WAIVING THE ATTORNEY-CLIENT PRIVILEGE IN "HYBRID" INTERNAL REVENUE SERVICE INVESTIGATIONS

I. INTRODUCTION

Representation of clients for tax matters presents a member of the legal profession with an abundance of responsibilities – wholly aside from the Internal Revenue Code. For example, a tax lawyer, as in any area, owes an ethical obligation of confidentiality to his client. This generally precludes voluntary disclosures by the lawyer.[1] It has been argued that, based on the relationship between the individual and the government in a tax dispute, a greater obligation of individual disclosure is required than in other litigated areas.[2]

A related principle is the attorney-client privilege, a rule of evidence that limits the information that can be extracted from the attorney. This information will remain confidential if the communication in question was between the attorney and client, and if it meets certain requirements. The client must seek legal advice, as well as be in an expectation of confidentiality.[3] The attorney-client privilege is the oldest of the privileges for confidential communications, and is more restricted in scope than those confidences falling under the ethical obligation of

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1. *See* B. WOLFMAN & J. HOLDEN, ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE 104 (1985) (quoting MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (Model Rules): "[a] lawyer shall not reveal information relating to the representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation").

2. The argument states that the rules protecting "client confidences" should take into account the balance of power between the individual and the government, and tilt it toward the government. *See* Popkin, *Client-Lawyer Confidentiality*, 59 TEX. L. REV. 755, 775-76 (1981).

3. *See* 8 J. WIGMORE, EVIDENCE § 2292 (McNaughton rev. 1961). The general requirements for invoking the privilege are as follows: (1) Where legal advice of any kind is sought, (2) from a professional legal advisor in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence, (5) by the client, (6) are at his instance permanently protected, (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived. *Id.* The privilege is said to promote freedom of consultation of legal advisers by clients, allowing an unlimited flow of information between attorney and client, and enabling the attorney to give informed legal advice. *Id.* § 2291.

confidentiality.[4] Those privileges, though, are more durable.[5]

Application of the attorney-client privilege in the tax field, just as with the ethical obligation of confidentiality, may present the practitioner with responsibilities not found in other areas. For during an actual Internal Revenue Service investigation, the nature of the inquiry is a "hybrid civil-criminal investigation."[6] The investigative focus is not identifying the perpetrator of a reported crime (as in the normal police investigation), but whether or not a crime has been committed.[7]

One responsibility related to the privilege is understanding the breadth of the client's waiver. If the client voluntarily discloses privileged information at one stage of an IRS investigation (*e.g.*, a civil audit), the attorney must be informed as to the result of an attempt at claiming the privilege during a later stage (*i.e.*, the criminal investigation). The attorney must also know that normally the government is free to use information legitimately obtained during a civil audit for later criminal

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4. These confidential communications, formerly "secrets" under the ABA Code of Professional Responsibility, arise whether or not the client has sought legal advice. *See* ABA CODE OF PROFESSIONAL RESPONSIBILITY (ABA Code), DR 4-101(A) (secret referring to "other information gained in the professional relationship that the client has requested to be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client"). *See generally* Comment, *Extrajudicial Disclosures of Confidential Communications—A Continuing Dilemma for the Lawyer*, 1 J. LEGAL PROF. 93, 97 (1986).

5. The ethical obligation of confidentiality confronting a lawyer extends to all confidences of the client, from any source whatsoever, whereas the attorney-client privilege only arises (along with the other requirements) when legal advice is sought. The attorney-client privilege is generally waived on disclosure to third parties; the ethical obligation continues to exist despite the transmission of the same matter to third parties. A primary distinction is that the ethical obligation disallows only voluntary disclosure by a lawyer. For example, a court-ordered disclosure will end the obligation, when the attorney-client privilege extends beyond merely the voluntary disclosure scenario. *See generally* B. WOLFMAN & J. HOLDEN, *supra* note 1, at 110; Comment, *supra* note 4, at 97.

Thus, the attorney-client privilege is perhaps more durable in a sense. But, as cases have noted, the attorney-client privilege is at best a fragile, easily waivable right, with no presumption of its continuance. It is required to be strictly construed within the narrowest possible limits. *See* E. CLEARY, MCCORMICK ON EVIDENCE § 93 (3d ed. 1984) [hereinafter MCCORMICK].

