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Andrew W. Jones

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FASB –THE IRS’S NEW BEST FRIEND: HOW FIN 48 AFFECTS THE TAXPAYER-IRS RELATIONSHIP AND POTENTIAL TAXPAYER CHALLENGES

“[I]t would not be overstating the case to conclude that FIN 48 may prove to be one of the most significant enforcement tools the IRS has been presented with in recent years.”¹

INTRODUCTION

For Big Ben’s Barbeque, business was booming.² What was once just a sole street-side barbeque stand in the mountains of North Georgia had evolved into a lucrative and well-known producer of a barbeque sauce. The founder, Ben, negotiated a line of credit with a local bank to fund the day-to-day operations. To protect the bank’s investment, it required the company to submit financial statements, audited by an “independent” audit firm.³ As his production capacity grew, Ben began selling limited quantities of barbeque sauce in North Carolina.

It was this interstate expansion that added the word “nexus” to Ben’s tax vocabulary. In short, once a taxpayer establishes a “substantial nexus”⁴ with another state, the taxpayer must file an

1. Jennifer Blouin, Cristi Gleason, Lillian Mills & Stephanie Sikes, *Do Firms Eat Their Tax Cookies Before FIN 48 Reveals the Cookie Jar?* (Sept. 3, 2007) (unpublished Ph.D. dissertation, University of Arizona) (on file with authors).

2. The facts of the following hypothetical are intended to illustrate the implications of FIN 48 and are not derived from any source.

3. “Independent auditors” are hired by a taxpayer to attest to the accuracy of the taxpayer’s financial statements. *See H. Rosenblum, Inc. v. Adler*, 461 A.2d 138, 148 (N.J. 1983) (overruled on other grounds). An “independent audit” may be needed for many different reasons, such as to comply with the Securities and Exchange Commission (SEC), or, as with Ben, to comply with the terms of a line of credit. “Examiners,” on the other hand, are “auditors” employed by tax agencies, like the IRS, to enforce tax laws and collect tax revenue. *See generally* Kevin M. McCarron, *Tax Examiners, revenue agents and collectors*, *Occupational Outlook Quarterly*, Spring, 2001, at 33, available at <http://www.bls.gov/opub/ooq/2001/Spring/art05.pdf>.

4. For a taxpayer, “nexus” exists within a state when the connection between the taxpayer and that state is sufficient for the state to constitutionally impose a tax on the taxpayer. *See* VentureLine, *Nexus*, http://www.ventureline.com/Glossary_n.asp.

income tax return in that state.⁵ However, the line that separates what is and is not a “substantial nexus” is far from clear.⁶ Three years ago, for the first time, Ben’s accountant determined that if the company’s decision to not file a return in North Carolina were challenged, the company could lose the argument. In discussing their options, Ben simply said, “Minimize taxes, but don’t break the law.”

The accountant was routinely familiar with his ethical responsibilities. In accordance with his “right and responsibility to be an advocate for [his client],”⁷ he knew he could take a favorable position so long as, if challenged, the position has a “realistic possibility of being sustained.”⁸ He concluded that their position easily met the “reasonably possible” standard three years ago and still does today. Accordingly, his decision not to file a return in North Carolina fell entirely within his ethical duties.

Although the independent auditors routinely inquired about potential liabilities resulting from litigation, including tax litigation, no financial statement disclosure regarding the tax position was required.⁹ Last week, however, just when Ben thought he knew all he would ever have to know about taxes, his accountant called, mumbling excitedly about something called “FIN 48.”¹⁰ As if he had just discovered color television, he explained how FIN 48 would change the company’s financial statements as a result of the

5. See, e.g., *Lanco, Inc. v. Dir., Div. of Taxation*, 908 A.2d 176 (N.J. 2006) (holding that a sufficient economic presence is enough to establish a substantial nexus).

6. See, e.g., Jean T. Wells & Gwendolyn McFadden-Wade, *Nexus and FIN 48: States of Flux*, 204 TAX PRACTICE CORNER 3 (Sept. 2007), available at <http://www.journalofaccountancy.com/Issues/2007/Sep/NexusAndFin48StatesOfFlux.htm>.

7. Statement on Standards for Tax Serv. No. 1, Tax Return Positions, ¶ 4 (Am. Inst. of Certified Pub. Accountants 2000).

8. *Id.* ¶ 2.a. (realistic possibility standard); ¶ 9 (providing that a position may be taken even if it is not warranted). A “tax position,” in general terms, is a decision that a certain factual circumstance should be accorded a certain tax treatment, which is reflected in a tax return. See *id.* ¶ 1.

9. See Statement of Fin. Accounting Standards No. 5, Accounting for Contingencies, ¶ 10 (Fin. Accounting Standards Bd. 1975), available at <http://www.fasb.org/st/> [hereinafter *FAS 5*], (not requiring any disclosure when there is “no manifestation by a potential claimant of an awareness of a possible claim...”).

10. Fin. Accounting Standards Bd. Interpretation No. 48, Accounting for Uncertainty in Income Taxes (2006), available at <http://www.fasb.org/st/> [hereinafter *FIN 48*]. FIN 48 superseded FAS 5 for income taxes. *Id.* app. C, ¶ 2.

company's decisions not to file tax returns in North Carolina.¹¹ "Yes," he said, "in this case, *not* filing a return *is* a 'tax position' under FIN 48."¹² Because some of these positions—taken in the current year *and in prior years*—do not have a fifty percent or higher likelihood of prevailing if challenged by a tax agency, the company will have to recognize¹³ additional liabilities not only for a portion of the unpaid tax, but also for interest and penalties, even though, most likely, no interest or penalties would ever be paid.¹⁴

But the tax accountant didn't stop there. Furiously pounding his ten-key, he calculated how much he thought the liability would increase over the *subsequent* year. This too would have to be disclosed in the *current* year's financial statements, along with the "nature of the uncertainty" and the nature of the cause of the increased sales in North Carolina.¹⁵

Ben was concerned not only about his accountant's heart rate but also that such a financial statement disclosure could affect his debt-covenant ratios,¹⁶ allowing the creditor to immediately call his line of credit.¹⁷ Most of all, however, he worried that the level of detail required in the footnote disclosures would practically invite litigation with the North Carolina tax agency.¹⁸ His sole debatable tax position is the "nexus" issue, and everybody knows the only other state with which his company could arguably be "connected" is North Carolina. Thus, as he saw it, this disclosure would effectively say, "North

11. *See id.* ¶ 23.

12. *See id.* ¶ 4.a.

13. When an event is "recognized," it is reflected in the financial statements, as opposed to mere footnote disclosure or no disclosure at all. *See id.* ¶ 10.

14. *See FIN 48, supra* note 10, ¶ 7 (requiring the presumption that any tax position will be challenged in applying the "more-likely-than-not" standard); *id.* ¶ 15–16 (requiring recognition of a liability for interest and penalties); *id.* ¶ 23 (applying FIN 48 to positions taken in prior years).

15. *See id.* ¶ 21.d.

16. For example, a creditor might require that if a debtor's liabilities divided by its assets (the "Debt to Assets Ratio") ever exceeds a certain number, the creditor shall have the right to call the loan, that is, to deem it immediately collectible. *See* Financial Education, Debt to Assets, <http://financial-education.com/2007/01/30/debt-to-assets/>.

17. *See, e.g.,* Internal Revenue Service, *Frequently Asked Questions About FIN 48*, <http://www.irs.gov/businesses/corporations/article/0,,id=171859,00.html> ("[FIN 48] may have an impact on loan covenants . . .").

18. *See* discussion *infra* Part I.D. (discussing how FIN 48 could be a "roadmap" for a tax agency).

Carolina, if you examine me, this is the issue you should focus on, and this is how much I think you will probably win.” In other words, he thought this would reveal his tax strategies and legal theories—his “work product” —to his opponent in potential future litigation. Distraught, Ben and his accountant began to evaluate their options.

Could Big Ben’s Barbeque object to making the disclosure itself? If not, he knew the company would have to prepare FIN 48 workpapers to satisfy the independent auditors and that these workpapers would contain his legal theory supporting the position and an evaluation of the potential loss or gain to the tax agency.¹⁹ Would North Carolina’s tax agency request his workpapers? If they are requested, could he refuse to provide them? If the agency simply requests the same workpapers from the independent auditor, could he prevent the independent auditor from disclosing them to the agency?

Ben’s situation illustrates the concerns of taxpayers nationwide. Collectively, the requirements provide tax agencies with a roadmap—a tool it can use for audit selection²⁰—to identify positions about which a taxpayer is uncertain and to gain insight into the attorney’s evaluations of those potential claims.²¹ If the IRS gains access to FIN 48 workpapers, legal theories, views on settlement viability, and detailed analyses of individual positions would be revealed.²² In subsequent litigation, with weaknesses and theories exposed, the taxpayer would be left “[s]tanding [n]aked [b]efore the IRS.”²³

This Note will address each of Ben’s questions, ultimately concluding that taxpayers are practically compelled to make the

19. An auditor will generally obtain documents, prepared by the reporting company, that show in detail the individual components comprising a number reported in the financial statements or footnotes. The auditor will use those documents, called “workpapers,” to identify issues and request “evidentiary” support (i.e. invoices, contracts, letters from counsel). *See generally* CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 106, § 326A, ¶ .02–.03 (Am. Inst. of Certified Pub. Accountants 1980).

