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HAND OVER YOUR TAX ACCRUAL WORKPAPERS: THE FIRST CIRCUIT IN *UNITED STATES V. TEXTRON* EXPOSES DUAL- PURPOSE DOCUMENTS TO DISCOVERY

Abstract: On August 13, 2009, the First Circuit in *United States v. Textron Inc.* held that tax accrual workpapers are not protected from discovery under the attorney work-product privilege. In so doing, the court eviscerated the last line of protection for dual-purpose tax documents from the prying eyes of the IRS and opposing parties in litigation.

INTRODUCTION

In the wake of Enron and other corporate financial scandals, corporate taxpayers have been increasingly subject to government regulation.¹ Recently, the Internal Revenue Service (IRS) has concentrated on tax shelters—corporate transactions designed to avoid tax liabilities.² Tax shelters deprive the U.S. Treasury of a large source of revenue and contribute to the federal budget deficit.³ To detect tax shelters, the IRS now frequently requests disclosure of corporate taxpayers' tax-related documents.⁴ Corporate taxpayers, however, are reluctant to provide this information freely and have tried to shield their tax documents from discovery by using various legal doctrines including the attorney-client privilege, the tax practitioner-client privilege, and, recently, the attorney work-product privilege.⁵

¹ See Michelle M. Henkel, *The Pursuit of Transparency Does Not Trump the Work Product Privilege*, 60 TAX EXECUTIVE 175, 175 (2008); Michael L. Seigel, *Corporate America Fights Back: The Battle Over Waiver of the Attorney-Client Privilege*, 49 B.C. L. REV. 1, 2–3 (2008).

² See Tracy A. Kaye, *The Regulation of Corporate Tax Shelters in the United States*, 58 AM. J. COMP. L. 585, 585, 587 (2010).

³ See *id.* at 587. In 2001, the IRS estimated that corporate tax shelters constituted \$10 to \$15 billion of the \$30 billion in unreported corporate income taxes. *Id.*

⁴ See Andrew Golodny, *Lawyers Versus Auditors: Disclosure to Auditors and Potential Waiver of Work-Product Privilege in United States v. Textron*, 61 TAX LAW. 621, 621 (2008); Paul McCord, *Circling Sharks: Toward a Better Understanding of the Tax Lawyer's Role Under Circular 230, FIN 48 and the Work-Product Doctrine*, 34 MICH. TAX LAW. 26, 26 (2008).

⁵ See Philip N. Jones, *First Circuit in Textron Gives IRS Access to Tax Accrual Workpapers*, 111 J. TAX'N 199, 199 (2009). The attorney-client privilege and tax practitioner-client privilege generally are not successful defenses in these cases. *Id.* They are usually waived in tax return litigation involving corporate taxpayers that show their tax documents to independent auditors. See, e.g., *United States v. Textron Inc. (Textron I)*, 507 F. Supp. 2d 138,

In August 2009, the U.S. Court of Appeals for the First Circuit, sitting en banc, decided *United States v. Textron Inc.* and the issue of whether a corporate taxpayer's tax accrual workpapers are protected under the limited attorney work-product privilege.⁶ The en banc court, reversing the decisions of the district court and a First Circuit panel, held that Textron's tax accrual workpapers were not privileged under the work-product doctrine and granted the IRS a monumental win.⁷ The court based its ruling on its conclusion that tax accrual workpapers are prepared for business purposes, not for litigation.⁸ It also expressed a desire to support the IRS.⁹

Taxpayers and practitioners have voiced sharp outcry in the wake of the *Textron* decision.¹⁰ One concern is that the IRS now has an unfair advantage in tax return litigation.¹¹ More broadly, any adversary, not just the IRS, may now access an opponent's tax accrual workpapers.¹² The *Textron* decision, however, is unlikely to be short-lived, as the U.S. Supreme Court denied certiorari in May 2010.¹³ Additionally, the IRS has continued to demand transparency and disclosure and is unlikely to cease requesting tax accrual workpapers.¹⁴

This Comment begins in Part I with an overview of the First Circuit's en banc decision in *Textron*.¹⁵ Part II then discusses the majority's reasoning and the heavy emphasis the decision placed on IRS's inter-

151 (D.R.I. 2007) (noting that the tax practitioner-client and attorney-client privileges are waived by disclosure of privileged items to a third party).

⁶ *United States v. Textron Inc. (Textron II)*, 577 F.3d 21, 22 (1st Cir. 2009) (en banc), cert. denied, 130 S. Ct. 3320 (2010). For a description of tax accrual workpapers, see *infra* notes 22–27 and accompanying text.

⁷ See *Textron II*, 577 F.3d at 26.

