Wells Fargo Takes Up Cudgel to Protect Tax Accrual Workpapers

The IRS, trying to capitalize on the *Textron* decision, is engrossed in litigation with Wells Fargo over tax accrual workpapers in the U.S. District Court for the District of Minnesota. This case may well work its way to the U.S. Court of Appeals for the Eighth Circuit and beyond.

On September 1, 2010, Wells Fargo & Company asked a federal district court in Minnesota to quash a summons issued by the U.S. Internal Revenue Service (IRS) to Wells Fargo's independent auditor seeking "all of the Tax Accrual Workpapers for … taxable years ended December 31, 2007, and December 31, 2008" (hereinafter known as the Auditor Summons). ***Wells Fargo v. United States*****,** No. 10-mc-57 (D. Minn.). The Auditor Summons defines these documents as "any and all analyses, computations, opinions, notes, summaries, discussions, and other documents relating to such reserves and any footnotes." On November 1, 2010, the government filed a response seeking to enforce the Auditor Summons and asking for a hearing. In a related case, the government asked the same court to enforce summonses issued to Wells Fargo seeking the same documents and corresponding witness testimony. The court combined the two cases and, based on the court filings, an evidentiary hearing appears imminent.

Wells Fargo's action to quash the Auditor Summons is the most recent effort by a large corporation to maintain the protected nature of its tax accrual workpapers. Circuit courts have reached different outcomes with respect to the issue of whether so-called tax accrual workpapers are protected by the **work-product doctrine**. These documents generally contain legal analyses, opinions and discussion of the merits and odds of success in tax litigation regarding uncertain tax positions, and support the creation and entry of tax reserves on a company's financial statements.

Wells Fargo seeks to protect its tax accrual workpapers, which reside in its own files, as well as those in the auditor's possession. With respect to Wells Fargo's files, its brief identifies the following categories of documents for which it seeks protection from disclosure: memoranda based on advice of in-house tax controversy attorneys identifying and evaluating the legal merits of uncertain tax positions and selecting a reserve percentage based on the likelihood of settlement; meeting agendas and e-mails identifying and/or evaluating litigation risks associated with uncertain tax positions, including the corresponding reserve percentage and correspondence regarding settlement negotiations with the IRS; and spreadsheets, reports and electronic data files identifying uncertain tax positions, and/or evaluating appropriate legal tax reserve percentages and/or reserve amounts. Wells Fargo also seeks to protect tax accrual workpapers in the auditor's files, which Wells Fargo identifies as replications of some of the disputed tax accrual workpapers in Wells Fargo's files, and documents created by the auditor that reflect opinion work product of Wells Fargo.

The work-product doctrine finds its origins in the Supreme Court of the United States case, ***Hickman v. Taylor*****,** 329 U.S. 495 (1947), which provided for protection from disclosure to an adversary of materials prepared by or for a party or by or for that party's representative (including a consultant or agent) in anticipation of litigation. Relevant to the *Wells Fargo* case is how courts deal with a dual-purpose document, or one created for both litigation and non-litigation purposes. When applying the "in anticipation of litigation" standard to dual-purpose documents, most courts use what is known as the "because of" test, which focuses on whether "in light of the nature of the document and the factual situation in a particular case, the document can fairly be said to have been prepared or obtained *because* of the prospect of litigation." ***United States v. Adlman*** , 134 F.2d 1194, 1202 (2d Cir. 1998) (*citation omitted*). At least one circuit court has fashioned a more restrictive test, which requires that the "primary motivating purpose" behind the creation of a document be to aid in possible future litigation. ***United States v. El Paso Co.***, 682 F.2d 530 (5th Cir. 1982).

For almost 30 years, corporate America and the federal government have been battling over the disclosure of tax accrual workpapers. The U.S. Court of Appeals for the First Circuit is the most recent circuit court to hold

that tax accrual workpapers are not protected by the work-product doctrine. ***United States v. Textron*****,** 577 F.3d 21 (1st Cir. 2009) (*en banc*), *cert. denied* 130 S. Ct. 3320 (2010). View 3-2 *En Banc* First Circuit Decision in *Textron* Rules That Tax Accrual Workpapers Are Not Protected Work Product for further background regarding the history of the Textron litigation. Arguably, the First Circuit fashioned a new test for the "anticipation of litigation" standard by protecting only those documents "prepared for use in potential litigation."

Since the government's win in *Textron*, the pendulum has swung the other direction courtesy of the D.C. Circuit in ***United States v. Deloitte****, LLP*, 610 F.3d 129 (D.C. Cir. 2010). A detailed discussion of this decision can be found in Deloitte Decision Protects Work Product Disclosed to Independent Auditor. Deciding to protect a document prepared by an independent auditor containing work product of the taxpayer's attorneys, the *Deloitte* court focused on the content of the document as opposed to its function. Addressing an issue of first impression, the court also determined that disclosure of work-product material to the taxpayer's independent auditor did not constitute a waiver because such auditor was neither a potential adversary nor a conduit to another adversary. The government did not seek Supreme Court review.

