No. 09-750

In the Supreme Court of the United States

TEXTRON INC. AND SUBSIDIARIES, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

This case involves documents known as tax-accrual workpapers. The workpapers were created by petitioner, a public corporation, in order to (a) calculate adequate tax reserves for its financial statements and (b) demonstrate to its independent auditor that the financial statements comply with generally accepted accounting principles. The question presented is as follows:

Whether petitioner's tax-accrual workpapers are immune from compelled disclosure to the Internal Revenue Service as attorney work product prepared in anticipation of litigation.

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OPINIONS BELOW

The opinion of the en banc court of appeals (Pet. App. 1a-46a) is reported at 577 F.3d 21. The opinion of the court of appeals panel (Pet. App. 47a-88a) is unreported but is available at 2009 U.S. App. LEXIS 1538. The opinion of the district court (Pet. App. 89a-118a) is reported at 507 F. Supp. 2d 138.

JURISDICTION

The judgment of the court of appeals was entered on August 13, 2009. On October 20, 2009, Justice Breyer extended the time within which to file a petition for a writ of certiorari to and including December 24, 2009, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. Publicly traded corporations are required by the federal securities laws to file annually with the Securities and Exchange Commission (SEC) financial statements that have been audited by a public accounting firm. Such corporations are also required to obtain from the auditor an unqualified or "clean" opinion that the financial statements conform with generally accepted accounting principles (GAAP).[1] Pet. App. 2a; C.A. App. 208-209, 282-285; see 15 U.S.C. 78m(a)(2); 17 C.F.R. Pt. 210. A company's failure to satisfy those requirements could affect its ability to list its stock on a public exchange. C.A. App. 283. To prepare financial statements that comply with GAAP, public companies must, *inter alia*, calculate reserves to account for deferred and contingent tax liabilities. Those calculations must include estimates of the liability the company would face if the Internal Revenue Service (IRS) were to challenge uncertain positions on the company's self-assessed federal income tax return. Pet. App. 2a; C.A. App. 40-43.

Independent auditors must review the financial statements of their public-company clients according to the standards of the audit profession, which at the time relevant to this case were established by the American Institute of Certified Public Accountants (AICPA) and were known as generally accepted auditing standards (GAAS).[2] 17 C.F.R. 210.1-02(d), 240.13a-1; C.A. App. 40.

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[1] GAAP are established by the Financial Accounting Standards Board (FASB) and published in Statements on Financial Accounting Standards. C.A. App. 40.

[2] In 2003, the Public Company Accounting Oversight Board (PCAOB) assumed responsibility for the promulgation of auditing standards for audits of public companies. C.A. App. 40. The PCAOB adopted substantial portions of GAAS as interim rules. PCAOB R. 3200T.

Those standards require auditors to obtain from the company evidence supporting the accuracy of the financial statements, including evidence regarding its reserve account for deferred and contingent tax liabilities. C.A. App. 40-46, 208-210, 282-287; see AICPA, *AU Section 326: Evidential Matter* (2002), http://pcaobus.org/Standards/Auditing/Pages/AU326.aspx; AICPA, *AU Section 9326: Evidential Matter: Auditing Interpretations of* Section 326 (Apr. 2003) (*AU § 9326*), http://pcaobus.org/Standards/Auditing/Pages/AU9326.aspx.

To demonstrate that the amount it has reserved is consistent with GAAP, a company creates tax-accrual workpapers, which (i) list and analyze each uncertain tax-return position taken by the company, (ii) estimate the likelihood that the position will not withstand scrutiny, and (iii) calculate the additional tax liability that would result from a successful challenge by the IRS. Independent auditors require access to those workpapers in order to provide the clean opinion that the client needs to meet SEC filing requirements and to keep its securities listed on an exchange. Pet. App. 19a-20a; C.A. App. 40-47, 208-210, 282-284. Such documentation is required even if the client does not perceive any possibility of a successful challenge by the IRS, because the client must establish that its reserve of zero is adequate. *Id.* at 285-286.

