To Keep Your Secret Is Wisdom: *US v. Sanmina Corp.* Sheds Light on the Work-Product Doctrine

By Mark Leeds and Minju Kim [1]

The second half of the Samuel Johnson quote excerpted in our title is "*but to expect others to keep it is folly*." Forewarned is forearmed. Your authors spend a fair amount of their time preparing written analyses of US tax issues presented by various types of transactions. The clients for whom these analyses are prepared expect that the work is done for them in confidence. But frequently our clients share the written work with accountants and other non-lawyers. This sharing raises the issue as to whether privilege has been waived and the client would have to turn over the written work to the Internal Revenue Service (the "IRS") in the event of an audit. In *Sanmina Corp.*, decided on August 7, 2020,[2] the Ninth Circuit Court of Appeals held that the taxpayer waived one form of privilege, but retained another, after it turned over internal legal advice to a law firm and two of the "big four" accounting firms.

One may reasonably ask why a taxpayer who has sought and received written tax advice that a particular position was "more likely than not" to, or "should," be sustained would not want to turn over such advice to the IRS. One reason is that an issue raised and analyzed by a tax adviser may not be important to the IRS. If written tax advice makes a big deal about an issue, however, the IRS could choose to use the adviser's concern to challenge the taxpayer on that issue with the roadmap provided by the taxpayer, which otherwise would simply have been accepted in the audit. Furthermore, turning over one document to help persuade the IRS of an issue can result in a subject matter waiver, which requires disclosure of additional related privileged communications.[3] For these reasons and others, taxpayers frequently desire to keep their tax planning as private as possible.

I. Background on Privileges for Tax Advice

Attorney-Client Privilege. Tax legal advice rendered by an attorney can qualify for the attorney-client privilege, the work-product doctrine or both. The attorney-client privilege exists to protect the confidential communications between an attorney and its client, and vice versa, which are made to or by the client for the purpose of receiving legal advice.[4] The Ninth Circuit employs an easy to understand eight-part test to determine whether an attorney-client communication is protected by this privilege:

1) When legal advice of any kind is sought
2) from a professional legal adviser in his capacity as such,
3) the communications relating to that purpose,
4) made in confidence
5) by the client,
6) are at his instance permanently protected

7) from disclosure by himself or by the legal adviser,
8) unless the protection is waived.[5]

The attorney-client privilege extends to communications with third parties engaged to assist the attorney in providing legal advice.[6] But the client must prove that the communications to the third party were made to assist the attorney in rendering legal advice, not for another purpose, such as, accounting advice or a valuation. If the client provides otherwise-privileged legal advice to anyone other than its lawyer (e.g., non-legal adviser for accounting or tax return preparation purposes), the attorney-client privilege could be waived.

Work-Product Doctrine. If a client waives the attorney-client privilege by providing the advice to its accountants for tax preparation purposes (or otherwise), the communication may still remain privileged by the attorney work-product doctrine.[7] This doctrine generally offers "qualified" protection "from discovery documents and tangible things prepared by a party or his representative in anticipation of litigation."[8] A taxpayer asserting that communications disclosed to someone outside of the attorney-client relationship is protected work-product would be aided by contemporaneous correspondence acknowledging that the disclosure is for the purpose of addressing IRS audit controversies.

In short, the work-product doctrine becomes applicable when the client is preparing for a controversy, such as an IRS audit and it and/or the attorneys seek the assistance of non-legal professionals in addressing an actual or perceived tax controversy risk. A client can waive the attorney work-product protection by turning over the information to an adversary. Additionally, this protection is lost if and when the client makes the advice available to the IRS or another adversary or discloses the communication in a manner that makes it more likely that an adversary could obtain it.

Waiver. There are key differences between communications protected by the attorney-client privilege and work-product doctrine, especially as relates to waiver. The attorney-client privilege is waived by voluntarily disclosing documents to third parties.[9] This can be a hair-trigger waiver. As we'll see below, in *Sanmina Corp*., the IRS asserted that turning over the in-house legal memoranda *to a law firm* caused a loss of privilege. Any disclosure to an accountant or other non-lawyer can lead to a claim of waiver of the attorney-client privilege.