⁸ See *id.*

⁹ See *id.* at 30.

¹⁰ See William E. Massey, *Supreme Court Will Not Review First Circuit's Textron Decision*, 21 J. INT'L TAX'N 9, 9–11 (2010). Eleven amicus curiae briefs were filed with the Supreme Court encouraging it to hear the *Textron* case, criticizing the First Circuit's standard and expressing fear of the standard's effect on the use of tax counsel. *Id.*; see also Jerald David August & Jason M. Grimes, *The Discovery Status of Tax Accrual Workpapers After Textron*, BUS. ENTITIES, Jan./Feb. 2010, at 10 (“[T]he First Circuit’s decision and underlying rationale has and will continue to receive a stentorian cry of ‘no thank you’ from tax lawyers, tax managers, and in-house counsel to public and private corporations and companies . . .”).

¹¹ See *Textron I*, 507 F. Supp. 2d at 155.

¹² See Federal Tax Coordinator 2d, ¶ T-1330 (RIA 2010).

¹³ See *Textron Inc. v. United States*, 130 S. Ct. 3320 (2010).

¹⁴ See McCord, *supra* note 4, at 28. In 2010, the IRS announced that it is developing a schedule requiring certain corporate taxpayers to report uncertain tax positions on their tax returns. See I.R.S. Announcement 2010-9, 2010-7 I.R.B. 408 (Feb. 16, 2010); I.R.S. Announcement 2010-17, 2010-13 I.R.B. 515 (Mar. 29, 2010).

¹⁵ See *infra* notes 18–72 and accompanying text.

ests in revenue collection.¹⁶ Finally, Part III argues that, as a result of the desire to support the IRS, the *Textron* majority created an overly narrow, tax-centric work-product standard that fits poorly in the broader scope of attorney work-product.¹⁷

I. TAX ACCRUAL WORKPAPERS AND THE WORK-PRODUCT PRIVILEGE:
WHAT THEY ARE AND HOW THE *TEXTRON* COURT
CONSIDERED THEM IN TANDEM

A. *Tax Reporting Requirements and Tax Accrual Workpapers*

Federal securities laws require publicly traded corporations like Textron to obtain audited financial statements annually from independent accounting firms.¹⁸ This audit typically requires an accountant to issue a favorable, or “clean,” opinion letter, which certifies that the company’s financial statements fairly represent the company’s financial condition.¹⁹ Prior to issuing this opinion letter, accountants usually request to view the company’s tax returns so that they can identify transactions that may result in tax liabilities, or “contingencies,” if challenged by the IRS.²⁰ The company must quantify these contingencies and set aside enough money in reserve to satisfy them.²¹

Tax accrual workpapers are often used to determine the size of a company’s reserves by analyzing the tax impact of completed transactions.²² Although there is no standard definition for tax accrual workpapers, the IRS defines them as

those audit workpapers, whether prepared by the taxpayer, the taxpayer’s accountant, or the independent auditor, that

¹⁶ See *infra* notes 73–86 and accompanying text.

¹⁷ See *infra* notes 87–106 and accompanying text.

¹⁸ See 15 U.S.C. §§ 78l, 78m (2006) (requiring balance sheets to be certified by a public accounting firm if so required by regulation and permitting the SEC to promulgate asset and liability reporting rules); 17 C.F.R. § 210.1-01 to .12-19 (2009). Companies may also have to obtain clean opinion letters for other reasons. See *United States v. El Paso Co.*, 682 F.2d 530, 534 n.3 (5th Cir. 1982) (observing that the New York Stock Exchange and certain banks may require companies to undergo audits and maintain reserves for contingencies).

¹⁹ Jones, *supra* note 5, at 199.

²⁰ *Id.* As the First Circuit noted in *Textron*, the requirement that auditors examine the company’s tax accrual workpapers is based on a number of promulgated auditing standards. See *United States v. Textron Inc. (Textron II)*, 577 F.3d 21, 23 n.1 (1st Cir. 2009) (en banc).

²¹ Jones, *supra* note 5, at 199.