6. United States v. Leahey, 434 F.2d 7, 8 (1st Cir. 1970).

7. *Id.* at 8 (noting that suspects are rarely interrogated while in custody during an IRS investigation, differing from a typical police investigation). *See also* Duke, *Prosecutions for Attempts to Evade Income Tax: A Discordant View of a Procedural Hybrid*, 76 YALE L.J. 1, 2-3 (1966) (stating that income tax prosecutions have run against the main currents of criminal prosecutions generally, based on the fact that civil and criminal sanctions apply to the same conduct and are invoked by the same officials).

prosecution.[8]

Members of the legal profession (whether a tax specialist or not) should generally be aware of particular scenarios of client disclosures that waive the attorney-client privilege in relation to this dual civil-criminal investigation. With the goal of a fully informed and protected client, the attorney holds a duty to make every effort to preserve the client's privilege.

II. The Breadth of a Waiver

In order to waive the attorney-client privilege, there must be an intention to relinquish a known right; the waiver can be words expressing the intent to waive it, or conduct such as partial disclosure.[9] The power to waive the privilege falls exclusively on the client.[10]

The breadth of this waiver presents several initial questions during a tax dispute. Based on the combined civil-criminal nature of an IRS investigation,[11] waiver may occur during what the client believes is solely a civil affair. Would this effective "civil waiver" constitute a continuous waiver on through the later developing criminal stages of the investigation, opening up the door to questions of self-incrimination?

Clearly, waiving the privilege at one stage of a trial will see a claim of confidentiality overruled, if that party attempts to invoke the privilege in the same trial.[12] Any alternative result would leave the privilege holder with an unfair advantage. In the words of Justice Holmes in the landmark case of *Green v. Crapo*:[13]

> the privacy for the sake of which privilege was created was gone by the appellant's own consent, and the privilege does not remain under such circumstances for the mere sake of giving the client an additional weapon to use or not at his own choice.[14]

This general rule of law, however, does not clearly define the breadth of the waiver of the attorney-client privilege in the previously discussed civil-criminal tax investigation. Would a waiver during a civil audit—if the taxpayer during this investigation had no inclination of

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8. Donaldson v. United States, 400 U.S. 517 (1971).

9. McCormick, *supra* note 5, § 93.

10. *Id.* The client as holder of the privilege can thus waive it alone or through authorizing an attorney, agent or representative. *Id.*

11. *See supra* notes 6-7 and accompanying text.

12. McCormick, *supra* note 5, § 93.

13. 181 Mass. 55, 62 N.E. 956 (1902).

14. *Id.* at 57, 62 N.E. at 959.

criminal overtones—also carry over to the criminal portions, and fit the "current trial" rule and thus equal a permanent waiver?[15]

III. A VOLUNTARY DISCLOSURE IS A PERMANENT WAIVER: *United States v. Miller*

Factually, *United States v. Miller*[16] fits the overall scenario of the attorney-client privilege being waived in the process of a civil tax audit, and later developing into a criminal investigation. As part of an IRS audit of the Millers' pawn shop, ledger books were turned over to the investigating agent for the purpose of handwriting and ink analysis.[17] The IRS agents, after having made copies of the books, returned the ledgers on demand of the Millers' attorney. Shortly thereafter, a criminal investigation[18] of the same taxpayer ensued[19] and, pursuant to Federal Rules of Criminal Procedure Rule 17(c), a subpoena for the ledgers in question was issued.

The attorney for the Millers refused to turn the ledger books over, asserting the attorney-client privilege, and the protection afforded by

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15. It is said that a publicly made waiver of the privilege in the trial of one case will see a claim of the privilege in another separate case fail. The analogy is to the rule denying a claim of the attorney-client privilege when a third person is present at the time the client consults with the attorney. *See* MCCORMICK, *supra* note 5, § 93. Similarly, it is generally stated that disclosure of any significant portion of a confidential communication waives the privilege as to the whole. United States v. Davis, 636 F.2d 1028, 1043 (5th Cir. 1981).

16. 660 F.2d 563 (5th Cir. 1981).

17. A separate issue was whether the person turning over the books actually had authority to do so, thus another defense to the claim that the privilege was not waived. The Millers' lawyer had hired an accountant as an aide for the audit, who turned over the ledger books. *Miller*, 660 F.2d at 570, 571. The court found that the disclosure was voluntary, and was aided by the fact that a power of attorney was signed by the Millers authorizing the action for this specific IRS matter. The court also stated that an attorney holding an implied authority from a client may disclose client confidences "when necessary in the opinion of the attorney," and that the waiver would stand, save a showing of attorney bad faith. *Id.* at 571, 572 (quoting 8 WIGMORE, EVIDENCE § 2325).