20. “Audit selection” is the process by which a tax agency identifies taxpayers to examine.

21. *See, e.g.*, Roger A. Pies & Adam Gropper, *FIN 48 Considerations: Tax Attorneys’ Prospective*, TAX NOTES, Apr. 30, 2007 (emphasizing the value in issue-spotting).

22. *See, e.g.*, Todd Reinstein, *FIN 48: Will It Be a Roadmap for the IRS?* FED. TAX WKLY., No. 8 (Feb. 22, 2007) (emphasizing value to IRS of underlying workpapers).

23. Marie Leone, *FIN 48: Standing Naked Before the IRS*, CFO.COM, May 22, 2007, available at <http://www.cfo.com/article.cfm/9216349>.

required financial statement disclosures, but that the supporting workpapers should remain protected in the hands of the taxpayer and the taxpayer's independent auditors. Unfortunately, however, until the courts or legislature uniformly protects the workpapers, taxpayers will face the substantial risk of having to reveal prejudicial information to taxing agencies. Part I will introduce the Financial Accounting Standards Board, discuss the purpose behind and specific requirements of FIN 48, and consider the methods by which the IRS may utilize FIN 48 to its advantage.²⁴ Part II will analyze the current state of the law regarding the work product doctrine, focusing on the element of preparation "in anticipation of litigation" and "waiver."²⁵ Part III will evaluate the FASB's reasons for promulgating FIN 48 and the likelihood that the rule will remain intact.²⁶ Part IV will identify and assess the viability of potential challenges that a taxpayer may assert at various stages of FIN 48 compliance.²⁷

I. THE BACKDROP

A. *The Financial Accounting Standards Board*

Congress, through the Securities and Exchange Act of 1934, created the Securities and Exchange Commission (SEC) and vested in it the power to set accounting standards.²⁸ Since 1973, the SEC has delegated this authority to the Financial Accounting Standards Board (FASB), an independent body usually comprised of three individuals from public accounting firms, two from private industry, one academic and one investor.²⁹ Thus, the powers of the FASB are

24. See discussion *infra* Part I.

25. See discussion *infra* Part II.

26. See discussion *infra* Part III.

27. See discussion *infra* Part IV.

28. See 15 U.S.C. §§ 78a-78kk (2006) (creating and vesting power in SEC).

29. See Accounting Series Release No. 150 (Dec. 20, 1973) (SEC concluding private sector would most effectively set accounting standards); Comm. Statement of Policy Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, SEC Release Nos. 33-8221, 34-47743, 80 SEC Docket 139, at 16 (Apr. 25, 2003) (reaffirming FASB as delegate in light of Sarbanes-Oxley). See also David S. Ruder, Charles T. Canfield & Hudson T. Hollister, *Creation of World Wide Accounting*

limited to those delegated by the SEC—to set “financial accounting and reporting standards,” otherwise known as Generally Accepted Accounting Principles (GAAP).³⁰

B. Taking Away the Cookie Jar: The Purpose of FIN 48

The FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) to reduce the “noncomparability” of financial statements resulting from diverse accounting practices for income tax benefits.³¹ Before FIN 48, some entities adhered to a policy of recognizing tax benefits when ultimate realization was “probable;” others recognized the amount expected to settle; some used a probability threshold; and some did not consistently apply any methodology.³² Consequently, comparisons of financial statements between entities failed to provide adequately meaningful insight regarding tax benefits to a user.³³

Further, the absence of clear guidance enabled management to use the “cookie jar” method to inappropriately “smooth earnings.” If managers can reduce volatility in their income stream, “smoothing earnings,” they can reduce the perceived risk to investors, thereby increasing the stock price.³⁴ For example, managers could reduce their “estimate” of potential future tax losses to give the company a needed boost in income (dipping into the cookie jar).³⁵ Then, when income is plentiful, they can increase their same “estimate” to reduce income and replace the cookies.³⁶ The catch? There may not always

Standards: Convergence and Independence, 25 NW. J. INT’L L. & BUS. 513, 520-21, 523 (2005) (outlining history of the FASB and its predecessors).

30. Comm. Statement of Policy Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, SEC Release Nos. 33-8221, 34-47743, 80 SEC Docket 139, at 16 (Apr. 25, 2003).

31. *FIN 48*, *supra* note 10.

32. *Uncertainty in Income Taxes, A Roadmap to Applying Interpretation 48*, DELOITTE, at 2, available at http://www.deloitte.com/dtt/cda/doc/content/us_assur_RoadmapFIN48a.pdf.

33. See *FIN 48*, *supra* note 10, app. B, ¶ 62.

34. See generally Michael D. Akers, Don E. Giacomino, & Jodi L. Bellovary, *Earnings Management and its Implications, Educating the Accounting Profession*, THE CPA JOURNAL, Aug. 2007.

35. *Id.* A reduction in this liability, known as a “reserve,” would have the effect of increasing net income for that period.

36. *Id.*

be cookies to put back in the jar.³⁷ Prior to FIN 48, there was substantial flexibility in determining when and to what extent a tax benefit should be recognized, measured, derecognized, and reserved.³⁸ Mandated consistency in accounting standards, such as FIN 48, curtails management's ability to engage in this "cookie jar" approach.³⁹

C. *FIN 48: The Nuts and Bolts*

To fully grasp how FIN 48 may effectively provide a roadmap for the IRS, it is first necessary to understand what exactly FIN 48 requires.

1. *Scope and Effective Date*

FIN 48 is broader in scope than may appear on first impression. It applies to all income tax positions of all entities adhering to GAAP, including not-for-profit and pass-through entities.⁴⁰ A "tax position" includes, for example, decisions not to file returns, allocations of income between jurisdictions, exclusions from taxable income, and determinations that an entity or transaction qualifies for tax-exempt status.⁴¹ For public companies, FIN 48 became effective for fiscal years beginning after December 15, 2006.⁴² However, because some entities were confused as to whether FIN 48 applied to them, the FASB postponed the effective date for nonpublic companies to fiscal years beginning after December 15, 2007.⁴³

37. *Id.*

38. *See, e.g., FIN 48, supra* note 10, at 2.

39. *See generally* Akers, Giacomino, & Bellovary, *supra* note 34.

40. *FIN 48, supra* note 10, ¶ 1.

41. *Id.* ¶ 4.

42. *Id.* ¶ 22.

43. Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises, FASB Staff Position No. 48-2, ¶¶ 3, 5 (2008), *available at* <http://www.fasb.org/st/>.

2. *Recognition and Measurement*

Compliance with FIN 48 is a two-step process—recognition and measurement—subject to potential subsequent recognition, derecognition, and measurement.⁴⁴ A tax benefit is recognized when it is “more likely than not, based on the technical merits, that the position will be sustained upon examination.”⁴⁵ The “technical merits” of a position are derived from tax law and past administrative practices of the IRS.⁴⁶ However, because this analysis presumes the position will in fact be examined, an entity may not consider the likelihood of being selected for audit.⁴⁷

Upon determination that a position requires recognition, the amount recognized is measured as the amount which is more likely than not to be realized upon “effective” settlement.⁴⁸ To address the “cookie jar” problem, subsequent derecognition must be supported by new information, and reserves may not be used as a substitute for subsequent derecognition.⁴⁹

Positions that fail the “more likely than not” test will be reflected as a current liability,⁵⁰ labeled “unrecognized tax benefits.”⁵¹ In addition, interest and penalties must be accrued on the unrecognized tax benefit as if the position had been rejected.⁵²

44. *FIN 48*, *supra* note 10, ¶¶ 5–8, 10–12. The first step, “recognition,” is the determination of whether the threshold for recognition has been met; the second step, “measurement,” measures the amount which should be recognized. *Id.* “Subsequent recognition” and “derecognition” refer to subsequent adjustments to or elimination of the liability. *Id.*

45. *Id.* ¶ 6.

46. *Id.* ¶ 7.b.

47. *Id.* ¶ 7.a.

48. *Id.* ¶ 8. This provision was amended to replace the phrase “ultimate” settlement with “effective” settlement. *See* Definition of Settlement in FASB Interpretation No. 48, FASB Staff Position No. 48-1, ¶ 2-4 (2007), available at [http://www.fasb.org/st/ \[hereinafter FSP 48-1\]](http://www.fasb.org/st/ [hereinafter FSP 48-1]).

49. *See FIN 48*, *supra* note 10, ¶ 11.

50. Current liabilities are “[a] company’s debts or obligations that are due within one year.” Investopedia, *Current Liabilities*, <http://www.investopedia.com/terms/c/currentliabilities.asp>.

51. *FIN 48*, *supra* note 10, ¶ 17.

52. *Id.* ¶ 15-16.

3. *Note Disclosure*

The disclosure requirements of FIN 48 are extensive. Entities must include a reconciliation of unrecognized tax benefits from the beginning to the end of the period, showing separately the increases and decreases resulting from tax positions taken in prior periods, positions taken in the current period, reductions relating to positions effectively settled, and reductions resulting from lapse of a statute of limitations.⁵³ The total expense and liability for interest and penalties must be disclosed.⁵⁴ Perhaps the most controversial requirement is the disclosure pertaining to unrecognized tax benefits that are “reasonably possible” to “significantly increase or decrease within twelve months of the reporting period.”⁵⁵ For these positions, the entity must disclose the nature of the uncertainty and the potential underlying event and the “range of the reasonably possible change.”⁵⁶

D. *The Roadmap: How FIN 48 Helps Tax Agencies*

As if there were any doubt, IRS Chief Counsel Donald Korb ended all debate when he said, “IRS agents are not going to turn a blind eye [to FIN 48 disclosures],” rather, “[the IRS] will use the information to [its] advantage.”⁵⁷ In fact, IRS examiners of large businesses are required to attend a six hour continuing professional education program on FIN 48 and how to use the disclosure information.⁵⁸ FIN 48 may provide the IRS with two sources of information: that which is contained in the financial statement disclosures themselves and,

53. *Id.* ¶ 21.a. See *id.* app. A, ¶ 33 for an illustration of this “tabular reconciliation.”