In performing the audit, the independent auditor generates its own tax-accrual workpapers. The auditor's workpapers must contain an item-by-item analysis of the company's tax-accrual analysis and the auditor's judgment on the correctness of the client's tax position. Pet. App. 2a, 12a; C.A. App. 42-47. In *United States* v. *Arthur Young & Co.*, 465 U.S. 805 (1984), this Court unanimously held that the IRS may obtain the auditor's tax-

accrual workpapers. The Court explained that those workpapers were "highly relevant" to an IRS audit and that, although the IRS's summons authority is subject to "'traditional privileges and limitations,'" the workpapers are not "protected by some form of work-product immunity." *Id.* at 815 (quoting *United States* v. *Euge*, 444 U.S. 707, 711 (1980)). While recognizing that the auditor's workpapers recorded the taxpayer's own tax-accrual analysis, the Court concluded that the securities laws and auditing standards already required that the auditor have unfettered access to that analysis, and that there was no need to further encourage candor on the taxpayer's part by according a work-product protection to the auditor's tax-accrual workpapers. See *id.* at 817-819 & nn.13-14.

b. Under longstanding policy, the IRS does not routinely seek to obtain tax-accrual workpapers through its summons power, but exercises that authority only in unusual circumstances. See *Arthur Young*, 465 U.S. at 820-821 & n.17; I.R.S. Announcement 84-46, 1984-18 I.R.B. 18; IRS, *Internal Revenue Manual* § 4024.4, at 4000-33 (1981). The IRS's most recent statement of its policy explains that it will seek tax-accrual workpapers if it has reason to believe that a particular company has engaged in one or more specified types of tax-avoidance strategies, known as "listed transactions." I.R.S. Announcement 2002-63, 2002-2 C.B. 72.[3]

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[3] Corporate tax returns have become so complex in recent years that IRS revenue agents are forced to spend considerable time simply searching for the uncertain issues that need to be audited rather than discussing those issues with the taxpayer. IRS, IR-2010-013, *Prepared Remarks of IRS Commissioner Doug Shulman to New York State Bar Association Taxation Section Annual Meeting in New York City* (Jan. 26, 2010), http://www.irs.gov/newsroom/article/0,,id=218705,00.html.

c. Recognizing that the IRS possesses (though it rarely exercises) the authority to obtain tax-accrual workpapers, the AICPA and the Financial Accounting Standards Board (FASB) have long advised that such workpapers are indispensable to a public-company audit even though the "IRS could legally" obtain them. AICPA, *Practice Guide on Accounting for Uncertain Tax Positions Under FIN 48*, at 12 (2006). In this regard, the AICPA has warned that a public company's failure to provide its auditors with sufficient information regarding the company's tax accrual could negatively impact the auditor's ability to certify the financial statements. *AU § 9326* ¶¶ 2.06-2.14. FASB has rejected complaints by public companies about financial-accounting rules that require them to create documents that could assist the IRS. In doing so, FASB has emphasized that accounting rules appropriately "provide a 'roadmap' for taxing authorities," noting that the taxing authorities are "acting in the broader public interest in regulating compliance with self-reporting income tax laws." FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, App. B: Background Information & Basis for Conclusions* ¶ B64 (2006) (*FIN 48*).

2. Petitioner is a publicly traded company. During its audit of petitioner's 2001 tax return, the IRS learned

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In an effort to resolve that problem, the Commissioner of Internal Revenue has proposed that certain large business taxpayers be required to disclose on their annual tax returns any tax position that they, or their independent auditors, have determined to be an uncertain one. I.R.S. Announcement 2010-9, 2010-7 I.R.B. 408; see also I.R.S. Announcement 2010-17, 2010-13 I.R.B. 515 (extending comment period). That proposal would not affect tax-accrual workpapers. Rather, the existing policy of restraint described in the text would continue to apply. See 2010-7 I.R.B. at 409.

that petitioner had repeatedly engaged in listed transactions (of a form known as the "Sale-In, Lease-Out" (SILO) tax shelter) that the IRS had determined were abusive.[4] The IRS accordingly issued a summons to petitioner, seeking petitioner's tax-accrual workpapers for the audit of its 2001 financial statements, as well as the tax-accrual workpapers generated by petitioner's independent auditor for that year. Pet. App. 2a-5a; C.A. App. 10-28.