18. The criminal investigation was "accepted" by the IRS Intelligence Division in October of 1976, after having rejected the referral from the civil audit revenue agent on two prior occasions. The time period of the fraud in question occurred from 1973-75, during which civil audits took place in all three years. *Miller*, 660 F.2d at 564, 565.

19. The Millers were never informed during any of the three referrals to the Intelligence Division of the suspected criminal overtones. The final referral, which was accepted, occurred two days after the two books were turned over to the revenue agent. *Id.* at 565.

the privilege to preexisting documents turned over to the attorney to obtain legal advice.[20] The government, with possession of the copies already in hand, sought more extensive testing, and claimed that the ledger books in issue were no longer confidential because of their prior voluntary disclosure.[21]

Based on the "current trial" rule of waiver[22] and *United States v. Pipkins*,[23] the court in *Miller* held that refusing to comply with the subpoena was improper. The previous voluntary disclosure to the IRS of the books at issue stripped those books of their confidential nature, and in turn the attorney-client privilege could not be asserted. It also said that without this privilege, the Millers' could not assert their fifth amendment privilege against self-incrimination.[24]

There was a dissent in *Miller*. That opinion made mention of the civil-criminal nature of an IRS investigation, framing the central question of the case as whether the "voluntary production of personal papers in a civil tax audit constitutes an absolute unconditional waiver of all rights (including the Fifth Amendment) when criminal proceedings follow thereafter?"[25] The dissent appeared to couple both the attorney-client privilege and the privilege against self-incrimination together to hold that the books remained confidential. For this particular judge, a defeat of both of these privileges, especially after the government "could have conducted whatever tests it desired," was simply "too big a jump."[26]

Based on the rule of law from *Miller*, the civil-criminal advancement in a typical IRS audit is not a strong enough transition to fit as a

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20. One defense to the prior disclosure was that the documents would have been privileged in the hands of the client by reason of the fifth amendment, under the rule of Fisher v. United States, 425 U.S. 391 (1976). This rule involves the turning over of personal papers and when they can speak as for the party turning them over. *Miller*, 660 F.2d at 566.

21. Thus, the original copies of the ledger books (*i.e.*, the information contained in them) was admitted to be clearly available to the government and usable in the criminal proceeding at hand. The issue was whether this initial disclosure would waive the original books for any remaining purposes. *Miller*, 660 F.2d at 572.

22. *See supra* notes 12-14 and accompanying text.

23. 528 F.2d 559 (5th Cir.), *cert. denied*, 426 U.S. 952 (1976) (denying claim of confidentiality based on previous disclosure of handwriting style to the government).

24. *Miller*, 660 F.2d at 572.

25. *Id.*

26. *Id.* The dissent stated that "[t]o conclude that the previous voluntary disclosure of the two ledger books during a civil audit equates with the stripping from the books their confidential nature, *for all purposes*, and thus defeats the attorney-client privilege is too big a jump for me." *Id* (emphasis in original).

separate trial and possibly allow an exemption to the waiver of the attorney-client privilege. A waiver of this privilege is seemingly as durable as the privilege itself.

IV. Possible Challenge to Waiving the Privilege: Government Misrepresentation

A taxpayer faced with a "routine" tax audit may see criminal implications as quite unforeseeable. A visit from an IRS agent could only expose a miscalculated deduction or a good faith taxpayer mistake, not spawn a full-fledged criminal investigation.

As noted earlier,[27] a disclosure waiving the attorney-client privilege at the civil stage of the game will be a continuous waiver of the privilege if a criminal investigation ensues. The evidence legitimately obtained in the civil audit will be usable in a later-developing criminal investigation.

A taxpayer may not be immediately informed that the civil audit is transferred to the criminal division of the IRS.[28] It follows that a defense to the claim of waiver will be that the government gathered this evidence for its criminal prosecution through the consensual audit path, affirmatively misrepresenting its intentions along the way.

A. Requirement of a "Flagrant" set of Facts

Cases not specifically involving the attorney-client privilege often are nevertheless relevant in this examination of possible government misrepresentation.[29] A rather blatant example is *United States v. Tweel*,[30] a case with a fourth amendment backdrop. The unreasonable search stemmed from an IRS agent's microfilming of the taxpayer's records. These records had been turned over by the taxpayer's ac-

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27. *See supra* notes 21-23 and accompanying text.

28. If an agent during an audit discovers "firm evidence of fraud" he must suspend his activities "at the earliest opportunity" and report his finding to the Intelligence Division. United States v. Kaatz, 705 F.2d 1237, 1243 (10th Cir. 1983) (quoting the Audit Technique Handbook for Internal Revenue Agents, § (10)(91)(1)). Violation of the Handbook rules provides no basis for a cause of action for violation of constitutional rights. *See* United States v. Caceres, 440 U.S. 741 (1979).