54. *Id.* ¶ 21.c.

55. *Id.* ¶ 21.d.

56. *Id.* ¶ 21.d. If applicable, a statement that the range cannot be estimated will suffice. *Id.*

57. Richard Meyer, *Real Beneficiary of FIN 48 May be the IRS*, COMPLIANCE WK., May 30, 2007 (quoting Donald Korb, IRS Chief Counsel) (internal quotations omitted).

58. Memorandum from Deborah M. Nolan, Commissioner of the Large and Mid-Size Business Division [hereinafter *LMSB*], *FIN 48 and Tax Accrual Workpaper (TAW) Policy Update*, LMSB-04-0507-044 (May 10, 2007) (requiring the CPE program). See also LMSB Division At-a-Glance, <http://www.irs.gov/irs/article/0,,id=96387,00.html>. The LMSB defines large business as those with more than \$10 million in assets. *Id.*

possibly, the supporting workpapers in the possession of the disclosing entity or independent auditor.

1. *The Financial Statements and Footnote Disclosures*

The implications of FIN 48 are not limited to access to workpapers. The financial statements themselves may provide the IRS with valuable information.⁵⁹ The Large and Mid-Size Business Division (LMSB) of the IRS explained the IRS will have a “better view of a taxpayer’s uncertain tax positions . . . [but not] a *perfect* view of the issues and amounts at risk.”⁶⁰

The adjusting entry to beginning retained earnings⁶¹ may serve as the first red flag.⁶² A typical implementation footnote might read, “As a result of the implementation of [FIN 48], the Company recognized approximately a \$200 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings.”⁶³ Although the entry will not reveal any specific issue, it will provide insight into the extent to which the taxpayer took aggressive positions in prior years.⁶⁴ The IRS may be more interested in positions taken in prior years because it has a smaller window of opportunity to revisit those positions.⁶⁵

The footnote disclosures are far more informative than the financial statements themselves. The tabular reconciliation requires, among other things, disclosure of “decreases in unrecognized tax benefits relating to settlements with tax authorities.”⁶⁶ An issue is

59. See Pies & Gropper, *supra* note 21, at 6.

60. FIN 48 Implications – LMSB Field Examiners’ Guide, LMSB-04-0507-045 (May 2007) [hereinafter *LMSB Field Examiners’ Guide*] (heading titled “Answer 1”) (emphasis added).

61. Retained earnings are the “percentage of net earnings not paid out as dividends, but retained by the company” Investopedia, *Retained Earnings*, <http://www.investopedia.com/terms/r/retainedearnings.asp>.

62. See Steven R. Schneider, *FIN 48 for Tax Lawyers—Accounting for Uncertainty in Income Taxes*, 48 TAX MGMT MEMORANDUM 8, 4 (Apr. 16, 2007).

63. *FIN 48*, *supra* note 10, app. A, ¶ 33 (providing this illustrative disclosure).

64. See Schneider, *supra* note 62, at 4.

65. See *id.* at 5.

66. *FIN 48*, *supra* note 10, ¶ 21.a(3).

“effectively settled” when, for example, the IRS has completed its examination of the return but has not examined that particular issue, so long as it is “remote that the [IRS] would examine or reexamine [that] tax position.”⁶⁷ Because the IRS adheres to a policy of not reopening completed examinations, this situation qualifies for recognition.⁶⁸ However, the recognition of significant amounts of unrecognized tax benefits immediately after completion of the IRS’s examination might disclose to the IRS the value of the aggressive tax positions *not* previously examined; thus, the IRS would be tempted to reopen the examination and revisit those positions.⁶⁹ The degree to which the IRS will exploit this disclosure remains unclear, but it appears likely that more examinations will be reopened as a result.⁷⁰

The IRS is also likely to closely monitor the “twelve-month warning” disclosures.⁷¹ For all positions for which the unrecognized tax benefits are “reasonably likely” to “significantly” change within twelve months of the reporting date, the taxpayer must disclose the nature of the uncertainty, the nature of the event potentially causing the change, and an “estimate of the range of the reasonably possible change.”⁷² Last, the interest and penalties disclosure will not typically provide insight into the *specific* positions, but it will provide the IRS with yet another measure of potential revenue.⁷³

67. *FSP 48-1*, *supra* note 48, ¶ 4 (May 2, 2007).

68. See generally *LMSB Field Examiners' Guide*, *supra* note 60 (discussing the interplay between the IRS’S policy of not reopening returns and FIN 48).

69. See *FSP 48-1*, *supra* note 48, ¶ 12 (Trott, dissenting) (“[The] disclosure could give [the IRS] reason and incentive to reopen the examination that had been closed . . .”); Schneider, *supra* note 63, at 5 (“IRS’ interest is likely to be piqued if, after the close of an audit, [it] sees a large release of tax reserves.”).

70. Blouin, Gleason, Mills & Sikes, *supra* note 1, at 10 (Robert D. Adams, senior adviser to the commissioner of the LMSB division of the IRS, commented “that the IRS might reopen an audit more often than has been the past practice to ask about a FIN 48 disclosure”); LMSB, Frequently Asked Questions About FIN 48, <http://www.irs.gov/businesses/corporations/article/0,,id=163683,00.html> (commenting that when the IRS “observes a large reserve released after an audit cycle,” applying the same criteria to reopening closed examinations, it “will take the necessary steps to protect the Government’s interest”).

71. See Schneider, *supra* note 62, at 5.

72. *FIN 48*, *supra* note 10, ¶ 21.d.

73. See Schneider, *supra* note 62, at 5.

2. *The Workpapers*

Absent any protection based on privilege, the IRS enjoys broad authority to demand workpapers, leaving taxpayers to rely primarily on the IRS's self-restraint.⁷⁴

a. *Workpapers: What Can the IRS Legally Demand?*

The IRS may examine anything which “may be relevant”⁷⁵ Unlike Rule 401 in the Federal Rules of Evidence,⁷⁶ Congress intended “to allow the IRS to obtain items of even *potential* relevance . . . without reference to its admissibility.”⁷⁷ Thus, because of the “congressional policy choice *in favor of disclosure*,” the IRS's authority to demand workpapers is formidable.⁷⁸

b. *Workpapers: IRS's Policy of Restraint*

After the Supreme Court authorized the IRS to request tax accrual workpapers in *United States v. Arthur Young & Co.*,⁷⁹ the IRS announced its intention to adhere to its “policy of restraint” and *not* request them.⁸⁰ The IRS determined that FIN 48 workpapers are “tax accrual workpapers” and, therefore, are subject to the policy of restraint.⁸¹ However, two taxpayer concerns are left unresolved. First, in light of the FIN 48 temptations, how long will the IRS retain its policy of self-restraint? Second, under what circumstances might the IRS demand FIN 48 workpapers, despite its policy of restraint?

74. See *United States v. Arthur Young & Co.*, 465 U.S. 805, 816 (1984) (stating that, regarding the immunity of workpapers from disclosure, “Congress has endowed the IRS with expansive information-gathering authority”).

75. 26 U.S.C. § 7602(a)(1) (2006).

76. Fed. R. Evid. 401 (broadly defining “relevance”).

77. *Arthur Young*, 465 U.S. at 814 (1984) (emphasis in original).

78. *Id.* at 816 (emphasis in original).

79. 465 U.S. 805, 821 (1984).

80. See I.R.S. Announcement 84-46, 1984-18 I.R.B. 18 (noting the “administrative sensitivity” to the concerns of the accounting profession).

81. See *LMSB*, *supra* note 58 (announcing that IRS counsel determined that FIN 48 workpapers are subject to the policy of restraint).

There is reason to doubt that the IRS's policy of restraint will remain intact because the entire policy is currently under revision.⁸² Even though the IRS emphasized that it is revising the policy of restraint "overall and not just for FIN 48 workpapers," FIN 48 undeniably presents a tempting opportunity.⁸³ Discussing the revision, Robert Adams, Senior Advisor to the LMSB Commissioner, elaborated, "The IRS is moving to more transparency."⁸⁴ "More transparency" can only mean more disclosure, which does not bode well for the longevity of the policy of restraint. Further, this would not be the first time the IRS has retreated from its policy of restraint. In 2002, the IRS narrowed the applicability of the policy to exclude "listed transactions" in order to "curb abusive tax avoidance."⁸⁵

Second, even if the policy of restraint survives, the protection it provides is limited because IRS examiners are allowed to routinely inquire about the aggregate amounts in the financial statements or disclosed in the notes.⁸⁶ In fact, the LMSB Field Examiners Guide to FIN 48 dictates that examiners *should* consider FIN 48 disclosures.⁸⁷ However, except for "unusual circumstances" and "listed transactions," examiners may not request that the taxpayer produce audit or tax accrual workpapers, describe their contents, or reveal the existence of a reserve for any specific transaction.⁸⁸ Taken together, although the IRS's policy of restraint currently provides some workpaper protection, that protection is far from absolute, and further, the IRS may decide in the future to cease adherence to the

82. *Id.* ("LMSB is evaluating [the policy] to ensure that it is still appropriate. . ."). Yet, to date, the LMSB has not announced a change to the policy.