Petitioner's tax-accrual workpapers were created annually by accountants and attorneys in its Tax Department, and then reviewed by its independent auditor, Ernst & Young (E&Y). Petitioner's workpapers consisted of (i) a spreadsheet listing every material item in petitioner's tax return that, if challenged by the IRS, could result in additional taxes being assessed; and (ii) documents supporting the reserve calculations on the spreadsheet. Pet. App. 3a. For each uncertain tax position, the spreadsheet calculated a reserve amount by multiplying the dollar amount subject to possible dispute by the percentage estimate of the IRS's chances of success. *Id.* at 2a-3a; C.A. App. 83, 161-166. The workpapers included items that petitioner intended to concede, such as items that had been resolved in prior audits. *Id.* at 80, 83. Petitioner's employees testified that they had created those workpapers in order to establish a GAAP-compliant tax reserve on the company's financial statements and to demonstrate the accuracy of those statements to its auditor (as securities laws and auditing

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[4] See generally, *e.g.*, *Wells Fargo & Co.* v. *United States*, 91 Fed. Cl. 35, 39 (2010) (explaining why the SILO tax shelter is without economic substance, and stating that the shelter is "offensive to the Court on many levels").

standards required). Pet. App. 13a-14a; C.A. App. 82, 92-93, 168-169, 175-176, 208-209.

Petitioner refused to produce any of the requested documents. It asserted, *inter alia*, that its workpapers were protected as attorney work product. Pet. App. 5a. The government petitioned the United States District Court for the District of Rhode Island to enforce the summons.

3. The district court denied the government's petition for enforcement. Pet. App. 89a-118a.

a. The district court first determined that the threshold requirements for a summons had been satisfied. See *United States* v. *Powell*, 379 U.S. 48, 57-58 (1964). In particular, the court rejected petitioner's contention that the summons had been issued for an improper purpose. Pet. App. 95a-99a. As petitioner's senior tax attorney conceded, the IRS was not always able to spot all of the uncertain tax positions that petitioner itself had identified, given the complexities of petitioner's consolidated tax return (which for the 2001 tax year exceeded 4000 pages). C.A. App. 214. The district court concluded that the summons was a valid effort to ensure that petitioner's 2001 tax liability was correctly determined. Pet. App. 97a.

b. The district court held, however, that petitioner's tax-accrual workpapers were protected as work product. The court recognized that the First Circuit applies work-product protection to documents created "because of" the prospect of litigation. Pet. App. 107a-108a (quoting *Maine* v. *United States Dep't of the Interior*, 298 F.3d 60, 68 (1st Cir. 2002)). The court noted that the "because of" standard is "more inclusive" (*i.e.*, protects more documents) than the standard applied in the Fifth Circuit, which examines whether the "primary purpose"

for creating a document was to aid in litigation. *Id.* at 107a (quoting *United States* v. *El Paso Co.*, 682 F.2d 530, 542 (5th Cir. 1982), cert. denied, 466 U.S. 944 (1984)).

The district court found that petitioner had generated its workpapers to establish a reserve on its financial statements and to demonstrate to its auditor that the reserve complied with GAAP so that the auditor would render a "clean" opinion. Pet. App. 93a-94a. The court did not find that petitioner intended to use these workpapers to assist in the conduct of future litigation, or that the workpapers related to any existing or expected lawsuit. Rather, the court determined that the tax-accrual workpapers were work product notwithstanding their regulatory purpose because they "would not have been prepared at all 'but for' the fact that [petitioner] anticipated the possibility of litigation with the IRS." *Id.* at 108a. The district court concluded on that basis that the tax-accrual workpapers had been prepared "because of" litigation. See *id.* at 108a-110a. The court also determined that, although petitioner had waived any claim of attorney-client or tax-practitioner privilege by disclosing its tax-accrual analysis to E&Y, *id.* at 110a-112a, the work-product protection survived the disclosure, *id.* at 112a-116a.

4. The government appealed both the holding that the tax-accrual workpapers were shielded by the work-product protection and the holding that petitioner had not waived that protection.[5] In their briefs on appeal, the government and petitioner agreed that the decision in *Maine*, *supra*, was the controlling precedent in the

[5] The government also appealed the district court's failure to address the aspect of the summons that directed petitioner to produce E&Y's workpapers if it could. Gov't C.A. Br. 74-77.

First Circuit and that the court of appeals should apply the "because of" test. The parties disagreed, however, on whether tax-accrual workpapers are protected under that standard. See, *e.g.*, Gov't C.A. Br. 28-29, 36, 47; Pet. C.A. Br. 36.

5. A divided panel of the court of appeals affirmed in part, vacated in part, and remanded for further proceedings. Pet. App. 47a-88a.

a. The panel majority held that petitioner's tax- accrual workpapers were work product because they were "dual purpose documents" generated both "to assist in litigation" and "to comply with securities requirements." Pet. App. 62a-64a. The majority concluded that "the anticipation of litigation coupled with securities and reporting requirements * * * effectively forced [petitioner] to operate under the hypothetical belief that litigation would occur" over each disputable tax position on its return. *Id.* at 72a.