29. *See, e.g.*, United States v. Caldwell, 820 F.2d 1395 (5th Cir. 1987). The taxpayer in this case claimed that an interview was illegally obtained through representations of only a civil audit, but that truly "[f]rom the outset, this was a criminal investigation." *Id.* at 1399. He claimed that the IRS, through fraud and trickery, characterized the interview as purely civil. *Id.* at 1400.

30. 550 F.2d 297 (5th Cir. 1977).

countant, only after the accountant specifically asked the investigating agent if a criminal inquiry of his client was being made.[31]

The revenue agent said that no special agent was involved, leading the accountant to believe that the investigation was solely civil.[32] After enunciating the general standard for government deception (mere failing to warn the taxpayer that the civil investigation may result in criminal charges does not equal trickery[33]), the court focused on the "flagrant"[34] facts of the case and suppressed the documents obtained. The conduct of the IRS was "shocking"[35] and the failure to apprise the taxpayer of the "obvious criminal nature" was a "sneaky [and] deliberate deception by the agent" that disregarded the taxpayer's rights.[36]

B. A "Clear and Convincing" Standard

Similar to *Tweel,* other successful cases claiming government deception involve rather drastic facts.[37] It will take facts similar to these cases for a taxpayer who waived the attorney-client privilege during a civil audit to claim that the government tricked him. For, based on the standards put forth in *United States v. Prudden,*[38] the taxpayer who waived his privilege will have the burden of proving some "affirmative

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31. The taxpayer in *Tweel* had "laundered" parts of his income to avoid paying taxes; the taxpayer assigned income to lower bracket taxpayers, as well as assigning it for offsetting income with losses. This was the basis of the government's evidence in a prior conviction of tax evasion from the years 1967-69. *Tweel,* 550 F.2d at 298.

32. This particular audit was in fact conducted at the request of the Organized Crime and Racketeering Section of the Justice Department. *Id.* at 298. The revenue agent, even on a specific inquiry, clearly did not inform the accountant that the audit "was not a routine audit to which any taxpayer may be subjected from time to time." *Id.*

33. *See infra* note 39 and accompanying text.

34. *Tweel,* 550 F.2d at 299.

35. *Id.* at 300.

36. *Id.* at 299.

37. *See, e.g.,* Stuart v. United States, 416 F.2d 459 (5th Cir. 1969). In *Stuart,* the taxpayer turned records over to the investigating revenue agent "primarily for the [agent's] convenience," as the taxpayer worked at night. *Id.* at 462. Upon indications of fraud, the government attempted to compel the taxpayer to produce his records. Based on the taxpayer's privilege against self-incrimination, the court did not enforce the subpoena; had the taxpayer been originally informed that a criminal investigation was in progress, he could have rightfully withheld the records. *Id.* at 463. The government thus played a significant role in the transfer of the records, and it should not gain an advantage because the taxpayers, "acting reasonably as human beings and citizens, did it a favor." *Id.*

38. 424 F.2d 1021 (5th Cir. 1970).

misrepresentation to establish the existence of fraud, and this showing must be clear and convincing."[39]

The taxpayer in *Prudden* attempted to establish misrepresentation through evidence at several junctures of his investigation by the IRS. As to the taxpayer's claim of deception in his actual audit, the court said the IRS agents did not have to warn him directly that they were undertaking a criminal investigation, and an "[a]udit and examination is but one means of gathering evidence in a tax fraud case."[40]

Also, the taxpayer was unconvincing in proving deception through the overall friendliness of the investigating agents, and through their promise and advice. The court discussed the nature of such an investigation:

> A 'routine' tax investigation openly commenced as such is devoid of stealth or deceit because the ordinary taxpayer surely knows that there is inherent in it a warning that the government's agents will pursue evidence of misreporting without regard to the shadowy line between avoidance and evasion, mistake and willful omission.[41]

The court then found that "the mere failure of a revenue agent (be he regular or special) to warn the taxpayer that the investigation may result in criminal charges, absent any acts by the agent which materially misrepresent the nature of the inquiry, do not constitute fraud, deceit and trickery."[42] After all, the court said, a reasonable man is "bound to be aware" that yearly income tax filings could result in a charge of wrongdoing.[43]

The court was quick to note in passing that Prudden was a "well-educated businessman with a law degree and experienced in the tax field."[44] Based on this fact, it was plausible that he would know that a

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39. *Id.* at 1033.

