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## PRIVILEGED COMMUNICATION WITH TAX PRACTITIONERS

By Victor Sy, CPA, MBA

The Internal Revenue Service Restructuring Act of 1998 extends an old privilege (previously accorded only to lawyers) to a new group of tax practitioners (CPAs, enrolled agents and enrolled actuaries). Communications between clients and federally authorized tax practitioners are now privileged (meaning such practitioners cannot be forced to testify against their clients regarding communications with those clients). In other words, your discussions with your CPA or enrolled agent now enjoy the same benefits that were once enjoyed only by lawyers. Let's explore this newfound right accorded to taxpayers and their representatives.

1. **What does the new statute cover?** First, the privilege belongs to you, the taxpayer, not your practitioner. Practitioners can neither claim nor waive such privilege without your consent. Second, the new privilege applies only to tax advice. It does not apply to tax preparation work or non-tax consulting work. The statute specifically excludes communications related to criminal matters. If a case that was not criminal winds up to be a criminal case, the privilege is retroactively revoked, meaning that there is no privilege from the start. The lesson here is for you to seek advice from an attorney experienced in criminal tax matters at the first sign that your case could be referred to the IRS Criminal Investigation Division (CID). The privilege also does not apply to state and local taxes as well as tax shelters.
2. **What is tax advice?** Since the privilege only applies to tax advice, we have to understand clearly what is meant by "tax advice." This definition includes tax representation, communications, memos concerning taxes, tax planning memos, tax-risk assessment memos and others concerning tax characterization (capital gains versus ordinary gains). It also seems logical that contemporaneous memos to your CPAs files, memorializing client discussions about tax issues, are also privileged.
3. **What about non-federally-authorized tax practitioners?** What happens when non-CPA professionals such as appraisers, engineers, and staff work on your case? The new statutes state that they are also covered by the privilege status if they are an integral part of the tax planning process and are supervised by a federally authorized tax practitioner. For example, if I represent you in an IRS examination, I may delegate to one of my staff or hire an appraiser to determine the fair market value of your residence. They become part of my team and are covered by the same privileged communication statute because they act as my agents. Therefore, the new law protects the correspondence, memoranda, telephone calls and conversations between us.
4. **Can privileged communications be waived?** Either you or your tax practitioner can waive the newfound privilege. Of course, you CPA or enrolled agent cannot waive it without your consent. Privileged communications can also be waived, intentionally or inadvertently, by a variety of means: disclosing such data to the IRS, including the information in financial statements, or telling a third party about the communications. While it is not yet clear whether the inclusion of a completed transaction in a tax return waives the privilege, it seems likely that the presence of any third party not involved in rendering tax advice waives the privilege. For example, if you meet with your CPA and your banker to discuss various transactions, that meeting probably waives the privilege since the banker is not involved in rendering tax advice. The presence of any third party waives the privilege because there is no exception of privacy with respect to a third party present in such meetings.

5. **How do you respond to summons for protected communication?** When the IRS summons communications covered by this privilege, you have the opportunity to claim the privilege. If you do want to claim such privilege, inform your tax practitioner who is not able to provide privileged information without your consent.
6. **How does this privilege relate to the burden of proof that is shifted to the IRS in court cases?** Remember that one of the conditions for shifting the burden is for you to reasonably cooperate with IRS requests for information during the hearing. Does refusing to provide information violate this “reasonable cooperation provision?” No. If you or your CPA reasonably believes that it is privileged, the mere refusal will not violate the provision and will not prevent a shift in the burden of proof should a dispute reach the courts.
7. **How does one increase the likelihood that communications will be privileged?** Perhaps, the most important step is to clearly label all privileged communications by including in front of the communication a notice such as “THIS COMMUNICATION IS PRIVILEGED UNDER IRC SECTION 7525. THIS PUTS ALL PARTIES ON NOTICE THAT THE PRACTITIONER BELIEVES THAT THE COMMUNICATION IS COVERED BY THIS NEW TAX PRIVILEGE.” The other solution is to have a separate file for tax advice files. Privileged communications should not be included in tax returns, financial statements or other documents that are not covered by the privilege.

In conclusion, this is a new right that you and your CPA or enrolled agent can exercise. Be aware of it so that the next time you meet with your tax representative, include it in the discussion just in case you may need it in the future.