²² See Christian M. Hoffman & Matthew C. Baltay, *Maintaining Client Confidences: Developments at the Supreme Judicial Court and First Circuit in 2009*, Bos. B. J., Fall 2009, at 20, 22.

relate to the tax reserve for current, deferred and potential or contingent tax liabilities . . . and to footnotes disclosing those tax reserves on audited financial statements. These workpapers reflect an estimate of a company's tax liabilities and may also be referred to as the tax pool analysis, tax liability contingency analysis, tax cushion analysis, or tax contingency reserve analysis.²³

Tax accrual workpapers often also include "hazard-of-litigation" percentages, or percentage estimates of the IRS's chances of success if it challenges a debatable return item.²⁴

Tax accrual workpapers are thus a valuable resource to the IRS.²⁵ They enable the IRS 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."²⁶ They also essentially allow the IRS to know exactly how much a corporate taxpayer is willing to pay to settle each disputable transaction, given the hazard-of-litigation analyses.²⁷

B. *The Attorney Work-Product Privilege*

The attorney work-product privilege was first articulated in the landmark U.S. Supreme Court case of *Hickman v. Taylor* in 1947.²⁸ The privilege is now codified in Rule 26(b)(3) of the Federal Rules of Civil Procedure.²⁹ The rule protects fact and opinion work-product produced "in anticipation of litigation or for trial" by a party's lawyer or representative.³⁰ A party may waive this privilege.³¹ An opposing party may over-

²³ Audit Workpapers, Tax Accrual Workpapers, and Tax Reconciliation Workpapers Defined, IRM 4.10.20.2 (July 12, 2004). For an overview of cases discussing the discovery status of tax accrual workpapers and the different labels that have been applied to such workpapers, see generally August & Grimes, *supra* note 10, at 18–27.

²⁴ See *United States v. Textron Inc. (Textron I)*, 507 F. Supp. 2d 138, 142 (D.R.I. 2007).

²⁵ See *United States v. Arthur Young & Co.*, 465 U.S. 805, 813 (1984). In 2002, the IRS announced that it would begin requesting tax accrual workpapers if taxpayers engaged in listed transactions. I.R.S. Announcement 2002–63, 2002–27 I.R.B. 72 (July 8, 2002). A listed transaction is one that the IRS has identified as being the same as or substantially similar to a tax avoidance transaction. See Treas. Reg. § 1.6011-4(b)(2) (2005).

²⁶ *Arthur Young*, 465 U.S. at 813.

²⁷ See Henkel, *supra* note 1, at 176.

²⁸ 329 U.S. 495, 510–12 (1947).

²⁹ FED. R. CIV. P. 26(b)(3).

³⁰ See *id.*

³¹ See *Textron I*, 507 F. Supp. 2d at 152 ("[D]isclosures that are inconsistent with keeping the [protected] information from an adversary constitute a waiver of the work product privilege."); Henkel, *supra* note 1, at 179–80 (discussing waiver in non-tax and tax cases).

come the privilege by showing a substantial need for the work-product and an inability to obtain the material without undue hardship.³²

Rule 26(b)(3) allows attorneys to prepare a case properly without undue interference from an opposing party.³³ Litigation requires that attorneys gather information, sift through facts to determine what information is relevant, and prepare legal theories.³⁴ The *Hickman* Court recognized that, if work-product were available to opposing parties, much of what is currently written in case preparation would remain unwritten to the detriment of the legal profession.³⁵ Moreover, the adversarial system would be undermined if parties had access to an opposing party's thoughts and strategies regarding litigation.³⁶

The Supreme Court has not defined when documents are prepared "in anticipation of litigation," so two tests had developed by the time of *Textron* to determine which documents qualify.³⁷ The Fifth Circuit employs a "primary purpose" test that analyzes whether "the primary motivating purpose behind the creation of the document was to aid in possible future litigation."³⁸ Most courts, including the First Circuit, however, have adopted a "because of" test.³⁹ This test asks "if 'in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained *because of* the prospect of litigation.'"⁴⁰ Under the "because of" test, a document receives work-product protection if it was created be-

See generally Jean A. Pawlow & Kevin Spencer, *Adrift in a Sea of Uncertainty: Tax Accrual Workpapers Are Work-Product . . . but Showing Them to Your Auditor May Waive the Protection*, 61 TAX EXECUTIVE 33 (2009) (discussing waiver of work-product protection, particularly in the context of the *Textron* district court decision).

³² FED. R. CIV. P. 26(b)(3)(A)(ii).

³³ *See* FED. R. CIV. P. 26(b)(3); *Hickman*, 329 U.S. at 510.

³⁴ *Hickman*, 329 U.S. at 511.

³⁵ *Id.*

³⁶ *See id.*

³⁷ Henkel, *supra* note 1, at 176; *see Textron II*, 577 F.3d at 26; *see also* Jones, *supra* note 5, at 199–200 (providing an overview of the status of work-product law at the time of *Textron*).

³⁸ *El Paso*, 682 F.2d at 542 (quoting *United States v. Davis*, 636 F.2d 1028, 1040 (5th Cir. 1981)) (internal quotation marks omitted).

