Bernardo v. Commissioner, 104 T. C. 677 (1995)

The attorney-client privilege extends to third-party communications made to assist in rendering legal advice, but not to communications with accountants hired directly by the client for non-legal purposes.

Summary

In Bernardo v. Commissioner, the U. S. Tax Court addressed the scope of the attorney-client privilege and work product doctrine in a tax dispute over charitable contribution deductions. The case involved documents withheld by the taxpayers on grounds of privilege. The court ruled that the privilege did not extend to communications with an accountant hired by the taxpayers for tax preparation, but did protect communications with an art appraiser hired by the attorney to assist in legal advice. The court also held that documents prepared in anticipation of litigation after the IRS's Art Advisory Panel's report were protected as work product, and that filing a petition did not waive these privileges. The decision clarifies the application of these privileges in tax cases.

Facts

Bradford and Marybeth Bernardo claimed charitable contribution deductions for donating a sculpture to the Massachusetts Bay Transportation Authority. The IRS challenged the deductions, asserting the sculpture's value was lower than claimed. The taxpayers withheld certain documents from the IRS, claiming attorney-client privilege and work product protection. These documents included communications with their accountant, Daniel Ryan, who prepared their tax returns and represented them during the audit, and with an art appraiser, Kenneth Linsner, engaged by their attorney, Benjamin Paster, to appraise the sculpture's value. The IRS moved to compel production of these documents, arguing the privileges did not apply.

Procedural History

The IRS filed a motion to compel the production of documents withheld by the taxpayers. The taxpayers objected, claiming attorney-client privilege and work product protection. The U. S. Tax Court held a hearing on the motion, where the taxpayers submitted affidavits and testimony regarding the engagement of the accountant and appraiser. The court then issued its opinion on the applicability of the privileges to the withheld documents.

Issue(s)

1. Whether communications between the taxpayers' accountant and their attorneys are protected by the attorney-client privilege?
2. Whether documents prepared by the taxpayers' representatives before the issuance of the notice of deficiency are protected by the work product doctrine?
3. Whether the taxpayers impliedly waived the attorney-client privilege and work

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product protection by filing a petition with the Tax Court?

Holding

1. No, because the accountant was hired directly by the taxpayers for tax preparation and audit representation, not to assist the attorneys in providing legal advice.
2. Yes, because documents prepared after the IRS's Art Advisory Panel's report, but before the notice of deficiency, were created in anticipation of litigation.
3. No, because the taxpayers had not affirmatively raised a claim that could only be disproven through discovery of attorney-client communications.

Court's Reasoning

The court analyzed the attorney-client privilege, noting it extends to third-party communications made to assist in rendering legal advice. However, the privilege did not apply to the accountant's communications because he was hired directly by the taxpayers for tax preparation and audit representation, not to assist the attorneys in providing legal advice. The court distinguished this from the appraiser's communications, which were privileged because he was engaged by the attorney to assist in legal advice regarding the sculpture's value. Regarding the work product doctrine, the court held that documents prepared after the Art Advisory Panel's report were created in anticipation of litigation, as the taxpayers reasonably anticipated challenging the IRS's valuation. The court rejected the IRS's argument that filing a petition waived these privileges, stating that such a waiver requires the taxpayer to affirmatively raise a claim that puts their state of mind or knowledge in issue.

Practical Implications

This decision clarifies the scope of the attorney-client privilege and work product doctrine in tax disputes. Taxpayers and their attorneys should carefully consider who engages third-party experts and for what purpose, as this will determine whether their communications are privileged. Accountants hired directly by taxpayers for tax preparation and audit representation are not covered by the privilege, while experts engaged by attorneys to assist in providing legal advice may be protected. The ruling also emphasizes that the work product doctrine can apply to documents prepared before a notice of deficiency is issued, if litigation is reasonably anticipated. Finally, the decision underscores that filing a petition alone does not waive these privileges, providing guidance for taxpayers challenging IRS determinations. Subsequent cases have cited Bernardo when addressing similar privilege issues in tax disputes.

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