In contrast, the work-product doctrine is not as easily waived.[10] The work-product doctrine is waived only when material is disclosed to an adversary.[11] This principle, while generally recognized, was first made explicit in the *Sanmina* decision. Not surprisingly, a disclosure that substantially increases the risk "for potential adversaries to obtain the information" also waives the work-product doctrine.[12]

II. So What Happened in *Sanmina*?

In *Sanmina Corp*., the dispute arose between the IRS and Sanmina with respect to a $503 million worthless stock deduction claimed by Sanmina. To support its position, Sanmina provided the IRS with a valuation report that was prepared by a law firm at the time that the deduction was claimed. A footnote in the report referenced two memoranda prepared by Sanmina's in-house tax counsel relating to the relevant stock, and the text of the report stated that these documents were relied upon in writing the valuation report. The taxpayer also shared these two memoranda outside of Sanmina with two of the "big four" accounting firms, which provided tax advice related to Sanmina's decision to take the worthless stock deduction. The IRS demanded that the memoranda be turned over, but Sanmina refused, claiming the attorney-client privilege and work-product protection.[13]

The Ninth Circuit Court first dealt with the issue of whether Sanmina waived the attorney-client privilege. The issue here was whether Sanmina shared the memoranda with the law firm for the purpose of obtaining legal advice. It was the Ninth Circuit Court's view that if the purpose of the engagement with the law firm was not for obtaining legal advice, then the law firm should be treated as a third party for the purposes of the attorney-client privilege and Sanmina's disclosure of the memoranda to the law firm expressively waived the privilege.[14]

Sanmina argued that it sought advice from the law firm concerning the propriety of the tax deduction after anticipating an audit from the IRS, and therefore there was an attorney-client relationship between Sanmina and the law firm. However, the Ninth Circuit Court also noted that Sanmina disclosed the memoranda to the law firm for a non-legal purpose, which was to produce the valuation report, which was to be used for tax compliance reasons. After acknowledging that there could be a "dual purpose" (i.e., seeking both legal and non-legal advice) for sharing the memoranda to the law firm, the Ninth Circuit Court followed the district court's fact finding that Sanmina's purpose was to obtain a non-legal valuation analysis from the law firm.[15] Thus, the court held that Sanmina expressly waived attorney-client privilege over the memoranda written by the in-house tax counsel when it disclosed the memoranda to the law firm. Since the court concluded that the taxpayer shared the advice with the law firm for a non-legal purpose, it did not analyze the impact of the fact that the taxpayer also shared the advice with the accounting firms.

With respect to the work-product doctrine, the Ninth Circuit Court first addressed whether Sanmina's disclosure of the memoranda to the law firm qualified as a "disclosure to an adversary." The Ninth Circuit Court answered easily that the law firm was not an adversary nor a potential adversary, citing *Deloitte*[16] where the court held a taxpayer's disclosure of its attorney work product to an independent auditor does not constitute disclosure to an adversary sufficient to waive the protection.

The Ninth Circuit Court of Appeals then moved on to the issue of whether the law firm was nonetheless a "conduit to an adversary." The court rejected the IRS's position that the law firm was a "conduit" for disclosure to the IRS on the ground that the law firm's valuation report would be used for tax reporting purposes. Noting that Sanmina's sharing the memoranda with the law firm to obtain a valuation report for the IRS did not necessarily mean that Sanmina knew or should have known that the resulting valuation report would disclose or make reference to its attorney work product. The Ninth Circuit Court reached the conclusion that Sanmina had a reasonable expectation of confidentiality over the memoranda at the time of its disclosure to the law firm.

The final step of the analysis with respect to the work-product doctrine involved the issue of whether Sanmina waived work-product protection when it provided the IRS with the law firm valuation report, which contained footnote references to the internal legal work that was a basis for the conclusion made in the valuation report.[17] This was clearly a close call in the view of the court. The court considered whether the fact that the taxpayer turned over a report that cited the internal legal advice resulted in subject matter waiver with respect to such advice. But the court concluded that the fact that the internal communications were cited did not create a subject matter waiver that caused Sanmina to lose its work-product privilege.

The focal point of this "subject matter waiver" inquiry was whether and to what extent fairness mandated the disclosure of the memoranda in this case. Sanmina produced to the IRS both the law firm report as well as the underlying transactional documents on which the in-house memoranda and the law firm report relied. These disclosures provided the IRS with the same underlying facts on which Sanmina's attorneys relied in generating the legal opinions contained in their memoranda. According to the Ninth

Circuit Court, this information should be enough for the IRS to reach into its own conclusion for the tax deduction. Given the totality of the facts and circumstances, the Ninth Circuit Court concluded that fairness did not require the categorical disclosure of Sanmina's protected work product to the IRS, but rather requires, at most, the disclosure of the factual work product contained in the memoranda upon which the law firm relied. Therefore, the Ninth Circuit Court held that Sanmina's disclosure of the memoranda to the law firm waived the attorney-client privilege, but such disclosure did not waive their work-product protection, except for the factual content of the memoranda.