The panel further concluded, however, that petitioner might have waived any work-product protection by disclosing its workpapers to E&Y, and it ordered a remand for the district court to address that issue. Pet. App. 74a-78a. The panel recognized that, under *Arthur Young*, the IRS could obtain E&Y's own workpapers, and that E&Y's workpapers would likely "incorporate [petitioner's] analysis." *Id.* at 76a. The court accordingly directed the district court to make factual findings regarding "the actual contents of E&Y's workpapers" and "the extent to which disclosure of such workpapers would effectively constitute disclosure of [petitioner's] own assessment." *Id.* at 76a-77a.[6]

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[6] The panel also held that the district court should have addressed the request for E&Y's workpapers, and that petitioner had no basis

b. Judge Boudin dissented from the panel's holding that the tax-accrual workpapers were protected work product. He found that holding to be "at odds with" the First Circuit's analysis in *Maine*, *supra*, which he termed "the governing rubric." Pet. App. 84a, 88a. In *Maine*, the court of appeals had stated that documents that are required to be created for non-litigation purposes are not work product, even if those documents discuss litigation. 298 F.3d at 70. In Judge Boudin's view, *Maine* therefore "squarely answer[ed] the question" presented in this case. Pet. App. 83a.

6. The government sought rehearing en banc, which the court of appeals granted. On rehearing, the parties again agreed that the "because of" standard adopted in *Maine* should govern. *E.g.*, Gov't Supp. C.A. Br. 2.

7. The en banc court of appeals reversed in an opinion by Judge Boudin, holding that petitioner's tax-accrual workpapers were not protected work product. Pet. App. 1a-46a.

a. The en banc court held that petitioner's workpapers were not protected as attorney work product because they "were prepared in the ordinary course of business" and "were independently required by statutory and audit requirements." Pet. App. 9a, 18a. In reaching that conclusion, the court expressly "reaffirm[ed] *en banc*" its prior ruling in *Maine*, which had adopted the "because of" test for work-product protection. *Id.* at 9a. The court further reaffirmed that, under that test, "work product protection does not extend to 'documents that are prepared in the ordinary course of business or that would have been created in essentially

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(such as privilege) for withholding those workpapers if it possessed them. The panel remanded for factual findings regarding whether petitioner could obtain the workpapers from E&Y. Pet. App. 78a-80a.

similar form irrespective of the litigation.'" *Id.* at 18a (quoting *Maine*, 298 F.3d at 70).

The en banc court held that petitioner's tax-accrual workpapers were prepared in "the ordinary course of business," and that their "only purpose" was to permit petitioner to comply with certain "statutory and audit requirements." Pet. App. 9a, 18a. The court rejected, as factually unsupported, petitioner's argument that the workpapers had a dual purpose and were created "for use" in litigation as well as for financial-reporting purposes. *Id.* at 11a-15a. The court explained that the district court had not found "that the work papers were prepared *for use* in possible litigation—only that the reserves would cover liabilities that might be determined in litigation." *Id.* at 11a. The en banc court further concluded that, "[i]f the [district] judge had made a 'for use' finding—which he did not—that finding would have been clearly erroneous." *Id.* at 11a-12a.

The en banc court noted that the protection of attorney work-product is "aimed centrally at protecting the *litigation process*" and is not "designed to help the lawyer prepare corporate documents or other materials prepared in the ordinary course of business." Pet. App. 19a. The court rejected petitioner's argument that producing tax-accrual workpapers to the IRS would chill their creation in the future, noting that public companies were legally obligated to create those workpapers "to comply with the securities laws and accounting principles." *Ibid.* The court also emphasized that the IRS faces "practical problems * * * in discovering underreporting of corporate taxes" given the length and complexity of corporate tax returns, and that permitting the IRS to obtain tax-accrual workpapers "serves the legitimate, and important, function of detecting and dis-

allowing abusive tax shelters" lurking in a lengthy return. *Id.* at 20a-21a.

b. Judge Torruella dissented, joined by Judge Lipez. Pet. App. 21a-46a. The dissenting judges would have held that petitioner's tax-accrual workpapers were created for both business and litigation purposes and therefore should be protected under the "because of" work-product test set out in *Maine*. *Id.* at 34a-43a. The dissenters concluded that petitioner's tax-accrual workpapers were prepared "because of" litigation because "the driving force behind the preparation" of those workpapers "was the need to reserve money" in order "to fund payment of tax disputes." *Id.* at 40a.