83. *IRS Treatment of FIN 48 Workpapers May Change*, FED. TAX WKLY, No. 7 (Feb. 15, 2007) (Robert Adams, Senior Adviser to the LMSB Commissioner, speaking to the Washington D.C. Bar Association Section of Taxation on February 8, 2007).

84. *Id.*

85. Announcement 2002-63, 2002-27 I.R.B. 72.

86. See Internal Revenue Manual § 4.10.20.2.2.b, available at <http://www.irs.gov/irm> [hereinafter *I.R.M.*].

87. See *LMSB Field Examiners' Guide*, *supra* note 60.

88. See *I.R.M.*, *supra* note 85, at § 4.10.20.3.2 (defining policy for audit and tax workpapers); *id.* at § 4.10.20.2.2 (identifying other requests essentially equivalent to a workpaper request). An "unusual circumstance" is generally when the examiner, after having exhausted all other potential sources of information, still needs additional facts. See *generally id.* at § 4.10.20.3.1.2. "Listed transactions" are those identified by the IRS as "tax avoidance transactions." Treas. Reg. § 1.6011-4(b)(2) (2007).

policy, at least as it pertains to FIN 48 workpapers. Thus, taxpayers' primary objection is that the FIN 48 disclosure, or the workpapers that support it, will disclose their tax strategies and legal theories—in essence, their “work product.”⁸⁹

II. THE WORK PRODUCT DOCTRINE

A. *The Work Product Doctrine: The Rule and its Purpose*

First established in the 1947 landmark case, *Hickman v. Taylor*,⁹⁰ and later codified in the Federal Rules of Civil Procedure,⁹¹ the work product doctrine exists to protect the adversarial nature of litigation.⁹² To allow one litigant to benefit from the fruits of its opponent's efforts would discourage diligent advocacy.⁹³ As Justice Jackson elaborated in *Hickman v. Taylor*, “Discovery was hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary.”⁹⁴ Thus, the doctrine's founders foresaw a practice where attorneys and their clients would refrain from memorializing their thoughts in fear of having to disclose them to their opponents.⁹⁵ To prevent illogically-developed conclusions based on faded memories, the work product doctrine creates and protects a “zone of privacy,” within which matters remain free from discovery and may be fully developed.⁹⁶

The doctrine currently protects from discovery “documents and tangible things . . . prepared in anticipation of litigation.”⁹⁷ The opponent may overcome this protection only by showing a

89. See discussion *infra*, Part II.

90. *Hickman v. Taylor*, 329 U.S. 495, 510 n.9 (1947) (adopting the work product doctrine from English courts).

91. Fed. R. Civ. P. 26(b)(3).

92. See *Hickman*, 329 U.S. at 516 (1947) (Jackson, J., concurring) (“[A] common law trial is and always should be an adversary proceeding.”).

93. *Jumpsport, Inc. v. Jumpking, Inc.*, 213 F.R.D. 329, 334-35 (N.D. Cal. 2003).

94. 329 U.S. at 516 (Jackson, J., concurring).

95. See *Jumpsport*, 213 F.R.D. at 334–35 (quoting *United States v. Meyer*, 398 F.2d 66, 74 (9th Cir. 1968)).

96. See *id.*

97. Fed. R. Civ. P. 26(b)(3).

“substantial need” to prepare its case and the inability to obtain the “substantial equivalent” without “undue hardship.”⁹⁸ However, even when such a showing is made, the “mental impressions, conclusions, [and] legal theories of an attorney . . . concerning the litigation” shall be protected.⁹⁹ Within the context of FIN 48, two primary issues emerge: first, whether workpapers prepared to document FIN 48 disclosures are prepared “in anticipation of litigation,” and second, whether the protection, if any, is waived upon disclosure in the financial statements or to independent auditors.¹⁰⁰

B. “In Anticipation of Litigation”

Courts have been trending towards broader interpretations of the phrase, “in anticipation of litigation,” to include materials prepared not only for the “primary purpose” of litigation, but also those prepared “because of litigation.”¹⁰¹ Tax accrual workpapers often estimate in percentage terms the likelihood of prevailing if challenged by the IRS.¹⁰² These workpapers may be created “because of” litigation, but for the “primary purpose” of satisfying their independent auditors.¹⁰³ However, even among the courts interpreting the phrase more expansively, uncertainty remains as to whether a party may invoke work product protection when it is *required* by regulation to create materials containing legal evaluations and theories regarding future litigation.¹⁰⁴ Materials created to comply with FIN 48 fall squarely within this category.

98. *Id.*

99. *Id.*

100. See discussion *infra*, Part II.B-C.

101. *Tronitech, Inc. v. NCR Corp.*, 108 F.R.D. 655, 656 (S.D. Ind. 1985). See, e.g., *Jumpsport*, 213 F.R.D. at 336-37 (following the “because of” test, as of 2003, the “more widely endorsed” standard, even though it was introduced in *Adlman* only five years prior). See *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998).

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

103. See *id.* at 150 (holding tax accrual workpapers protected in a “because of” jurisdiction and distinguishing a contrary case, *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982), because that case was in a “primary purpose” jurisdiction).

104. Compare Melissa D. Shalit, Note, *Audit Inquiry Letters and Discovery: Protection Based on Compulsion*, 15 CARDOZO L. REV. 1263, 1279 (1994) (concluding work product will not likely apply), with Ricardo Colón, *Caution: Disclosures of Attorney Work Product to Independent Auditors May*

1. Trend Toward the More Inclusive and Flexible “Because of” Test

In 1981, in *United States v. Davis*, the Fifth Circuit adopted the “primary purpose” test.¹⁰⁵ To invoke protection under this test, a party must show that the “primary motivating purpose behind the creation of the document was to aid in possible future litigation.”¹⁰⁶

However, in 1998, the Second Circuit in *United States v. Adlman* rejected *Davis* in favor of a broader “because of” test.¹⁰⁷ Under the *Adlman* rule, a document is 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 fairly be said to have been prepared or obtained *because of* the prospect of litigation.”¹⁰⁸ The court emphasized that the *purpose* with which the document was prepared is “irrelevant to the question whether it should be protected” as work product.¹⁰⁹ The court first looked to the federal rule, which protects materials “prepared in anticipation of litigation *or for trial*.”¹¹⁰ If the rule was intended to limit protection to documents prepared “to assist in preparation for trial,” the words, “in anticipation of litigation” would be superfluous.¹¹¹ Moreover, the policies of protecting “each side’s informal evaluation of its case” and encouraging independent preparation would be undermined if documents were unprotected “merely because they were prepared to assist in the making of a

Waive the Privilege, 52 LOY. L. REV. 115, 125-26 (2006) (concluding work product should and most often does apply under the “because of” test).

105. *United States v. Davis*, 636 F.2d 1028, 1040 (5th Cir. 1981); *see Adlman*, 134 F.3d at 1198 (subsequently characterizing the *Davis* holding as “far beyond the issues raised”).

106. *Davis*, 636 F.2d at 1040.

107. *Adlman*, 134 F.3d at 1202–03.

108. *Id.* at 1202 (quoting CHARLES ALLEN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, 8 FEDERAL PRACTICE AND PROCEDURE § 2024, at 343 (2d ed. 1994) (emphasis added in *Adlman*) (internal quotations omitted)).

109. *Adlman*, 134 F.3d at 1200.

110. *Id.* at 1197 (quoting Fed. R. Civ. P. 26(b)(3)) (emphasis added).

111. *Adlman*, 134 F.3d at 1198.

business decision expected to result in the litigation.”¹¹² *Adlman*’s “because of” test is now overwhelmingly the majority rule.¹¹³

2. *Materials that Would have been Created in Substantially Similar Form*

The *Adlman* court also stated that materials which would have been prepared in “substantially similar form but for the prospect of that litigation” are not protected.¹¹⁴ If read literally, materials could remain unprotected merely because they were prepared for a dual-purpose, thus reintroducing the relevancy of the purpose for which the materials were prepared.¹¹⁵ This outcome would contradict *Adlman*’s holding that the purpose of creation is irrelevant.¹¹⁶ In *Jumpsport v. Jumpking*, Judge Brazil explained that *Adlman* did not intend for this language to create a bright-line exception to the rule that materials prepared “because of” litigation were protected.¹¹⁷ Instead, the language was intended as a reassurance that the breadth of the new test was not unlimited.¹¹⁸ Such a reassurance was necessary because the *Adlman* test was introduced amongst

112. *Id.* at 1199 (quoting Fed. R. Civ. P. 26(b)(3) advisory committee’s note).