The litigation in *Wells Fargo* is focused on whether the work-product doctrine applies to dual-purpose documents prepared by taxpayers to support their FIN 48 tax reserves, which but for the anticipated litigation would not have been necessary (*e.g.*, ***Regions Financial Corp. v. United States*****,** 101 A.F.T.R.2d (RIA) 2179 (N.D. Ala. 2008). The court will also confront tax accrual workpapers that were prepared by the auditor, but that contain opinion work-product material of Wells Fargo's attorneys. Additional issues are, assuming work-product protections apply, whether the government can overcome the privilege by making the required showing and whether Wells Fargo has waived the protections by disclosing the documents to the auditor.

When defining the "anticipation of litigation standard," the Eighth Circuit adopted the "because of" test. ***Simon v. G.D. Searle & Co***., 816 F.2d 397 (8th Cir. 1987); ***PepsiCo, Inc. v. Baird, Kurtz & Dobson LLP***, 305 F.3d 813 (8th Cir. 2002). This is the same "broad" test applied in a majority of circuits, including the circuit in which *Deloitte* was decided. Eighth Circuit law also dictates that for an adversary to obtain ordinary work product (such as raw factual information), it must demonstrate a "substantial need," but to obtain opinion work product (such as counsel's mental impressions, conclusions, opinions or legal theories), it must demonstrate "rare and extraordinary circumstances." ***Baker v. General Motors Corp.***, 209 F.3d 1051 (8th Cir. 2000).

Relying on ***Simon v. G.D. Searle & Co.*****,** 816 F.2d 397 (8th Cir. 1987), the government's primary position is that the tax accrual workpapers were prepared in the ordinary course of business as part of Wells Fargo's obligations pursuant to regulatory requirements, and not in anticipation of litigation. Additionally, the government asserts that the prospect of litigation was "too remote" to invoke the protections because the procedural events of having to create tax reserves (in some cases pre-return filing) and being under IRS examination are not "tantamount to anticipated litigation." The government argues that even if the work-product doctrine applies, the protection is "vitiated" because the IRS "has shown a substantial need" and the documents "cannot be obtained from another source."

The government also argues that even if the tax accrual workpapers are protected, Wells Fargo has waived the work-product privilege by providing the documents to the auditor's audit team. Citing ***In re Chrylser Motors Corp. Overnight Evaluation Program Litig****.*, 860 F.2d 844 (8th Cir. 1988) and other cases, the government asserts that disclosure of documents to an adversary or potential adversary, even with respect to a different action, waives work-product protections. The government takes the position that nothing prevents the auditor from becoming an adversary or a conduit to other adversaries.

For its part, Wells Fargo vigorously objects to the government's attempts to obtain its tax accrual workpapers, whether from Wells Fargo or the auditor. It explains that its tax accrual workpapers are, by their very nature, prepared in anticipation of litigation because they are created "because of the prospect of litigation." Wells Fargo states that but for the anticipated litigation with the IRS over its uncertain tax positions, Wells Fargo would have no need to create the tax accrual workpapers containing its attorneys' legal analyses and settlement positions. Wells Fargo also points out that Eighth Circuit law has no requirement that litigation be "imminent" to invoke the protections. Addressing the government's claim that it can overcome the protections of the work-product doctrine, Wells Fargo asserts that the government has failed to meet the required showing of "substantial need" (for ordinary work product) and made no effort to meet the Eighth Circuit's "rare or extraordinary circumstances" standard (for

opinion work product).

With respect to the government's waiver argument, Wells Fargo relies on ***Pittman v. Frazier*****,** 129 F.3d 983, 988 (8th Cir. 1993), which explains that a waiver occurs when the party who made the disclosure does so "with an actual intention that an opposing party may see the documents … ." Wells Fargo asserts that no waiver occurred because the disclosure to the auditor was neither to an adversary, nor is there any evidence Wells Fargo intended that the auditor would share the documents with an adversary. Rather, Wells Fargo relied on the auditor's legal and ethical obligations to maintain confidentiality.

Initially, the court set this matter for an evidentiary hearing to take place in March 2011. For logistical reasons, the hearing was vacated, but all indications are that it will take place in the near future. Each side has thoroughly briefed the issues and has chosen experienced litigation counsel to represent their respective interests. Considering the importance of the disputed issue and its potentially broad implications beyond tax accrual workpapers to a vast array of other types of dual-purpose documents, large corporations and their legal and tax representatives should be waiting with great anticipation as this case is ruled on by the trial court, and unquestionably as it is appealed to the Eighth Circuit (and potentially beyond).

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