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**MEMORANDUM FOR LOS ANGELES DISTRICT COUNSEL**

Attn: Joseph H. Park

**FROM:** Lawrence H. Schattner  
Chief, Branch 3  
(General Litigation)

**SUBJECT:** Request for Advice on Tax Advice Privilege in I.R.C. § 7525

This Chief Counsel Advice is in response to your June 1, 1999 memorandum received by the Office of Chief Counsel (General Litigation) on July 22, 1999. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. Chief Counsel Advice issued to Examination or Appeals is advisory only and does not resolve the Service's position on an issue or provide the final basis for closing a case. This document is not to be relied on or otherwise cited as precedent.

**ISSUE:**

Whether the tax advice privilege, which under the plain terms of I.R.C. § 7525(a)(2) is not applicable in criminal tax matters or proceedings, effectively applies in such criminal matters or proceedings where the subject communications occurred during, or with respect to, earlier civil matters or proceedings.

**CONCLUSION:**

The plain terms of I.R.C. § 7525 provide that the tax advice privilege is not applicable in criminal tax matters or proceedings. This statutory exception contains no limitations or conditions and the legislative history further indicates that none should apply. Therefore, the tax advice privilege is not applicable in criminal tax matters or proceedings even if a subject communication originated in the context of a civil matter or proceeding.

FACTS:

Although I.R.C. § 7525 clearly states on its face that the tax advice privilege is not applicable to criminal tax matters or proceedings, tax practitioners are beginning to argue that there are situations where the privilege applies in the criminal context. Specifically, some tax practitioners are arguing that communications between them and their clients during, or with respect to, a civil investigation are protected communications. They argue that such communications are privileged from disclosure in any later criminal tax matter or proceeding. In effect, these tax practitioners are attempting to “boot-strap” the privilege into criminal tax matters or proceedings.

DISCUSSION:

I.R.C. § 7525 establishes a limited tax advice privilege. I.R.C. § 7525 was added by section 3411(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, and is applicable to communications made on or after July 22, 1998. I.R.C. § 7525(a)(1) establishes the general rule as follows:

With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

I.R.C. § 7525(a)(2) plainly limits the context in which the privilege can be asserted to noncriminal tax matters or proceedings. The statute provides as follows:

Paragraph (1) [§ 7525(a)(1)] may only be asserted in—

- (A) any noncriminal tax matter before the Internal Revenue Service; and
- (B) any noncriminal tax proceeding in Federal court brought by or against the United States.

To date, there are no reported cases interpreting I.R.C. § 7525 or addressing the specific issue presented. Likewise, the legislative history does not directly address the specific issue presented.

The text of the various legislative reports closely follow the language of the statute. The Senate Committee Report, S. Rep. No. 105-174, reprinted in Standard Federal Tax Reporter (CCH) para. 42,816 (1999), states:

The privilege of confidentiality may be asserted in any noncriminal tax proceeding before the IRS, as well as in noncriminal tax proceedings in the Federal Courts where the IRS is a party to the proceeding.

The Senate Committee Report also reiterates this point:

The privilege granted by the provision may only be asserted in noncriminal tax proceedings before the IRS and in the Federal Courts with regard to such noncriminal tax matters in proceedings where the IRS is a party.

Id.

The Conference Committee Report, H.R. Conf. Rep. No. 105-599, reprinted in Standard Federal Tax Reporter (CCH) para. 42,816 (1999), contains similar language:

The conference agreement also clarifies that the privilege created by this provision may be asserted in non-criminal tax proceedings before the IRS and in the Federal courts with regard to a noncriminal tax proceeding where the United States is a party.

In sum, both the plain language of the statute and the legislative history are clear: the tax advice privilege may not be asserted in criminal proceedings.

Moreover, the law does not support tax practitioners' creative efforts to fashion an exception to the plain statutory rule that the tax advice privilege does not apply in criminal tax matters or proceedings.

It is well established that under the common law, no privilege attaches to transactions between a client and a federally authorized tax practitioner, including an accountant, and such person is competent to testify to communications between himself and his client in both civil and criminal proceedings. United States v. Arthur Young & Co., 465 U.S. 805 (1984); Couch v. United States, 409 U.S. 322 (1973); see "Privileged Communications between Accountant and Client," 33 ALR4th 539 § 2 (1984 & Supp. 1999); see generally 1 Am. Jur. 2d "Accountants," § 15 (1994 & Supp. 1999). It is also well established that statutes in derogation of common law must be strictly construed. American Casualty Co. v. M.S.L. Division, 406 F.2d 1219 (7<sup>th</sup> Cir. 1969); see Charney v. Thomas, 372 F.2d 97 (6<sup>th</sup> Cir. 1967) (statutes in derogation of common law must be construed narrowly). The courts have repeatedly held that changes in common law effected by statute must be clearly evidenced therein. See, e.g., United States v. Tilleraas, 709 F.2d 1088 (6<sup>th</sup> Cir. 1983); United States v. Mead, 426 F.2d 118 (9<sup>th</sup> Cir. 1970); United States v. Bowman, 358 F.2d 421 (3d Cir. 1966). No statute is to be construed as altering common law further than its words clearly import. United States v. Mead, supra. Even where a statute clearly expresses the intention to abrogate common law, the scope of common law will be altered no further than is necessary to give effect to the language of the statute. United States v. Tilleraas, supra.

In the instant case, I.R.C. § 7525(a)(2) clearly indicates that the tax advice privilege may not be asserted in criminal tax matters or proceedings. Neither the statute nor the legislative history indicates in any way that exceptions to this rule should be permitted, or that the privilege could effectively apply in a criminal proceeding if it stemmed from communications in the context of civil actions. Given that I.R.C. § 7525 is in derogation of the common law, it must be strictly and narrowly construed based upon its plain terms. The scope of the common law rule should not be altered any more than is necessary to implement the statute. Here, it is not necessary to extend the privilege to criminal proceedings when the communications originated in the context of civil actions to implement the statute. Although the statute extends the common law protections inherent in the attorney client privilege to tax advice communications between a taxpayer and a federally authorized tax practitioner, it is clear that this extension is not absolute. The limitations in subparagraph two are clear and should be upheld without qualification to effectuate the intent of the statute. In the absence of clear legislative intent to allow the “bootstrapping” of the privilege, the privilege should not be assertable in a criminal tax matter or proceeding regardless of where or in what context the tax advice communication originated.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We believe the argument of tax petitioners that the tax advice privilege may be “bootstrapped” in some criminal tax matters or proceedings has no support in the statute or the legislative history. The plain language of the I.R.C. § 7525 and the accompanying legislative history clearly state that the privilege is not applicable in criminal proceedings. Well established principles of statutory construction support the Service’s position that the privilege should not be extended beyond the plain language of the statute in the absence of clear and explicit legislative intent.