113. The “because of” test has been adopted by the appellate courts of eight circuits. *See* *Maine v. U.S. Dep’t of Interior*, 298 F.3d 60, 68 (1st Cir. 2002); *Adlman*, 134 F.3d 1194, 1203; *In re Grand Jury Proceedings (FMC Corp.)*, 604 F.2d 798, 803 (3d Cir. 1979); *Nat’l Union Fire Ins. Co. v. Murray Sheet Metal Co.*, 967 F.2d 980, 986 (4th Cir. 1992); *United States v. Roxworthy*, 457 F.3d 590, 600 (6th Cir. 2006); *Binks Mfg. Co. v. Nat’l Presto Indus., Inc.*, 709 F.2d 1109, 1120 (7th Cir. 1983); *Simon v. G.D. Searle & Co.*, 816 F.2d 397, 401 (8th Cir. 1987); *In re Grand Jury Subpoena (Mark Torf)*, 357 F.3d 900, 907 (9th Cir. 2004). *But see* *United States v. Davis*, 636 F.2d 1028, 1040 (5th Cir. 1981) (adopting the “primary purpose test”). The Eleventh Circuit has not formally adopted the “because of” test, but agreed with the Second Circuit that the primary purpose test is “at odds with the text and policies of [the work product doctrine].” *Regions Fin.Corp. v. United States*, No. 2:06-CV-00895-RDP, 2008 WL 2139008, *4 n.7–*5 (11th Cir. 2008) (quoting *Adlman*). In the Tenth Circuit, a district court has adopted the test. *See* *S.E.C. v. Nacchio*, No. 05-cv-00480-MSK-CBS, 2007 WL 219966, *6 (D Colo. 2007) (10th Cir.).

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

115. *See* *Jumpsport, Inc. v. Jumpking, Inc.*, 213 F.R.D. 329, 338, 342 (N.D.Ca. 2003).

116. Charles M. Yablon & Steven S. Sparling, *United States v. Adlman: Protection for Corporate Work Product?*, 64 *BROOK L. REV.* 627, 649 (1998) (The sentence “reintroduces concepts of business purpose that *Adlman* otherwise banishes”).

117. *Jumpsport*, 213 F.R.D. at 345–46.

118. *Id.* at 345–46 (explaining how parts of the opinion were unrelated to the facts before it, but attempted to dispel critics’ concerns, such as, for example, the dissent in *Adlman*).

formidable adverse precedent.¹¹⁹ Nevertheless, some courts have required the party invoking protection to prove that the materials would not have been prepared in substantially similar form in the absence of potential litigation.¹²⁰

C. *Waiver*

Fortunately, because the policies underlying the work product doctrine differ from those supporting the attorney-client privilege, work product protection is not as easily waived as the attorney-client privilege by disclosure to third-party.¹²¹ The purpose of the attorney-client privilege is “to encourage . . . full and frank discussion” by maintaining confidentiality, while the work product privilege exists “to prevent a potential adversary from gaining an unfair advantage”¹²² Thus, it is more likely that FIN 48 workpapers will remain protected and not be deemed waived under the work-product doctrine than under attorney-client privilege.¹²³

With the underlying policy in mind, work product protection is waived by disclosure to a third party only if the disclosure “substantially increase[s] the opportunities for potential adversaries to obtain the information.”¹²⁴ If the material is disclosed with the “actual intent” that an opponent may obtain it, the taxpayer may not subsequently invoke work product protection.¹²⁵ Thus, within the context of FIN 48, the controversy will primarily surround whether an independent auditor is an “adversary” and whether the taxpayer

119. *Id.* at 344.

120. *See* *Maine v. U.S. Dep’t. of Interior*, 298 F.3d 60, 70 (1st Cir. 2002) (denying protection based on insufficient showing that material would not have otherwise been created in substantially similar form); *Grinnel Corp. v. ITT Corp.*, 222 F.R.D. 74, 78 (S.D.N.Y. 2003).

121. *See* *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 152 (D.R.I. 2007).

122. *Id.*

123. *See id.* at 152–54 (finding that both the attorney-client and work-product privileges covered tax accrual workpapers and that the attorney-client privilege was waived but the work product privilege was not).

124. *See* WRIGHT, MILLER & MARCUS, *supra* note 108, § 2024. Work product protection may also be waived in other ways less relevant to FIN 48 compliance. *See generally* 23 AM. JUR. 2D *Depositions and Discovery* § 49 (2007) (discussing the various ways that work product protection can be waived).

125. *See* WRIGHT, MILLER & MARCUS, *supra* note 108, § 2024.

was de facto compelled to disclose the information either in the financial statements or to the auditor.¹²⁶

1. Is an Independent Auditor an Adversary?

Most courts properly hold that independent auditors are not “adversaries” in the context of a work product waiver.¹²⁷ First, the “common interest test” should not be applied to disclosures made to independent auditors.¹²⁸ Second, an application of the policies underlying the work product doctrine yields the conclusion that independent auditors are not adversaries.¹²⁹

a. The “Common Interest” Test and Independent Third-Parties

The “common interest” test is used in the classic scenario where two parties mount a common defense.¹³⁰ Because the two parties have common interests, disclosure by one to the other in no way makes the proceedings less adversarial; accordingly, work product protection is not waived.¹³¹ While that is undeniably a sensible rule, some courts subsequently applied the inverse of the rule and held that parties must be adversaries if they do *not* have a common interest.¹³² But what about relationships of confidence or independence where parties are neither “allies in interest” nor “opponents?”¹³³ The common interest test inappropriately excludes these relationships

126. See discussion *infra* Part II.C.1-2.

127. Compare *In re Pfizer, Inc. Sec. Litig.*, No. 90 Civ. 1260 (SS), 1993 U.S. Dist. LEXIS 18215, at *21-22 (S.D.N.Y. Dec. 22, 1993) (holding disclosure to an independent auditor does not waive work product protection) and *Textron*, 507 F. Supp. 2d at 152 (stating that “[m]ost courts” have found that independent auditors are not adversaries), with *Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113, 117 (S.D.N.Y. 2002) (holding that such a disclosure does waive work product protection).

128. See discussion *infra* Part II.C.1.a.

129. See discussion *infra* Part II.C.1.b.

130. See, e.g., WRIGHT, MILLER, & MARCUS, *supra* note 108, § 2016.2 n.35 (collecting cases).

131. *Id.*

132. See, e.g., *Medinol*, 214 F.R.D. at 115 (stating where the third-party is not “allied in interest . . . , the protection of the [work product] doctrine will be waived”).

133. See Colón, *supra* note 104, at 133-34 (arguing that auditors are independent, and that they are inappropriately deemed adversaries merely because they are not allies).

without considering the policies that underlie the work product doctrine.¹³⁴

If a disclosure does not make it substantially more likely that an opponent will gain access to the information, then protection should not be waived.¹³⁵ At least one court has indicated that the disclosure of materials to an indifferent or independent third-party who is ethically and contractually bound to maintain the material in confidence does not change the adversarial nature of potential future litigation.¹³⁶

b. Application to Independent Auditors

Independent auditors should be treated just as their name implies— independent, not adversarial; therefore, disclosures to them should not waive work product protection. In holding that the auditor relationship is adversarial, *Medinol* relied on the Supreme Court’s comments in *United States v. Arthur Young & Co.*, that the independent auditor is a “public watchdog” and “owes ultimate allegiance to the corporation’s creditors and stockholders.”¹³⁷ The workpapers in *Arthur Young* were prepared by the auditors, so the work product doctrine never applied to begin with.¹³⁸ The *Arthur Young* Court never reached the issue of waiver; it addressed an entirely different issue of whether there should be an accountant-client privilege akin to the attorney-client privilege.¹³⁹ In considering an accountant-client privilege, which would be based on “loyal representati[on],” it makes sense to differentiate between independent

134. *Id.*

135. WRIGHT, MILLER & MARCUS, *supra* note 108, at § 2024.

136. See *Genevit Creations v. Underwriters at Lloyd’s*, 166 F.R.D. 281 (E.D.N.Y. 1996) (extending work product protection to materials prepared in prior unrelated litigation because a confidentiality agreement was effectuated).

137. *Id.*; see also, e.g., *Medinol v. Boston Scientific Corp.*, 214 F.R.D. 113, 116 (S.D.N.Y. 2002) (relying on *Arthur Young* to find the auditor-client relationship adversarial) (quoting *United States v. Arthur Young & Co.*, 465 U.S. 805, 818 (1984)). *But see* Colón, *supra* note 105, at 132 (arguing that this rationale is erroneous).

138. *Arthur Young*, 465 U.S. at 815, 817.

139. See generally *id.*; see also Colón, *supra* note 104, at 133.

auditors and attorneys in terms of loyalty and advocacy.¹⁴⁰ It does not follow, however, that the distinction between independent auditors and attorneys should be drawn in the different context of waiving work product protection, which is predicated on the likelihood of adversaries to obtain protected information.¹⁴¹

The American Institute of Certified Public Accountants (AICPA), in defining the relationship between independent auditors and their clients, expressly rejected an adversarial role in favor of one of “professional skepticism.”¹⁴² “[I]ndependence does not imply the attitude of a prosecutor but rather a *judicial impartiality*”¹⁴³ Moreover, not only are independent auditors “impartial,” but they are also ethically (and usually contractually) bound to maintain confidence.¹⁴⁴ Ethically, auditors “shall not disclose any confidential client information without the specific consent of the client.”¹⁴⁵ Thus, the risk that an independent auditor may reveal the protected information to a potential adversary is negligible.

From a policy perspective, labeling independent auditors as “adversaries” for the purposes of work product waiver is undesirable.¹⁴⁶ If a taxpayer knows that anything it gives to the auditor may end up in the hands of a tax agency, the taxpayer will be less inclined to comply with the auditor’s requests.¹⁴⁷ The effect would be to undermine the purpose of requiring audits to begin with—

140. *Arthur Young*, 465 U.S. at 817. Although the Court in *Arthur Young* declined to create an accountant-client privilege, Congress later created a “tax practitioner-client” privilege which, like the attorney-client privilege, is easily waived. See 26 U.S.C. § 7525(a)(1) (2007).