³⁹ *See* *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998) (first adopting the test as originally articulated in 8 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 2024, at 343 (1994)); *accord* *United States v. Roxworthy*, 457 F.3d 590, 594 (6th Cir. 2006); *In re Grand Jury Subpoena*, 357 F.3d 900, 907 (9th Cir. 2004); *PepsiCo, Inc. v. Baird, Kurtz & Dobson LLP*, 305 F.3d 813, 817 (8th Cir. 2002); *Maine v. U.S. Dep't of Interior*, 298 F.3d 60, 68 (1st Cir. 2002); *Montgomery County v. MicroVote Corp.*, 175 F.3d 296, 305 (3d Cir. 1999); *EEOC v. Lutheran Soc. Servs.*, 186 F.3d 959, 968 (D.C. Cir. 1999); *Logan v. Commercial Union Ins. Co.*, 96 F.3d 971, 976–77 (7th Cir. 1996).

⁴⁰ *Adlman*, 134 F.3d at 1202 (citing WRIGHT ET AL., *supra* note 39, at 343).

cause of anticipated litigation and would not have been created in a substantially similar form but for the prospect of litigation.⁴¹

The Supreme Court has not directly ruled on whether the attorney work-product privilege protects tax accrual workpapers.⁴² In 1984, in *United States v. Arthur Young & Co.*, however, the Court ruled that the accountant work-product privilege does not apply to tax accrual workpapers.⁴³ The IRS has used this decision to assert its right to obtain such workpapers in any situation.⁴⁴

Before *Textron*, only the Fifth Circuit had directly addressed whether tax accrual workpapers are protected under the attorney work-product doctrine.⁴⁵ In the 1982 case *United States v. El Paso Co.*, the Fifth Circuit ruled that, under its “primary purpose” test, tax accrual workpapers are not work-product.⁴⁶ The court held that these workpapers were primarily created to “anticipate, for financial reporting purposes, what the impact of litigation might be on the company’s tax liability. [The corporate taxpayer] thus creates the tax pool analysis with an eye on its business needs, not on its legal ones.”⁴⁷ Because the primary purpose for creating these workpapers was to satisfy business needs, not to aid in litigation, they were not privileged.⁴⁸

C. *Textron* Challenges an IRS Summons

In 2003, the IRS audited *Textron*’s corporate income tax liability and determined that *Textron* had engaged in nine sale-in, lease-out (“SILO”) transactions.⁴⁹ Because SILOs are listed “tax avoidance transactions” under treasury regulations, the IRS issued an administrative summons to obtain all tax accrual workpapers for the years in ques-

⁴¹ *Id.* at 1195.

⁴² See *Textron II*, 577 F.3d at 26.

⁴³ See 465 U.S. 805, 817 (1984).

⁴⁴ See, e.g., I.R.S. Announcement 2002–63, 2002–27 I.R.B. 72 (July 8, 2002) (“The Supreme Court confirmed the [IRS]’s right to obtain Tax Accrual Workpapers under its summons authority.”).

⁴⁵ *Textron II*, 577 F.3d at 30 (“[W]ork product protection for tax audit work papers has been squarely addressed only in two circuits: this one and the Fifth.”); see also *El Paso*, 682 F.2d at 544.

⁴⁶ 682 F.2d at 544.

⁴⁷ *El Paso*, 682 F.2d at 543.

⁴⁸ See *id.*

⁴⁹ *Textron II*, 577 F.3d at 23–24. SILOs allow tax-exempt organizations (“TEOs”) to transfer depreciation and interest deductions, from which the TEOs cannot benefit, to other taxpayers who use them to shelter income from tax. *Id.* at 24. *Textron* engaged in SILOs when it purchased equipment from a foreign utility or transit operator and leased it back to the seller on the same day. *Id.* at 23–24.

tion.⁵⁰ Textron refused to provide these papers, citing work-product privilege, so the IRS filed an enforcement action in the U.S. District Court for the District of Rhode Island.⁵¹

The district court sided with Textron.⁵² The court applied the “because of” test and held that the tax accrual workpapers were work-product.⁵³ The court also held that the work-product protection was not waived when Textron submitted its workpapers to an independent accounting firm and that the IRS failed to demonstrate a substantial need for the workpapers.⁵⁴ The IRS appealed the decision, and a First Circuit panel affirmed.⁵⁵ The First Circuit then withdrew the panel’s decision when it voted to rehear the case en banc.⁵⁶

In a 3-2 decision written by Judge Michael Boudin, the en banc court ruled that Textron’s tax accrual workpapers were not attorney work-product.⁵⁷ The majority applied the “because of” test and decided that the documents were in fact “prepared to support financial filings and gain audit or approval” as required by securities laws and auditing requirements, and not because of the prospect of litigation.⁵⁸ To support this analysis, the majority noted that the *Hickman* reasoning focused on protecting documents prepared for use in litigation.⁵⁹ The majority also discussed an advisory committee note to Rule 26(b)(3) that approvingly cited cases denying work-product protection to docu-