8. The en banc court of appeals granted petitioner's unopposed motion to stay the mandate, noting that disclosure *pendente lite* would prejudice petitioner. Pet. App. 119a-120a. In granting that relief, the court explained that its ruling was "limited to materials prepared in the ordinary course of business and disclosed to auditors, since undisclosed materials generated by lawyers within the corporation are normally protected by the attorney client privilege regardless of whether prepared in anticipation of litigation." *Id.* at 120a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or another court of appeals. No court of appeals has held that tax-accrual workpapers are protected as work product. Indeed, every court of appeals that has considered the issue agrees with the decision below that, wherever the outer boundary of work-product protection may be drawn, it does not encompass documents that were, like the documents at issue here, generated in the ordinary

course of business. This case therefore does not present a suitable occasion for this Court to address the nearly 30-year-old circuit conflict over how to phrase the generally applicable test for work-product protection. Further review is not warranted.

1. The court of appeals' ultimate holding—that tax-accrual workpapers are not protected work product—does not conflict with any decision of another court of appeals. The only other court of appeals to have considered the issue also concluded (applying a different standard) that the work-product protection does not cover a public company's tax-accrual workpapers. See *United States* v. *El Paso Co.*, 682 F.2d 530 (5th Cir. 1982), cert. denied, 466 U.S. 944 (1984); see also Pet. 15, 20 (acknowledging that *El Paso* involved documents indistinguishable from those at issue here). In the nearly 30 years since *El Paso*, none of the thousands of publicly traded companies that share tax-accrual workpapers with their independent auditors every year has persuaded a federal court of appeals to accord work-product protection to those workpapers.[7] And during that time, this Court in *Arthur Young* expressly declined to recognize a work-product or analogous protection for the tax-accrual workpapers created and maintained by the outside auditor, which are closely related to the corporate workpapers at issue here, see, *e.g.*, Pet. App. 76a-77a.

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[7] As explained above, the IRS seeks tax-accrual workpapers only rarely. See p. 4, *supra.* The only other case involving tax-accrual workpapers that petitioner cites (Pet. 19) is an unpublished district-court decision, from which the appeal was dismissed when the corporation agreed to produce the documents. See Stipulation to Dismiss Appeal, *Regions Fin. Corp.* v. *United States*, No. 08-13866-C (11th Cir. filed Dec. 24, 2008).

Petitioner contends (Pet. 19-20) that cases from two other circuits extended work-product protection to documents that "do not meaningfully differ from" tax-accrual workpapers, and that its workpapers "would surely be covered under the 'because of' standard" as applied by those circuits. Petitioner's reliance on those decisions is misplaced. Both cases involved documents that allegedly "sought to protect [the company] from future litigation about a particular transaction," not documents prepared regularly, in the ordinary course of business, to satisfy a regulatory requirement. *United States* v. *Roxworthy*, 457 F.3d 590, 600 (6th Cir. 2006) (citation omitted); see *id.* at 598 ("[i]n the absence of any evidence to the contrary," corporation had shown that its memoranda were not prepared "as part of the ordinary course of business"); accord *United States* v. *Adlman*, 134 F.3d 1194, 1204 (2d Cir. 1998) (remanding for determination whether substantially the same memorandum would have been prepared in the ordinary course of business).[8] And as discussed below, the en banc court's application of the "because of" standard in this case is entirely consistent with the application of that standard in the Second, Sixth, and other circuits.

2. In the absence of any circuit conflict involving documents prepared to satisfy the particular regulatory requirements at issue here, petitioner contends that cases drawn from other contexts show that it would be entitled to work-product protection in other circuits.

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[8] Petitioner (Pet. 13) and its amici (*e.g.*, New Eng. Legal Found. Br. 7-8) construe the Second Circuit's decision in *Adlman* to hold that the relevant document was protected as work product. In fact, the court of appeals remanded that case for the district court to determine whether the document had been generated in the ordinary course of business, in which case it would *not* be protected. See *Adlman*, 134 F.3d at 1204.

But petitioner's description of the decision below disregards important aspects of both the en banc court's legal analysis and the court's understanding of the factual record.