141. See Colón, *supra* note 104, at 133.

142. See *id.* at 133–34.

143. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 1, § 220, ¶ .02 (Am. Inst. of Certified Pub. Accountants 1972) (emphasis added). *But see In re Disonics Sec. Litig.*, No. C-83-4584-RFP (FW), 1986 WL 53402, at *1 (N.D.Cal. June 15, 1986) (holding independent auditors are adversaries because they “ha[ve] responsibilities to creditors, shareholders, and the investing public”) (citing *Arthur Young*, 465 U.S. at 817-18)). The *Disonics* court, however, failed to explain how that fact makes it substantially more likely that opponents in litigation may obtain proprietary information. *Id.*

144. CODE OF PROF'L CONDUCT, Confidential Client Information No. 301, ¶ .01 (Am Inst. of Certified Pub. Accountants 1992).

145. *Id.*

146. See Colón, *supra* note 104, at 132–35.

147. *Id.* at 134.

the protection of investors.¹⁴⁸ Thus, independent auditors should not be deemed “adversaries” for the purpose of work product waiver.¹⁴⁹

2. *De Facto Compulsion*

To constitute a waiver, disclosure to a third-party must be voluntary.¹⁵⁰ Disclosure compelled by a court order does not waive work product protection.¹⁵¹ Courts are also “reluctant to find a waiver of a privilege when [disclosure is made] . . . under circumstances indicating there was *realistically no voluntary disclosure*.”¹⁵² The degree to which practical circumstances demonstrate absence of voluntary disclosure, however, is rarely adjudicated.¹⁵³

a. *FIN 48 Leaves Taxpayers With No Practical Choice*

Absent work product protection, GAAP-based taxpayers have little choice other than to disclose information containing counsel’s comments and assessments concerning possible litigation in their financial statements.¹⁵⁴ The SEC requires that financial statements be audited in accordance with GAAS, and GAAS requires the financial

148. *Id.* at 135.

149. The *Arthur Young* Court noted an additional concern that protecting similar workpapers would “destroy the appearance of auditor’s independence by creating the impression that the auditor is an advocate for the client.” *United States v. Arthur Young & Co.*, 465 U.S. 805, 819 n.15 (1984). If this were ever true, it is not anymore. Under *Sarbanes-Oxley*, independent auditors are now held accountable to the Public Company Oversight Board (PCAOB) via periodic inspections and, if necessary, investigations. *See* 15 U.S.C §§ 7211, 7215 (2007) (establishing the PCAOB and authorizing it to conduct investigations). Notably, all materials disclosed to the PCAOB are absolutely privileged. 15 U.S.C § 7215(b)(5)(A) (2007).

150. *See* MARC I. STEINBERG & RALPH C. FERRARA, SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT, § 11:15 (2007); *Niagara Mohawk Power Corp. v. Stone & Webster Eng’g Corp.*, 125 F.R.D. 578, 587–88 (N.D.N.Y. 1989) (affording protection when disclosure to adversary was not voluntary and noting that the waiver rule “applies equally to the work product privilege”).

151. *See* *Transamerica Computer Co. v. IBM Corp.*, 573 F.2d 646, 648, 650 (9th Cir. Cal. 1978) (treating the attorney-client and work product privileges as the same, the court stated that “a party does not waive the attorney-client privilege for documents which he is *compelled* to produce”) (emphasis in original); *see also* STEINBERG & FERRARA, *supra* note 150.

152. *See* *Simpson v. Braider*, 104 F.R.D. 512, 523 (D.C. 1985) (collecting cases) (emphasis added).

153. *See, e.g., id.* (noting the “dearth of judicial precedent”).

154. *See* Colón, *supra* note 104, at 138.

statements to be prepared in accordance with GAAP.¹⁵⁵ Failure to meet these requirements would result in a “qualified opinion,” which would be financially devastating to most reporting companies.¹⁵⁶

b. Building on FAS 5, Accounting for Loss Contingencies

The debate concerning work product protection is ongoing in the closely related context of attorney opinion letters written for compliance with the Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (FAS 5).¹⁵⁷ FAS 5 requires recognition and disclosure of “probable” loss contingencies and disclosure of loss contingencies that are only “reasonably possible.”¹⁵⁸ Because auditors lack the legal skills necessary to evaluate potential litigation, they are required to obtain “attorney opinion letters” from the client’s counsel.¹⁵⁹ Thus, FAS 5 “put[s] corporations in a position of having to disclose information otherwise protected by the work product privilege to independent auditors.”¹⁶⁰

Commentators generally agree that taxpayers are de facto compelled to disclose attorney opinion letters to comply with FAS 5.¹⁶¹ FIN 48 presents an even stronger case for expanding work product protection than FAS 5 because FIN 48 disclosures reveal information that is more useful to potential adversaries. For example, FAS 5 may not require disclosure when the potential claimant has

155. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standard No. 58, § 508.08(h) (Am. Inst. of Certified Pub. Accountants 1989) [hereinafter *AU 508*].

156. See, e.g., *Arthur Young*, 465 U.S. at 819 n.14. A “qualified opinion,” as opposed to an “unqualified opinion,” effectively states that the financial statements are not prepared in accordance with GAAP in some material respect. See *AU 508*, *supra* note 156, § 508.10.

157. See generally *FAS 5*, *supra* note 9; Peggy A. Heeg, *Auditors Are Increasingly at Odds with Attorneys: Loss-Contingency Views, Which Are Subject to Privilege, Are at Issue*, 29 NAT’L L.J. S1 NO. 12 (2006) (describing the debate).

158. See *FAS 5*, *supra* note 9, ¶¶ 8–10.

159. CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 12, §§ 337.06, 337.09 (Am. Inst. of Certified Pub. Accountants 1980).

160. See Colón, *supra* note 104, at 139.

161. See Shalit, *supra* note 104, at 1281 (concluding attorney letters pursuant to FAS 5 are de facto compelled); Colón, *supra* note 104, at 136 (same). See generally Michael F. Sharp & Abraham M. Stanger, *Audit-Inquiry Responses in the Arena of Discovery: Protected by the Work-Product Doctrine*, 56 BUS. LAW. 183 (Nov. 2000) (same).

made no “manifestation . . . of an awareness of a possible claim.”¹⁶² FIN 48, on the other hand, requires the presumption that a claim will be asserted.¹⁶³ Second, where a FAS 5 disclosure contemplates a virtually limitless number of potential or actual claimants, FIN 48 disclosures pertain only to tax positions.¹⁶⁴ Thus, while the law remains in a state of flux regarding FAS 5, FIN 48 may prove to be the catalyst that aligns the courts more uniformly with the commentators.

III. FIN 48: A LOOK TO THE PAST AND TO THE FUTURE

Even though there are legal grounds on which to protect privileged information, they are uncertain, and taxpayers are likely to conclude that raising a legal challenge could be a bad business decision.¹⁶⁵ The costs and adverse publicity associated with such a challenge, as well as the possibility that it would give the IRS yet another reason to initiate proceedings, may be too great to even attempt to invoke work product protection.¹⁶⁶ Grumbling at the prospect of turning over their legal theories and evaluations to their enemy, taxpayers are left asking two questions: Should the FASB have promulgated FIN 48, and if not, what, if anything, can be done about it?

A. *The Past: Should the FASB have Promulgated FIN 48?*

Without a doubt, the FASB, with FIN 48, has accomplished what it set out to do: improve transparency and comparability.¹⁶⁷ And without a doubt, FIN 48 clearly regulates financial reporting and,

162. See *FAS 5*, *supra* note 9, ¶ 10.

163. See *FIN 48*, *supra* note 10, ¶ 7.a.

164. See *id.* (limiting its application to *income* taxes).

165. See *United States v. Arthur Young & Co.*, 465 U.S. 805, 818-19 (1984) (“Responsible corporate management would not risk a qualified evaluation of a corporate taxpayer’s financial posture . . .”).

166. See discussion *infra* Part IV.A.-B. (discussing possible reactions of the IRS and investors to a taxpayer’s invocation of work product protection).

167. See, e.g., Meyer, *supra* note 57 (opining that FIN 48 eliminates confusion by providing a clear standard).

consequently, falls within the FASB's rule-making authority.¹⁶⁸ However, FIN 48 not only regulates financial reporting, but also substantially affects the legal relationship between the taxing agencies and taxpayers.¹⁶⁹ Furthermore, the FASB rejected the "roadmap" objection for a reason which may be inappropriate.¹⁷⁰ This is disheartening if and to the extent that FIN 48 disclosures in the financial statements themselves practically compel the revelation of work product, but the FASB cannot be responsible for the inconsistency with which courts protect the disclosure of FIN 48 workpapers to independent auditors.

FIN 48 reflects the belief that the taxpayers deserve less protection against the IRS than against other opponents in litigation.¹⁷¹ In rejecting the "roadmap" objection, the FASB refused to "analogize[] the relationship between a taxpayer and a taxing authority to the parties in a lawsuit."¹⁷² It continued, "A counterparty in a lawsuit is acting in its own particular interest, while a taxing authority is acting in the broader public interest in regulating compliance"¹⁷³ FIN 48, when compared to FAS 5, illustrates the different attitude. For example, FIN 48 establishes a presumption that all uncertain tax positions will be challenged, while FAS 5 excuses unasserted claims.¹⁷⁴

However, taxpayers should be entitled to the same level of protection against the IRS as against any other litigant. Donald Korb, IRS Chief Counsel, explained that "in an ideal world the views of the

168. See Comm. Statement of Policy Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, S.E.C. Release Nos. 33-8221, 34-47743, 80 SEC Docket 139, at 16 (Apr. 25, 2003).