⁵⁰ *Id.* at 24. Specifically, the contested documents included spreadsheets identifying each debatable return item, the dollar amount subject to potential dispute, and hazard-of-litigation percentages. *Id.* at 23. The IRS also requested workpapers created by Textron’s independent auditor to determine the sufficiency of Textron’s reserves. *Id.* For a list of transactions that the IRS considers “the same or substantially similar to . . . a tax avoidance transaction” see *Listed Transactions—LB&I Tier Issues*, IRS.gov, <http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html> (last updated Nov. 4, 2010).

⁵¹ See *Textron I*, 507 F. Supp. 2d at 141. Textron also asserted that the summons was issued for an improper purpose and that the documents were also protected under the attorney-client and tax practitioner-client privileges. See *id.* at 141, 146.

⁵² See *id.* at 141. The district court found that the documents were protected by the work-product privilege, though it also found that Textron waived any attorney-client or tax practitioner-client privilege when it provided its workpapers to its independent accountant. *Id.* at 152.

⁵³ *Id.* at 150.

⁵⁴ See *id.* at 154.

⁵⁵ See *Textron II*, 577 F.3d at 26.

⁵⁶ *United States v. Textron Inc.*, 560 F.3d 513, 513 (1st Cir. 2009) (granting petition for rehearing en banc).

⁵⁷ See *Textron II*, 577 F.3d at 26.

⁵⁸ *Id.* at 31–32.

⁵⁹ *Id.* at 29; see *Hickman*, 329 U.S. at 497.

ments made because of regulations, even though those documents might have become the subject of litigation.⁶⁰

The majority's characterization of the dual nature of tax accrual workpapers was an integral factor in the denial of work-product protection.⁶¹ Although the workpapers referred to items that might ultimately be litigated, the majority opined that the business nature of tax accrual workpapers was obvious:

Every lawyer who tries cases knows the touch and feel of materials prepared for a current or possible . . . law suit. . . . No one with experience of law suits would talk about tax accrual work papers in those terms. A set of tax reserve figures, calculated for purposes of accurately stating a company's financial figures, has in ordinary parlance only that purpose: to support a financial statement and the independent audit of it.⁶²

Noting this characterization, and asserting that there was no strong evidence to the contrary, the court also concluded that tax accrual workpapers would not even be useful in litigation.⁶³ Given this portrayal of the workpapers, it seemed logical that the workpapers would have been prepared in the ordinary course of business, regardless of the possibility of future litigation.⁶⁴

In a sharp dissent, Judge Juan R. Torruella criticized the majority's application of the "because of" test and argued that, if properly applied, the test would protect tax accrual workpapers as work-product.⁶⁵ Judge Torruella argued that the majority created and applied a new "prepared for" test that broke with precedent and was inconsistent with Rule 26(b)(3)'s text and purpose.⁶⁶ The dissent then contrasted the scopes of the two tests.⁶⁷ Although the traditional "because of" test examines the totality of the circumstances behind the creation of a doc-

⁶⁰ *Textron II*, 577 F.3d at 29 & n.7 (citing FED. R. CIV. P. 26 advisory committee's note (1970)).

⁶¹ *See id.* at 31–32.

⁶² *Id.* at 30.

⁶³ *See id.* at 28.

⁶⁴ *Id.* Some scholars agree that tax accrual workpapers are disclosure documents, not litigation documents. *See, e.g.*, Dennis J. Ventry Jr., *A Primer on Tax Work Product for Federal Courts*, 123 TAX NOTES 875, 876 (2009) ("[T]ax accrual workpapers never qualify as protected work product. . . . They exist exclusively because of financial accounting and disclosure requirements regardless of any prospect for future litigation.").

⁶⁵ *See Textron II*, 577 F.3d at 38 (Torruella, J., dissenting).

⁶⁶ *Id.* at 32.