First, the court of appeals did not depart in this case from the "because of" standard applied by most circuits. The First Circuit has adhered to the "because of" standard ever since its decision in *Maine* v. *United States Dep't of the Interior*, 298 F.3d 60 (2002), which the court "reaffirm[ed] *en banc*" in this case. Pet. App. 9a. Far from adopting a new standard, the court of appeals explained that documents prepared in the ordinary course of business have never been protected by the "because of" standard as elucidated in *Maine*; in the Second Circuit's decision in *Adlman*, *supra*; or elsewhere. See, *e.g.*, *id.* at 9a, 18a. Judge Boudin had previously made the same points in his dissent from the panel decision in this case. See *id.* at 83a, 84a, 85a, 88a (explaining that the First Circuit's decision in *Maine*, which relied on *Adlman*, provides the "governing rubric" that "squarely answers" the question).

Second, the court of appeals expressly concluded that the sole purpose of petitioner's tax-accrual workpapers was to comply with regulatory requirements, and that those workpapers were not assembled (primarily, secondarily, or at all) to prepare for litigation. Petitioner repeatedly asserts (Pet. 13, 18, 19, 23-24) that its workpapers were prepared in part for a litigation-related purpose.[9] But as the en banc court explained, the sole scrap of testimony on which petitioner relies "was *not* adopted by the district judge and [was] more than dubi-

[9] Petitioner, its amici, and the dissenting judges on the en banc court also incorrectly treat all dealings with the IRS as "litigation." See pp. 27-28, *infra*.

ous." Pet. App. 14a; see *id.* at 14a n.5 (explaining that the testimony of petitioner's Vice President of Taxes was inconsistent with that witness's own affidavit and "was not supported by detail or explanation in the record"). The en banc court ruled against petitioner not on the ground that dual-purpose documents fall outside the work-product protection, but because the record showed that petitioner's tax-accrual workpapers serve only a single purpose—a business purpose. See *id.* at 11a-12a ("If the [district] judge had made a 'for use' finding—which he did not—that finding would have been clearly erroneous.").[10]

3. Because petitioner's tax-accrual workpapers were created in the ordinary course of business for a regulatory rather than a litigation purpose, petitioner could not prevail under either of the competing formulations of the work-product doctrine. Petitioner (Pet. 12-20) and its amici are substantially correct in identifying a 28-year-old conflict between the "because of" standard, which is applied by the First Circuit and by many other courts of appeals, and the "primary purpose" standard, which has been endorsed only by the Fifth Circuit. That conflict does not affect the disposition of this case, however, since the "because of" standard applied by the court below provides *broader* work-product protection

[10] That factual conclusion was a sufficient basis to reject petitioner's claim that its tax-accrual workpapers were protected "dual-purpose documents." The government also argued below that, because petitioner's tax-accrual workpapers were generated in the ordinary course of business and to satisfy regulatory requirements, petitioner could not prevail on its work-product theory even if it could establish that those documents also had a litigation-related purpose. See Gov't C.A. Br. 52; Gov't C.A. Reply Br. 31; Gov't C.A. Supp. Br. 8-12. The en banc court of appeals' analysis of the record made it unnecessary for the court to reach that question.

than the competing "primary purpose" test. Indeed, petitioner concedes (Pet. 20) that it could not prevail under the Fifth Circuit's approach, and it identifies no court of appeals decision suggesting that documents generated in the ordinary course of business to satisfy regulatory requirements are protected work product. See pp. 18-21, *infra*. This case would therefore be an unsuitable vehicle for choosing between the competing formulations used to describe the scope of the work-product protection.[11]

The work-product protection derives from this Court's decision in *Hickman* v. *Taylor*, 329 U.S. 495 (1947), and is now codified in Rule 26(b)(3) of the Federal Rules of Civil Procedure. Protected work product comprises documents "prepared in anticipation of litigation or for trial." Fed. R. Civ. P. 26(b)(3)(A). Although Rule 26(b)(3) does not detail exactly what documents are protected, the Rule was promulgated with the understanding that the work-product doctrine would not apply