169. See *supra* notes 30-31 and accompanying text (FASB's authority is limited to regulating financial reporting); see also discussion *supra* Part II.C.2.a. (concluding that taxpayers are left with no practical choice).

170. See *FIN 48*, *supra* note 10, app. B ¶ 64.

171. See *FIN 48*, *supra* note 10, app. B ¶ 64; see also Tammy Whitehouse, *First FIN 48 Disclosures Show Tax Struggles*, COMPLIANCE WK., Apr. 24, 2007 (noting the "stigma on assertions of attorney-client privilege over tax documents" (paraphrasing Eli Dicker, Chief Tax Counsel for the Tax Executives Institute)).

172. See *FIN 48*, *supra* note 10, app. B ¶ 64.

173. *Id.*

174. See *supra* text accompanying notes 162-163 (comparing FIN 48 to FAS 5).

IRS and the taxpayer would converge on the right number”¹⁷⁵ Implicit in this convergence is the idea that *both* parties—the taxpayer *and* the IRS—will litigate with zealous advocacy, and through that zealous advocacy, the “right” result will eventually emerge in our tax laws.¹⁷⁶ Placing taxpayers and tax agencies—opposing litigants—on a tilted playing field hinders the evolutionary process, and the quality of our adversarial system and the law it produces diminishes.¹⁷⁷ Both the IRS and the judiciary embrace the idea that both the IRS and the taxpayers will push the envelope in protection of their rights, and that tendency will enhance a fair development of our tax laws. However, FIN 48 takes a contrary approach in suggesting that it is inappropriate for taxpayers to push the envelope.

To the extent that a FIN 48 financial statement disclosure *itself* requires revelation of privileged information, FIN 48 disregards the work product doctrine in favor of transparency; that is, FIN 48 places reporting companies in the unenviable position of practically having to sacrifice protected information created in anticipation of litigation in order to comply with financial reporting rules.¹⁷⁸ To be sure, only in rare circumstances will a FIN 48 disclosure itself reveal privileged information.¹⁷⁹ This is of little solace, however, to those few affected taxpayers.

On the other hand, the creation and disclosure of FIN 48 workpapers to independent auditors, as opposed to the disclosure of protected information in the financial statements themselves, may enable taxing authorities to obtain the workpapers.¹⁸⁰ Responsibility for this possibility, however, cannot rest with the FASB. In this arena, FIN 48 merely brings to the forefront a previously existing

175. See Meyer, *supra* note 57.

176. *Id.*

177. See generally Hickman v. Taylor, 329 U.S. 495, 516 (1947) (“[A] common law trial is and always should be an adversary proceeding.”) (Jackson, J., concurring).

178. See discussion *supra* Part II.C.2.a. (concluding that taxpayers are left with no practical choice); see also Leone, *supra* note 24 (concluding that “the FASB has gone too far with FIN 48”).

179. See discussion *infra* Part IV.A.

180. See discussion *supra* Part II.C. (concluding that disclosure of FIN 48 workpapers to independent auditors should not be, but frequently are, deemed a waiver).

problem—waiver of protection through disclosure to an auditor.¹⁸¹ Responsibility for that problem—a *legal* problem—rests with the legislature and the judiciary. In other words, FIN 48 does not mandate that taxpayers waive their privilege in an audit.¹⁸² In fact, strengthening work product protection would not in any way conflict with or infringe upon the purposes of FIN 48—transparency and comparability.¹⁸³ FIN 48 workpapers could remain protected in the hands of an auditor, and confidential disclosure to the PCAOB would adequately ensure that FIN 48 disclosures are accurate and made in good faith.¹⁸⁴ Thus, the FASB, in promulgating FIN 48, is not responsible for the failure of courts and legislatures to consistently protect those workpapers when disclosed to an auditor.

B. The Future: Is FIN 48 Here to Stay?

As is evident from the vast uncertainty and diversity in the legal standards governing privileges and how they are waived, the work product privilege has proven incapable of providing a timely, uniform solution to the problem.¹⁸⁵ Disgruntled taxpayers may direct their attention to Congress, seeking legislation that would uniformly protect the disclosure of FIN 48 workpapers to independent auditors.

Congress could enact legislation prescribing that disclosure of protected materials to independent auditors as part of a financial statement audit shall not constitute a waiver.¹⁸⁶ Congress has already provided this protection for workpapers disclosed by auditors to the PCAOB for purposes of routine examinations and investigations, and has also more recently created a tax practitioner-client privilege akin

181. The waiver problem existed previously in the context of FAS 5. *See* discussion *supra* Part II.C.2.b.

182. *See* discussion *supra* Part I.C. (detailing the requirements of FIN 48).

183. *See* FIN 48, *supra* note 10, *Reason for Issuing this Interpretation*.

184. *See* *supra* note 149 (arguing that the PCAOB would adequately protect the investors, even if a taxpayer's disclosures to independent auditors were confidential, with the exception of PCAOB inspections and investigations).

185. *See* discussion *supra* Part II.

186. *See* Colón, *supra* note 104, at 142–43 (“Congress must step in and enact legislation to clarify the inconsistency among the lower federal courts.”); 26 U.S.C.A. 7525 (creating a tax practitioner-client privilege).

to the attorney-client privilege.¹⁸⁷ This legislation has already been called for in response to FAS 5.¹⁸⁸ Because FIN 48 requires more intrusive disclosures that are more meaningful to opposing litigants or potential litigants, FIN 48 could provide the catalyst to trigger congressional action.

IV. TAXPAYER CHALLENGES “AS APPLIED”

In absence of legislative action or judicial uniformity, taxpayers must rely on challenging FIN 48 “as applied” to them specifically. Taxpayers’ challenges to compliance with FIN 48, with the IRS’s requests for workpapers, or both, will primarily be grounded on the work product doctrine. Challenges on these grounds will most likely be raised at any of three stages.¹⁸⁹ First, taxpayers theoretically could decline to make certain financial statement disclosures required by FIN 48, claiming that the information contained in the disclosure itself is privileged, a highly unlikely scenario.¹⁹⁰ Second, taxpayers could refuse to provide workpapers to the independent auditors.¹⁹¹ Third, taxpayers may instruct their independent auditors not to provide the requesting tax agency with FIN 48 workpapers.¹⁹² The following subsections will consider and compare the applicability of the work product doctrine and other considerations involved in raising a challenge at each opportunity.

A. Limited Disclosure

A taxpayer could invoke protection of the work product privilege at the earliest opportunity by declining to disclose the relevant information required by FIN 48. This challenge would take the form of a “non-disclosure disclosure,” otherwise known as a “limited

187. See *supra* note 149.

188. See Colón, *supra* note 104, at 142–43.

189. See discussion *infra* Part IV.A-C.

190. See discussion *infra* Part IV.A.

191. See discussion *infra* Part IV.B.

192. See discussion *infra* Part IV.C.

disclosure”—a note to the financial statements explaining that the taxpayer declined to disclose the relevant information because it is privileged. Because the omission of a disclosure required by GAAP would require the independent auditor to issue a qualified or adverse opinion, the taxpayer would attempt to enjoin the auditor from issuing a qualified or adverse opinion on the grounds of an incomplete FIN 48 disclosure.¹⁹³

Invocation of work product protection at this early stage of FIN 48 compliance would be difficult, but not impossible. Only in rare circumstances would the financial statement disclosures themselves reveal work product.¹⁹⁴

In some circumstances, a taxpayer may challenge the “twelve month warning” disclosure.¹⁹⁵ For unrecognized tax benefits that are “reasonably possible” to “significantly increase or decrease within twelve months of the reporting period,” FIN 48 requires the entity to disclose the nature of the uncertainty, the potential underlying event, and the “range of the reasonably possible change.”¹⁹⁶ If only one tax position is expected to settle in the next twelve months, mental impressions regarding that specific position must be revealed.¹⁹⁷ Even if more than one position is expected to settle, because this disclosure usually pertains to fewer tax positions, it is more likely that the IRS could discern the attorney’s evaluation of a specific position.¹⁹⁸ “[I]f there are five small issues and one big issue, it may not be difficult to figure out the company’s view of settlement prospects for the big issue.”¹⁹⁹

The disclosure of “effectively settled” positions within the tabular reconciliation may also reveal mental impressions.²⁰⁰ “Effective

193. See CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 32, § 431.03 (Am. Inst. of Certified Pub. Accountants 1980) (requiring a qualified or adverse opinion if management omits information in a footnote disclosure that is required by GAAP).

194. See discussion *supra* Part II.A.

195. See discussion *supra* Part I.D.1. (discussing the twelve-month warning disclosure).

196. *FIN 48*, *supra* note 10, ¶ 21.d.