⁶⁷ *See id.* at 34.

ument, the majority's formulation narrowly focused on whether the workpapers were prepared "for use" in possible litigation.⁶⁸

Judge Torruella also criticized the majority's characterization of tax accrual workpapers, arguing that the majority "misrepresent[ed] and ignore[d] the findings of the district court."⁶⁹ The proper role of an appellate court, he said, is to disregard a district court's factual findings only upon a showing of clear error.⁷⁰ Judge Torruella reprimanded the majority for "recharacteriz[ing] the facts as suit[ed] its purposes" and for not addressing the district court's findings that dual purposes drove the creation of the workpapers.⁷¹ He also felt that the district court's findings were correct—the workpapers served two purposes, not only business purposes.⁷²

II. THE *TEXTRON* COURT'S NARROW REASONING

A. *The Intended Scope of Rule 26(b)(3)*

Although the *Textron* majority insisted that its "prepared for" test supported the purposes of Rule 26(b)(3), the majority's construction of the rule is seemingly much narrower than the rule's language.⁷³ In his dissent, Judge Torruella argued that the majority's interpretation of the rule rendered meaningless the "in anticipation of litigation" language

⁶⁸ See *id.* at 32, 40–41.

⁶⁹ *Id.* at 32.

⁷⁰ *Id.* at 39.

⁷¹ *Textron II*, 577 F.3d at 39 (Torruella, J., dissenting). Those who support the majority's decision have noted, however, that the *Textron* district court never examined the privileged documents through an in camera review, and based its decision solely on the pleadings and affidavits. See Ventry, *supra* note 64, at 883–84. The argument is that the district court failed to meet its fact-finding obligations. *Id.* Thus, its determination that certain documents were work-product is not reliable. See *id.*

⁷² See *Textron II*, 577 F.3d at 39 (Torruella, J., dissenting). Some scholars agree with the dissent's characterization of the workpapers. See, e.g., Jones, *supra* note 5, at 201.

[T]he tax accrual workpapers served two purposes. If tax litigation with the IRS were not anticipated, the reserves would not be necessary. The litigation was not then pending, but the prospect of litigation was present or anticipated. But the immediate need for the reserves was to satisfy the auditors and to obtain clean financial statements, while the long-term need for the reserves was to secure the potential additional tax liability that might arise from a tax controversy.

Id.

⁷³ See *United States v. Textron Inc. (Textron II)*, 577 F.3d 21, 34 (1st Cir. 2009) (Torruella, J., dissenting).

by equating it to the “for trial” language.⁷⁴ He argued that because documents prepared “in anticipation of litigation” were also included in the rule, its drafters considered documents prepared “in anticipation of litigation” to be a different, broader category than documents prepared “for trial.”⁷⁵ He asserted that nothing in the rule, the advisory notes, or *Hickman* suggests that protection should be limited to documents created for use in trial.⁷⁶ Limiting the attorney work-product doctrine in this way was arguably only consistent with achieving the goals of the IRS.⁷⁷

B. Policy Considerations and the Internal Revenue Service

The IRS’s interest in obtaining access to tax accrual workpapers also played a significant role in the holding.⁷⁸ The court noted, for example, that tax avoidance “threatens the essential public interest in revenue collection.”⁷⁹ Some scholars agree with the majority’s application of the “because of” test, given public policy considerations.⁸⁰ One commentator notes that courts construe the attorney work-product privilege narrowly, especially in the context of IRS investigations.⁸¹ Courts do so because, as the Supreme Court suggested in the 1984 case of *United States v. Arthur Young & Co.*, congressional policy favors disclosure of all information relevant to a legitimate IRS inquiry.⁸²

Others, however, including Judge Torruella in his dissent, argue that the majority’s holding is skewed by one-sided policy considerations.⁸³ The dissent accused the majority of reformulating a new test

⁷⁴ See FED. R. CIV. P. 26(b)(3)(A); *Textron*, 577 F.3d at 34 (Torruella, J., dissenting).

⁷⁵ *Textron II*, 577 F.3d at 34 (Torruella, J., dissenting); see FED. R. CIV. P. 26(b)(3)(A).

⁷⁶ *Textron II*, 577 F.3d at 34 (Torruella, J., dissenting); see also Claudine Pease-Wingenter, *Prophetic or Misguided?: The Fifth Circuit’s (Increasingly) Unpopular Approach to the Work Product Doctrine*, 29 REV. LITIG. 121, 153–61 (2009) (discussing the Fifth Circuit’s “primary purpose” rule in light of policy considerations and the text of Rule 26(b)(3) and concluding that a textualist construction of the rule such that documents need not be produced to aid or assist in trial is consistent with the U.S. Supreme Court’s analysis of the rule in *Hickman*).

⁷⁷ *Textron II*, 577 F.3d at 36–37 (Torruella, J., dissenting).

⁷⁸ *Id.* at 31–32 (majority opinion) (“*Textron’s* work papers were prepared to support financial filings and gain auditor approval . . . and IRS access serves the legitimate, and important, function of detecting and disallowing abusive tax shelters.”).

⁷⁹ *Id.* at 31.

⁸⁰ See Ventry, *supra* note 64, at 876.