[11] Petitioner contends (Pet. 30) that the Court should overlook this case's unsuitability for plenary review because the Court may not soon "have the opportunity to [consider the question presented] again." As this Court recently made clear, however, there are "established mechanisms for appellate review" of orders resolving work-product claims. *Mohawk Indus., Inc.* v. *Carpenter*, 130 S. Ct. 599, 608 (2009). The courts of appeals regularly consider those issues in various procedural postures. See, *e.g.*, *Biegas* v. *Quickway Carriers, Inc.*, 573 F.3d 365, 381-382 (6th Cir. 2009) (appeal from final judgment); *National Union Fire Ins. Co.* v. *Murray Sheet Metal Co.*, 967 F.2d 980 (4th Cir. 1992) (appeal from denial of motion to enforce third-party subpoena). And litigants regularly seek review in this Court, including review of the Fifth Circuit's "primary purpose" test. See, *e.g.*, *Kaiser Aluminum & Chem. Corp.* v. *Department of Labor, Mine Safety & Health Admin.*, 532 U.S. 919 (2001) (No. 00-770) (denying certiorari petition that asked this Court to resolve, *inter alia*, split between the Fifth Circuit's test and other circuits' "because of" test).

to "[m]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes." Fed. R. Civ. P. 26(b)(3) advisory committee's note (1970) (1970 Committee Note).

Applying that limitation to the facts of this case, the en banc court of appeals held that petitioner's tax-accrual workpapers were not protected by the work-product protection because they "were prepared in the ordinary course of business." Pet. App. 18a (quoting *Maine*, 298 F.3d at 70). In so holding, the court did not, as petitioner contends (Pet. 11, 24), announce a "novel limitation" or "narrow" the work-product doctrine. Rather, the court simply applied a pre-existing limitation that has long been recognized by every court of appeals that has considered the issue.

The courts of appeals agree that "not all work undertaken by lawyers finds protection in the work-product privilege," and that the protection does not apply "to documents prepared by lawyers in the ordinary course of business or for other nonlitigation purposes." *In re Sealed Case*, 146 F.3d 881, 887 (D.C. Cir. 1998) (internal quotation marks and citation omitted); see *Adlman*, 134 F.3d at 1202 ("[I]t should be emphasized that the 'because of' formulation that we adopt here withholds protection from documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation. It is well established that work-product privilege does not apply to such documents.") (citing 1970 Committee Note); *Martin* v. *Bally's Park Place Hotel & Casino*, 983 F.2d 1252, 1260 (3d Cir. 1993) ("[T]he drafters of Rule 26(b)(3) excluded from the rule's protection '[m]aterials assembled in the ordinary course of business, or pursu-

ant to public requirements unrelated to litigation, or for other nonlitigation purposes.'") (quoting 1970 Committee Note); *National Union Fire Ins. Co.* v. *Murray Sheet Metal Co.*, 967 F.2d 980, 984 (4th Cir. 1992) ("[M]aterials prepared in the ordinary course of business or pursuant to regulatory requirements or for other non-litigation purposes are not documents prepared in anticipation of litigation within the meaning of Rule 26(b)(3)."); *Roxworthy*, 457 F.3d at 593 ("It is clear that documents prepared in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes, are not covered by the work product privilege.") (citing 1970 Committee Note); *Binks Mfg. Co.* v. *National Presto Indus., Inc.*, 709 F.2d 1109, 1119-1120 (7th Cir. 1983) (holding that there was no work-product protection for documents generated in the "ordinary course of business") (internal quotation marks and citation omitted); *Simon* v. *G.D. Searle & Co.*, 816 F.2d 397, 401 (8th Cir.) (stating that "'there is no work product immunity for documents prepared in the regular course of business rather than for purposes of litigation,'" and denying protection for documents that were not "prepared for purposes of litigation") (quoting 8 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 2024, at 198-199 (1970) (Wright & Miller 1970)), cert. denied, 484 U.S. 917 (1987).

Petitioner is also wrong in asserting (Pet. 16-17) that the en banc court diverged from other circuits' application of the "because of" test when it observed that the work-product protection applies only to documents that have some litigation-related "use" or "purpose." Other courts of appeals have similarly recognized that the work-product protection applies only to documents that