197. *Id.*

198. See Pies & Gropper, *supra* note 21, at 6.

199. *Id.*

200. See discussion *supra* Part I.D.1 (discussing the reconciliation).

settlements” include not only express settlements, but also positions *not* examined during a completed audit.²⁰¹ Through a process of elimination, the IRS could deduct the value of settlements of which it is aware and eliminate all positions it did examine to derive the attorney’s evaluation of unexamined positions.²⁰² After narrowing down the possibilities to such a small pool, a tax agency may be able to discern a taxpayer’s evaluation of a specific issue.²⁰³

These are the scenarios most likely to reveal protected information, but they are by no means exclusive. Essentially, any set of circumstances in which a FIN 48 disclosure allows the IRS to discern the value of a *specific* tax position, either directly or indirectly, should fall within the umbrella of the work product doctrine.

If successful, this preemptive challenge would preclude the IRS from utilizing proprietary information in subsequent litigation against the taxpayer.²⁰⁴ Second, by avoiding the relevant disclosure requirements entirely, the IRS could not use the information for audit selection.²⁰⁵

However, preemptively challenging FIN 48 compliance would in itself raise a flag.²⁰⁶ Both the taxing agencies and investors may view such an offensive maneuver as an indication of overly-aggressive tax positions.²⁰⁷ Further, because a limited disclosure would necessitate an injunctive action against the independent auditors—a suit in which the PCAOB would presumably intervene—substantial legal fees

201. See *FSP 48-1*, *supra* note 48, ¶ 4 (completed examination may constitute an effective settlement).

202. See Pies & Gropper, *supra* note 21, at 6.

203. *Id.*

204. See generally *Hickman v. Taylor*, 329 U.S. 495 (1947) (defining the implications of work product protection).

205. See discussion *supra* Part I.D. (describing the “roadmap” that a FIN 48 disclosure could provide).

206. See Aaron J. Rigby, *The Attorney-Auditor Relationship: Responding to Audit Inquiries, the Disclosure of Loss Contingencies and the Work-Product Privilege*, 35 No. 3 SEC. REG. L. J. 1 (2007) (describing the same dilemma, but within the context of audit inquiry letters; corporations must either disclose privileged information or limit disclosures and “risk receiving regulatory/shareholder criticism or worse, a devastating ‘qualified’ [opinion]”).

207. *Id.*

would be inevitable.²⁰⁸ Thus, except in extraordinary cases, the adverse practical consequences are so severe that a limited disclosure would not likely be considered.

B. Refusal to Provide Workpapers to Independent Auditors

Alternatively, a taxpayer could object to an independent auditor's request to provide audit inquiry letters or other materials in the course of a routine audit—another highly unlikely scenario.²⁰⁹ If the contents of FIN 48 workpapers constitute work product, the workpapers would be protected, unless that protection is waived.²¹⁰ Because the workpapers are never disclosed to the auditors, the uncertain issue of whether disclosure to an auditor constitutes a waiver is avoided.²¹¹

However, similar to the assertion that the disclosure itself is protected, to avoid a qualified opinion, the auditor must be enjoined from issuing a qualified opinion on the grounds of a FIN 48 scope limitation.²¹² In comparison to a limited disclosure, however, this challenge draws less adverse attention. This procedure is defensive in nature, rather than offensive (like a limited disclosure), because it only arises after the IRS has requested proprietary documentation and after a FIN 48 disclosure has been made.²¹³ For the same reason, investors and taxing agencies will not likely suspect that the taxpayer has taken an unethical or unreasonably aggressive position.²¹⁴

208. Because the PCAOB is charged with regulating the audit firms and one decision could set precedent for subsequent cases, the PCAOB would likely intervene. *See generally* 15 U.S.C §§ 7211, 7215.

209. *See* Shalit, *supra* note 104, at 1310 (acknowledging the possibility of refusing an independent auditor's request for an audit inquiry letter, but dismissing it as "unrealistic").

210. *See* discussion *supra* Part II.B.

211. *See* discussion *supra* Part II.C. (discussing waiver).

212. *See* discussion *supra* Part IV.A. (discussing injunctions that should be obtained).

213. *See* discussion *supra* Part IV.A. (discussing how investors may react adversely to a limited disclosure).

214. *Id.*

C. *Refusal to Disclose Workpapers to the Taxing Agency*

Taxpayers will generally make the financial disclosure and provide the supporting workpapers to the independent auditors, waiting until a taxing agency demands the workpapers to raise an objection. Although the law remains uncertain, courts *should* afford work product protection to these workpapers.²¹⁵

Awaiting a demand by the IRS presents several advantages; the taxpayer avoids the adverse publicity which will likely accompany an offensive challenge.²¹⁶ Additionally, the taxpayer may not be audited, but if an audit occurs, the IRS may not examine the position that is of particular concern to the taxpayer.²¹⁷ Alternatively, the taxpayer may be able to satisfy the IRS as to that position without providing the proprietary workpapers.²¹⁸ Thus, the taxpayer may minimize legal fees and await the last opportunity to object, a predicament which may never even arise.²¹⁹ Thus, this option *still* protects the most damaging information—legal theories and evaluations on an *individual* level—without raising a red flag to investors or the IRS, whether legitimate or not, that the taxpayer may have taken unreasonably aggressive positions.²²⁰ However, by disclosing the workpapers to an independent auditor, the taxpayer subjects itself to the legal uncertainty of whether such disclosure constitutes a waiver.²²¹

215. See discussion *supra* Part II.C. (concluding that FIN 48 workpapers should not be deemed waived upon disclosure to independent auditors in the course of a routine audit).

216. See discussion *supra* Part IV.A. (discussing potentially adverse investor reaction).

217. See generally *FSP 48-1*, *supra* note 48 (discussing the effect of audits where an individual aggressive tax position is *not* examined).

218. See Heeg, *supra* note 157 at 12 (emphasizing the need for counsel to “negotiat[e] disclosure issues [with auditors] at the outset of the relationship” to reduce the risk associated with waiving protection).

219. See generally *id.*

220. See discussion *supra* Part IV.A. (discussing potentially adverse investor reaction and the possibility of triggering additional scrutiny from the IRS).

221. See discussion *supra* Part II.C.1.b. (concluding that disclosures to independent auditors should *not* be held a waiver, but acknowledging the inconsistent holdings).

CONCLUSION

Why is FIN 48 so problematic? After all, it only requires a taxpayer to disclose on its financial statements positions it thought it could not win, and everyone must pay their fair share, right?²²² This seems to be the rationale the FASB adopted in promulgating FIN 48, and at least for clear-cut tax issues, it is undoubtedly appropriate.²²³ Tax *avoidance*—a *crime*—is not a part of this debate.²²⁴ However, taxes are not always clear-cut. George W. Bush commented, “The tax code is a complicated mess. You realize, it’s a million pages long.”²²⁵ Even Albert Einstein agreed.²²⁶ True to its name, “Accounting for *Uncertainty* in Income Taxes,” it is only at the margins—those areas of ambiguity—where FIN 48 enters the picture.²²⁷

Ambiguity in the tax law is resolved by *litigation*—a system of *adversaries*.²²⁸ For effective common law to develop, courts must hear “zealous advocacy” from *both* sides in *every* case.²²⁹ Tax law is no exception. The FASB, however, refuses to analogize the IRS-taxpayer relationship to a relationship of litigating opponents, and, consequently, affords less protection for the former relationship.²³⁰

FIN 48 requires detailed financial statement disclosures, which compile a “roadmap” to lead the IRS to the positions taxpayers feel least confident about.²³¹ These disclosures shift the power pendulum in favor of the tax agencies, and they have taken notice.²³² The IRS fully intends to use FIN 48 to its advantage, both in the audit

222. See *FIN 48*, *supra* note 10, ¶ 5.

223. See discussion *supra* Part III.B.1.

224. See I.R.C. § 7201 (2007) (defining tax avoidance as a crime).

225. *How Long Is It?* <http://www.trygve.com/taxcode.html> (Mar. 12, 2006).

226. Internal Revenue Service: Tax Quotes, <http://www.irs.gov/newsroom/article/0,,id=110483,00.html> (last visited Jan. 18, 2009) (quoting Albert Einstein, “The hardest thing in the world to understand is the income tax”).

227. See *generally* *FIN 48*, *supra* note 10.

228. See *generally* *Hickman v. Taylor*, 329 U.S. 495, 516 (1947) (Jackson, J., concurring) (“[A] common law trial is and always should be an adversary proceeding”).

229. *Id.*

230. See discussion *supra* Part III.B.1.

231. See discussion *supra* Part I.D.

232. See *supra* text accompanying note 57.

selection process and to spot issues within a particular audit;²³³ it may even begin routinely requesting FIN 48 workpapers.²³⁴

The law is currently inconsistent, but the policies underlying the work product doctrine strongly suggest FIN 48 workpapers should be protected, even if they are disclosed to independent auditors.²³⁵ The disclosure itself may also fall within the work product doctrine, possibly necessitating a “limited disclosure.”²³⁶ Only in rare cases, however, would the disclosure itself identify individual tax positions, and even in those rare situations, taxpayers will likely decline to object in order to minimize legal fees and adverse public perception.²³⁷

In the absence of much-needed legislation to add strength and uniformity to the work-product doctrine, taxpayers will unfortunately have to continue walking the line by attempting to satisfy the independent auditors while revealing to them as little as possible, and rolling the dice in hopes that their case will land in a more favorable jurisdiction.

Andrew W. Jones

233. See discussion *supra* Part I.D.

234. See discussion *supra* Part I.D.2.b.

235. See discussion *supra* Part II.B-C.

236. See discussion *supra* Part IV.A.

237. *Id.*