivalent to tax accrual workpapers.

Finally, the IRS can point to its limited resources and the complexity of potential tax sheltering or abusive transactions as evidence of the undue hardship it faces without access to a public corporation's tax accrual workpapers.[382] Such efforts require the IRS "to expend an ever increasing level of audit effort to uncover complicated and difficult planning techniques that nobody believes will work but can provide substantial underpayments if not properly discovered on audit."[383] Therefore, it is likely that the IRS can satisfy all three elements required to show a substantial need for a public corporation's tax accrual workpapers.

## *VII. Conclusion*

As stated and correctly applied—when determining whether a public corporation's tax accrual workpapers should be discoverable under an IRS summons—the current Federal Rule of Civil Procedure 26 leaves only the opportunity for absolute victory on behalf of the government or the public

379. *See Textron*, 577 F.3d at 31 (describing corporate tax returns as complex and voluminous, which justifies the administrative discovery powers granted to the IRS).

380. *See id.* at 23 (describing Textron's tax accrual workpapers).

381. *Id.*

382. *See supra* note 13 and accompanying text (acknowledging the personnel and resource deficiencies of the IRS, and the ability to hide abusive transactions from an audit due to the disclosure gap).

383. Wells, *supra* note 6, at 692.

corporation. Either the workpapers will be protected by the work product doctrine, leaving the IRS with little investigatory powers beyond taking corporations at their word, or the workpapers are not protected by the work product doctrine, leaving the taxpayer to decide what to disclose and how to maintain privilege protection in the future. This all-or-nothing outcome could be remedied by an amendment to Rule 26(b)(3) that addresses the doctrine's application in a regulatory context, such as a sliding scale approach.[384] But until a resolution gains enough momentum to change the meaning of "in anticipation of litigation," the billion-dollar question is: Who should win?[385]

Both circuit courts that have addressed this issue decided against extending work product protection to a public corporation's tax accrual workpapers.[386] For the reasons stated in this Note, a public corporation's tax accrual workpapers are undeserving of work product protection from an IRS summons, regardless of the test applied by the court. The remaining circuit courts that have not addressed the issue, and district courts outside of the First and Fifth Circuits, should view *El Paso* and *Textron* as exceedingly persuasive authorities.

Despite the controversy surrounding the *Textron* opinion, the First Circuit placed a reasonable limitation on the work product doctrine's scope and helped to level the playing field between the IRS and public corporations. The First Circuit correctly chose to give the government

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384. *See* Ventry, *Protecting Abusive Tax Avoidance*, *supra* note 13, at 884 ("We might consider . . . a sliding scale of protection for attorney work product . . . . Under a sliding scale analysis . . . a court could grant varying degrees of immunity depending on the strength of the applicant's showing.").

385. *See supra* note 12 and accompanying text (providing 2007 statistics of tax benefits received by S&P 500 companies, ranging from the millions to billions).

386. *See Textron*, 577 F.3d at 26 (concluding that the work product doctrine does not protect tax accrual workpapers from disclosure); United States v. El Paso Co., 682 F.2d 530, 543 (5th Cir. 1982) ("[W]e believe that the tax pool analysis does not contemplate litigation in the sense required to bring it within the work product doctrine."). The United States Court of Appeals for the District of Columbia acknowledges both *Textron* and *El Paso* in a case where the government relied on their rejection of work product protection of tax accrual workpapers to compel disclosure of corporation's memorandum, drafted by an independent auditor, because it was prepared during the audit process. *See* United States v. Deloitte LLP, 610 F.3d 129, 133 (D.C. Cir. 2010) (providing reasons for appeal from district court's denial of discovery); *id.* at 138 ("The government argues that *El Paso* and *Textron* demonstrate that when a document is created as part of an independent audit . . . its sole function is to facilitate that audit, which means it was not prepared in anticipation of litigation."). The court chose to distinguish the case from *Textron* or *El Paso*, rather than refute their holdings, but stated that "material developed in anticipation of litigation can be incorporated into a document produced during an audit without ceasing to be work product." *Id.*

broader discovery powers in this narrow, regulatory context rather than permit public corporations to continue underpaying tax obligations and claim tax benefits ranging in the hundreds of millions to billions of dollars. *Textron* is the correct answer to a billion dollar question.