⁸¹ *Id.*

⁸² See *United States v. Arthur Young & Co.*, 465 U.S. 805, 816 (1984).

⁸³ See *Textron II*, 577 F.3d at 32 (Torruella, J., dissenting); see also 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, 754 (2011) (“[T]he for use test also places *too much* emphasis on the potential business purpose . . . at the expense of the protection of impor-

purely “to assist the IRS in its quest to compel taxpayers to reveal their own assessments of their tax returns.”⁸⁴ Some scholars have similarly argued that *Textron* “reflects the determination of the IRS Commissioner to have the judicial system reflect the proper goals and aims involved in administering the tax laws.”⁸⁵ The majority’s goal, according to such critics, was to assist the IRS rather than to support *Hickman*’s policy goal of protecting attorneys’ mental impressions concerning litigation where those legal opinions may also be used in business decisions.⁸⁶

III. THE *TEXTRON* COURT’S MAJOR FLAW: UNDUE ATTENTION TO THE IRS’S INTERESTS

A. *The Interests of the IRS Overly Colored the Majority’s Characterization of Tax Accrual Workpapers*

The *Textron* majority mistakenly elevated the IRS’s interests over those of attorneys in characterizing tax accrual workpapers, and the legal opinions on litigation contained therein, as business documents.⁸⁷ The opinion cited no authority to support its assertion that no lawyer would characterize these documents as having been prepared for a lawsuit.⁸⁸ Instead, this assertion appeared to flow from the argument of the IRS itself that tax accrual workpapers are business documents.⁸⁹

The structure of the majority opinion suggests that the court ignored evidence that did not corroborate the IRS’s testimony.⁹⁰ For example, the majority approvingly cited the testimony of the former chief auditor of the Public Company Accounting Oversight Board to support its conclusion that tax accrual workpapers exist to obtain a clean audit.⁹¹ Additionally, in its discussion of the testimony given by *Textron*’s director of tax reporting, the court cited only her statements that sup-

portant legal opinions related to litigation.” (emphasis added)); Jacob A. Kling, Comment, *Tax Cases Make Bad Work Product Law: The Discoverability of Litigation Risk Assessments After United States v. Textron*, 119 YALE L.J. 1715, 1718 (2010) (“The majority was motivated by concern over the ability of the IRS to detect tax avoidance transactions . . .”).

⁸⁴ See *Textron II*, 577 F.3d at 32 (Torruella, J., dissenting).

⁸⁵ August & Grimes, *supra* note 10, at 10.

⁸⁶ See *id.*

⁸⁷ See *United States v. Textron Inc. (Textron II)*, 577 F.3d 21, 30 (1st Cir. 2009) (en banc); Hoffman & Baltay, *supra* note 22, at 23.

⁸⁸ See *Textron II*, 577 F.3d at 30.

⁸⁹ *Id.* at 39 (Torruella, J., dissenting) (“[I]n straining to ignore the documents’ litigation purposes, the majority [relied] heavily on the IRS’s expert.”); see *id.* at 27 (majority opinion).

⁹⁰ See *id.* at 27–28.

⁹¹ See *id.* at 27.

ported the same conclusion.⁹² The court noted that she discussed litigation in her testimony, but dismissed such statements and simply said that “[t]he Textron witnesses, while using the word ‘litigation’ as often as possible in their testimony, said the same thing [as the IRS witnesses].”⁹³ The majority also downplayed another Textron witness’s testimony that the workpapers could potentially be helpful in litigation.⁹⁴

The protection that the *Textron* court destroyed is exactly the expression of legal opinion that the attorney work-product doctrine was created to protect: attorneys’ mental impressions and opinions concerning litigation.⁹⁵ Although the workpapers may have also been created for business purposes, as one commentator has suggested, “in the case of tax contingency reserves, the prospect of future litigation and the business need for the documents are . . . intertwined.”⁹⁶ Given that tax accrual workpapers in fact provide legal advice and insight and do not solely serve a business need, the majority’s blanket assertion to the contrary is unconvincing.⁹⁷

B. *The Textron Test is Tax-Centric and Ignores the Plain Language of Rule 26(b)(3)*

The *Textron* majority ignored the plain language of Rule 26(b)(3) stating that documents made “in anticipation of litigation” constitute attorney work-product.⁹⁸ In so doing, it too narrowly tailored the work-product rule and failed to consider how the “prepared for” test would apply in scenarios other than those where the IRS attempts to discover tax avoidance.⁹⁹

The effect of ignoring Rule 26(b)(3)’s plain text and of applying the narrow “prepared for” test will likely be felt in litigation outside of

⁹² See *id.* at 27–28.

⁹³ *Id.* at 27.