40. *Id.*

41. *Id.* (quoting United States v. Sclanfani, 265 F.2d 408, 414-15, (2d cir. 1959), *cert. denied.*, 360 U.S. 918 (1959)).

42. *Id.*

43. *Id.* at 1035. Adding to this reasonable man standard, the court noted that if common sense and knowledge are not enough, then warnings found on the bottom of every tax form ("Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete") which the taxpayer must sign before filing, should suffice as sufficient notice to the taxpayer of possible impending criminal charges. *Id.*

44. *Id.* at 1035.

civil investigation in the tax area could lead to criminal charges.

C. *The Moral for the Legal Profession*

Once again, there is no question that revenue agents cannot obtain information from taxpayers through fraud, trickery or deceit; any information obtained via such means will not be "voluntary," leaving the attorney-client privilege intact. It also appears from the cases that misrepresentation is a common defense – *i.e.*, one often inserted in appellate briefs – but one that courts rarely use to deny the government the right to the previously disclosed information.[45]

The taxpayer in *Miller*[46] likewise failed in his claim of government trickery. The specific facts showed that the disclosure occurred prior to any knowledge of the developing criminal investigation.[47] Even though the Millers were not advised by the investigating agents of the referral to the criminal division, it is worthy to note that "neither the taxpayers nor their representatives ever asked whether the investigation had criminal overtones."[48]

Therefore, the first step in proving this possible fraud, and overcoming waiver of the attorney-client privilege, is to show that the client actually asked about the criminal possibilities. Prior to that, any member of the legal profession, upon a set of facts involving an Internal Revenue Service audit, must inquire from the revenue agent whether this particular case has been referred to the Intelligence Division. It appears that failure to inquire will leave the defense of government misrepresentation useless. As the *Prudden* court noted, "[s]ilence can only be equated with fraud where there is a legal or moral duty to speak or where an inquiry left unanswered would be intentionally misleading."[49]

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45. *See, e.g.*, United States v. Irvine, 699 F.2d 43 (1st Cir. 1983) (investigating agent failed to specifically state that he is conducting a criminal investigation, but obtaining the information has breached no constitutional duty); United States v. Ponder, 444 F.2d 816 (5th Cir. 1971) (evidence received from taxpayer after the criminal investigation held admissible, even without notice of their use, relying on the general rule that the investigating agents owed no duty to advise of criminal implications).

46. *See supra* text accompanying notes 16-26.

47. "Neither the taxpayers nor their representatives were advised of the suspected criminal overtones at the time of any of the three referrals to Intelligence." *Miller*, 660 F.2d at 565.

48. *Id.*

49. *Prudden*, 424 F.2d. at 1032.

V. CONCLUSION

A client disclosure during a tax audit clearly exposes the client to waiver of his claim to the attorney-client privilege. This remains the case, even when the IRS advances its investigation into criminal areas and even if the audited party was unaware of these criminal overtones. Although one could argue for application of some type of "limited waiver"[50] in such an IRS investigation, it is unlikely that a court will deviate from the long-established policies behind the attorney-client privilege.[51]

This result will continue to place a standard of competence on members of the legal profession to inform the client of (and more importantly protect) his privilege. Just as the attorney's ethical obligation of confidentiality is a solemn matter that requires a refrain from discussion, the attorney holds a duty to see that his client has not waived a recognized privilege. This duty to protect the attorney-client privilege, unlike the ethical obligation, may require attorneys to affirmatively make inquiries on behalf of their clients. Within the specific area of IRS investigations, lawyers must inquire into possible criminal ramifications for their client. Failure to make such an inquiry potentially forces clients to forfeit an important right.

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50. Such a "limited waiver" was recognized in Diversified Industries v. Meredith, 572 F.2d 596 (8th Cir. 1977). The approach in *Meredith* involved certain disclosures to the SEC. Later, after the initial subpoena for the information, a separate and nonpublic investigation ensued. The court held that only a limited waiver of the privilege occurred and "[t]o hold otherwise may have the effect of thwarting the developing procedure of corporations to employ independent outside counsel to investigate and advise them in order to protect stockholders, potential stockholders and customers." *Id.* at 611. This approach by the *Meredith* court has proven to be "wholly unpersuasive," and courts have not followed it. *See* Periman v. United States, 665 F.2d 1214, 1220 (D.C. Cir. 1981).

51. *See, e.g., Periman*, 665 F.2d at 1220 (concluding that a "limited waiver" would not serve the interests underlying the common law privilege for confidential communications between attorney and client).