The decision in Sanmina does not address the fact that the taxpayer provided the internal legal memoranda to the two accounting firms. The facts recite that these disclosures were made for tax advice as to whether to claim the $503 million deduction. Although the decision is silent on this point, it appears that the IRS conceded that disclosure to the accounting firms was protected by one or other privileges.

III. Takeaways from the Sanmina Decision

Sanmina, *supra*, highlights the importance of properly documenting and establishing the purpose for which privileged written memoranda and opinions are shared by taxpayers among their advisers. It also shows that even when a law firm is provided with legal advice prepared by other advisers, it is important to establish that the purpose of such sharing is for legal advice or controversy preparation, not only non-legal services. Taxpayers will find much wisdom in addressing privilege issues at the time that written advice is shared, rather than playing "catch-up" when they are audited on the subject matter of the advice.

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[2] No. 18-17036 (No Federal Reporter assignment as of the date hereof).

[3] Federal Rule of Evidence 502.

[4] *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

[5] *United States v. Graf*, 610 F.3d 1148, 1157 (9th Cir. 2010).

[6] *United States v. Richey*, 632 F.3d 559 (9th Cir. 2011), *rev'g and remanding* 2009-1 USTC ¶ 50,274 (DC. 2009) *citing Smith v. McCormick*, 914 F.2d 1159 (9th Cir. 1990).

[7] Tax return preparation advice would not be protected by the work-product doctrine. Thus, it's important to keep any information regarding tax return preparation separate.

[8] *Sanmina*, *supra*, quoting *Admiral Ins. Co. v. U.S. Dist. Ct.*, 881 F.2d 1486, 1494 (9th Cir. 1989) (citing Fed. R. Civ. P. 26(b)(3)); see also *United States v. Nobles*, 422 U.S. 225, 237-38, 95 S.Ct. 2160, 45 L. Ed. 2d 141 (1975). The federal Circuit Courts of Appeals are split concerning the application of the work-product doctrine to dual-purpose documents, which serve both litigation and business purposes, with some adopting a broad approach, while others employ a narrow test.

[9] *Bittaker v. Woodford*, 331 F.3d 715, 719 (9th Cir. 2003).

[10] *Transamerica Computer Co., Inc. v. Int'l Bus. Machines Corp.*, 573 F.2d 646, 647 n.1 (9th Cir. 1978).

[11] *United States v. Deloitte LLP*, 610 F.3d 129, 140, 391 U.S. App. D.C. 318 (D.C. Cir. 2010) ("Voluntary disclosure waives the attorney-client privilege because it is inconsistent with the confidential attorney-client relationship. Voluntary disclosure does not necessarily waive work-product protection, however, because it does not necessarily undercut the adversary process.").

[12] *Sanmina*, *supra*, quoting *Rockwell Int'l Corp. v. U.S. Dep't of Justice*, 235 F.3d 598, 605 , 344 U.S. App. D.C. 226 (D.C. Cir. 2001).

[13] The IRS first filed a motion to enforce the summons in the Northern District of California, claiming these protections were waived when Sanmina provided the memoranda to the law firm, and the district court upheld the IRS's challenges to the taxpayer's privilege claims. The district court found that communications between Sanmina and outside counsel who was retained to prepare a value analysis to be used for tax compliance constituted a waiver of privilege. Sanmina then appealed to the Ninth Circuit.

[14] The attorneys were not even in a Kovel arrangement where they were helping the in-house attorneys interpret the tax laws. The Kovel arrangement is a valuable tool to protect communications between an attorney or client and a third party (e.g., an accountant).

[15] The district court used the "because of" test to determine whether a dual purpose document was prepared for litigation. The district court concluded that the memoranda were protected work-product, because they were prepared "because of" a potential challenge by the IRS.

[16] *United States v. Deloitte LLP*, 610 F.3d 129, at 139 (D.C. Cir. 2010).

[17] This is often called as an "at issue" waiver, which occurs when a party to litigation affirmatively places the subject matter of its own privileged communication at issue in litigation, so that invasion of the privilege is required to determine the validity of a claim or defense of the party asserting the privilege. This waiver follows the logic of intentional disclosures in Federal Rule of Evidence 502.