⁹⁴ See *Textron II*, 577 F.3d at 28.

⁹⁵ See FED. R. CIV. P. 26(b)(3); *Textron II*, 577 F.3d at 36 (Torruella, J., dissenting) (“*Textron*’s litigation hazard percentages contain exactly the sort of mental impressions about the case that *Hickman* sought to protect.”); see also Massey, *supra* note 10, at 11 (noting one attorney’s opinion that “the decision by the en banc court eviscerated the work product protection that shielded exactly the type of attorney analysis that was present in this case”).

⁹⁶ Golodny, *supra* note 4, at 629 (quoting Terrence G. Perris, *Court Applies Work Product Privilege to Tax Accrual Workpapers*, 80 PRAC. TAX STRATEGIES 4 (2008)).

⁹⁷ See *id.*; Massey, *supra* note 10, at 11.

⁹⁸ See FED. R. CIV. P. 26(b)(3)(A); *Textron II*, 577 F.3d at 35 (Torruella, J., dissenting).

⁹⁹ See *Textron II*, 577 F.3d at 37 (Torruella, J., dissenting) (“The scope of the work-product doctrine should not depend on what party is asserting it.”).

the context of IRS audits.¹⁰⁰ The public policy considerations that appeared to drive the *Textron* majority's adoption of the IRS's argument are exclusive to the IRS.¹⁰¹ The First Circuit's new work-product rule, however, essentially gives any adversary access to its opponent's tax accrual workpapers.¹⁰² The IRS may even be the least of a corporation's concerns, because it only requests tax accrual workpapers when companies engage in listed transactions.¹⁰³ Outside of the audit context, other parties may not exercise such restraint when seeking tax accrual workpapers or similar risk assessment documents.¹⁰⁴ Additionally, the *Textron* decision will likely apply to other documents that, like tax accrual workpapers, have both business and litigation purposes.¹⁰⁵ Under the *Textron* rule, a corporation has no work-product protection against such requests.¹⁰⁶

CONCLUSION

Corporations must be able to prevent opposing parties in litigation from accessing their internal determinations of liabilities and hazard-of-litigation percentages. In *United States v. Textron, Inc.*, the First Circuit joined the Fifth Circuit in holding that tax accrual workpapers are not protected by the attorney work-product privilege, removing the last layer of protection from discovery for such documents. Although the *Textron*

¹⁰⁰ See *id.* (predicting that “the rule announced in this case will, if applied fairly, have wide ramifications” beyond the scope of audit litigation); Cosme Caballero, Note, *Curbing Corporate Abuse from Jurisprudential Off-Sites: Problematic Paradigms in United States v. Textron Inc.*, 65 U. MIAMI L. REV. 645, 645 n.4 (2011) (“Various critics of the First Circuit’s decision have correctly noted that the majority’s decision . . . may have far-reaching effects in the private and public sectors.” (internal citations omitted)); Sarah Seifert 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, 256 (2010) (noting *Textron*’s “sweeping consequences” for “tax litigation, discovery disputes, and corporate attorneys”).

¹⁰¹ See *Textron II*, 577 F.3d at 36 (Torruella, J., dissenting) (noting that the majority’s policy analysis “relie[d] . . . on case-specific rationales”); RIA, *supra* note 12, ¶ T-1330.

¹⁰² See RIA, *supra* note 12, ¶ T-1330 (observing that “under the [*Textron* “prepared for”] test, every party in litigation (not only IRS or state taxing authorities) whose opponent files generally accepted accounting principles financial statements reporting contingent liabilities for litigation exposure would be able to discover the hazards-of-litigation analysis of its opponent’s attorneys.”).

¹⁰³ Jones, *supra* note 5, at 203.

¹⁰⁴ *Id.*; see August & Grimes, *supra* note 10, at 27.

¹⁰⁵ See August & Grimes, *supra* note 10, at 27 (“Some legal advisors may view the analysis in *Textron* as more darkly asserting a broad impact on the issue of documents and memoranda in a company’s files pertaining to all liability reserves, not just tax reserves.”); Jones, *supra* note 5, at 203; Mallet, *supra* note 100, at 256.

¹⁰⁶ Jones, *supra* note 5, at 203; see *Textron II*, 577 F.3d at 26.

decision supports the IRS in its legitimate goal of discovering corporate tax shelters, it undermines the broader purpose behind the attorney work-product privilege. Rule 26(b)(3) exists to protect the opinions and mental impressions expressed in tax accrual workpapers, documents that are now subject to discovery in the First Circuit by any opposing party in litigation. Future circuits considering the status of tax accrual workpapers should avoid giving the IRS's interests undue weight and ensure that these documents receive robust work-product protection.

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