Bond Case Briefs

Municipal Finance Law Since 1971

Good-Faith Defense Waives Attorney-Client Privilege.

Taxpayers forfeit the protection of attorney-client privilege on tax opinion letters from a law firm if they seek to avoid accuracy-related penalties by asserting affirmative defenses of good faith and state of mind, the Tax Court held April 16.

In *AD Investment 2000 Fund LLC v. Commissioner*, 142 T.C. No. 13 (2014), Judge James S. Halpern said that "by placing the partnerships' legal knowledge and understanding into issue in an attempt to establish the partnerships' reasonable legal beliefs in good faith arrived at (a good-faith and state-of-mind defense), [the taxpayers] forfeit the partnerships' privilege protecting attorney-client communications relevant to the content and the formation of their legal knowledge, understanding, and beliefs."

"Read broadly, the opinion suggests that asserting the reasonable belief defense to the substantial understatement penalty or the general reasonable cause and good-faith defense impliedly waives the attorney-client privilege, regardless of whether the taxpayer intends to rely on an opinion or advice of counsel for penalty protection," said Andrew R. Roberson of McDermott Will & Emery.

"I don't think the Tax Court had ever articulated [this position] like this before," said Mark D. Allison of Caplin & Drysdale. "Taxpayers need to appreciate that when they are putting their belief [and] knowledge into play in litigation, it isn't merely the specific advice or analysis they're relying on that's going to be relevant to the court's analysis." Any advice or analysis the taxpayers received or prepared, whether or not it supports their position, will come into play, he said.

"Most people probably thought that if you are not relying on particular advice that you would never have to produce it or put it in play," Allison said. "It was always a risk in the past even if it was never stated quite this clearly."

In consolidated cases in *AD Investment 2000 Fund*, the IRS sought to impose penalties on son-o--BOSS partnership tax shelters. The IRS had adjusted partnership items of two partnerships and determined that section 6662 accuracy-related penalties should apply on the underpayments of tax. The IRS sought to compel production of six opinion letters from Brown & Wood LLP telling the taxpayers it was more likely than not that the anticipated tax benefits from the transactions would be upheld for federal income tax purposes.

The taxpayers argued that they were not required to produce the opinions under the attorney-client privilege. The IRS in turn asserted that that privilege was waived by the taxpayers' affirmative defenses against the penalty that their underpayment was due to their reasonable belief that the tax treatment was proper and their assertion that any underpayment was due to reasonable cause on which they acted in good faith.

Reg. section 1.6662-4(g)(4)(i) provides that the reasonable belief requirement is satisfied if either the taxpayer analyzes the pertinent facts and authorities and relied on the analysis to conclude that there is a greater than 50 percent likelihood that the tax treatment of the item would be upheld if

challenged by the IRS (self-determination), or if the taxpayer reasonably relies in good faith on the opinion of a professional tax adviser (reliance on professional advice).

The taxpayers in *AD Investment 2000 Fund* asserted only self-determination in their defense against the penalty. But the IRS argued that the opinions provided by the law firm were still relevant to that defense, because if the opinions contradict the claimed self-determination, they could show it to be unreasonable, and if they are consistent with the self-determination, they could show that no self-determination was made.

The Tax Court agreed with the IRS and emphasized fairness in compelling disclosure of the opinion letters. If the petitioners are to rely on professional legal knowledge to establish that the partnerships reasonably and in good faith believed that their claimed tax treatment of the items in question was more likely than not the proper treatment, "it is only fair that respondent be allowed to inquire into the bases of that person's knowledge, understanding, and beliefs including the opinions (if considered)," Halpern said in the opinion for the court.

"Taxpayers and their advisers will need to carefully consider the Tax Court's analysis when responding to the assertion of penalties, both at the administrative level and in Tax Court filings," Roberson said.

Allison said it would have been interesting to see what the Tax Court would have decided if the taxpayer asserted that the opinion letters were attorney work product. The differentiation between the attorney work product and attorney-client privileges is important in other cases, he said, noting that the work product privilege allows the court to make selective decisions about producing privileged information.

by Andrew Velarde and Matthew R. Madara

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com