have a litigation purpose. See *Roxworthy*, 457 F.3d at 595 (agreeing that "documents are not protected if they were created for nonlitigation purposes, regardless of content"); *Holmes* v. *Pension Plan of Bethlehem Steel Corp.*, 213 F.3d 124, 138 (3d Cir. 2000) ("A party claiming work- product immunity bears the burden of showing that the materials in question were prepared in the course of preparation for possible litigation.") (internal quotation marks and citation omitted); *Mercator Corp.* v. *United States (In re Grand Jury Subpoenas Dated Mar. 19, 2002 & Aug. 2, 2002)*, 318 F.3d 379, 384 (2d Cir. 2003) (stating that the purpose of the work-product protection is to "shelter[] the mental processes of an attorney as reflected in documents prepared for litigation"); *In re Grand Jury Subpoena (Mark Torf/Torf Envtl. Mgmt.)*, 357 F.3d 900, 910 (9th Cir. 2004) (holding that "documents are entitled to work product protection because, taking into account the facts surrounding their creation, their litigation purpose so permeates any non-litigation purpose that the two purposes cannot be discretely separated from the factual nexus as a whole"); *In re Sealed Case*, 146 F.3d at 887 (stating that the work-product protection "has no applicability to documents prepared by lawyers" for "nonlitigation purposes").[12]

Petitioner is therefore incorrect in asserting (Pet. 18-19) that in other circuits tax-accrual workpapers would be protected on the theory that they would not have

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[12] The Second Circuit in *Adlman* questioned whether work-product protection required a litigation-related use, but it did not decide the issue. See 134 F.3d at 1197-1199, 1203-1204. Neither petitioner nor its amici have identified any court of appeals decision applying work-product protection to a document that was not generated at least in part for a litigation purpose.

been generated "but for" the prospect of litigation. That theory, which the district court adopted, confuses the workpapers' content with their function. As the en banc court of appeals correctly explained, it is insufficient "to trigger work product protection that the *subject matter* of a document relates to a subject that might conceivably be litigated." Pet. App. 16a. Rather, in any work-product determination, the "critical" issue is the purpose or "function" for which a document is created. *Delaney, Migdail & Young, Chartered* v. *IRS*, 826 F.2d 124, 127 (D.C. Cir. 1987); see, *e.g.*, *Roxworthy*, 457 F.3d at 595 (stating that the "key issue in determining whether a document should be withheld is the function that the document serves," not its "content"); *Martin*, 983 F.2d at 1260 n.6 (stating that "a party's motivation in preparing a document" determines whether the work-product protection applies).

That tax-accrual workpapers could (in some instances) describe potential litigation does not mean that they are generated "because of" litigation. They are created because "statutory and audit requirements" mandate that they be created. Pet. App. 9a. Satisfying those requirements is the workpapers' function; describing the consequences that will likely follow from petitioner's assertion of uncertain tax positions (including the likely outcome of hypothetical litigation) is the workpapers' content. Petitioner's "but for" analysis misapplies the "because of" work-product test because it disregards the motivation behind the creation of tax-accrual workpapers. Cf. *El Paso*, 682 F.2d at 535 ("primary purpose" test similarly turns on the reason for creating a document, not on what the document contains).

4. Limiting work-product protection to documents that have some potential litigation purpose is consistent

with both the language and the purpose of Rule 26(b)(3). The court of appeals was therefore correct in concluding that tax-accrual workpapers are not protected work product.

a. Rule 26(b)(3)(A) generally protects from discovery "documents and tangible things that are prepared in anticipation of litigation or for trial." Petitioner (Pet. 9-10, 20) and its amici (*e.g.*, DRI Br. 11-12) suggest that the court of appeals' decision limits the work-product protection to materials "prepared for trial" and therefore renders superfluous the Rule's reference to materials "prepared in anticipation of litigation." That is incorrect. The en banc court of appeals summarized its analysis by explaining that "the work product privilege is aimed at protecting work done for litigation." Pet. App. 21a; see *id.* at 15a ("From the outset, the focus of work product protection has been on materials prepared for use in litigation, whether the litigation was underway or merely anticipated."); *id.* at 17a (referring to "materials prepared for a current or possible * * * law suit"). The court's more general references to materials prepared for "litigation" or for a "law suit" belie petitioner's contention that the court limited the protection to materials prepared "for trial."

Rule 26(b)(3)'s reference to materials prepared "in anticipation of litigation" does not support petitioner's contention that the work-product protection covers tax-accrual workpapers. Rather, as the court of appeals explained, that phrase confirms that the work-product protection shields work that is done for litigation but in advance of a lawsuit's commencement. Pet. App. 16a. That common-sense reading of Rule 26(b)(3) is supported by the Advisory Committee's notes on the Rule, which explain that work-product protection does not

extend to documents that were generated for a nonlitigation purpose: "Materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes are not under the qualified immunity provided by this subdivision." 1970 Committee Note. The en banc court of appeals acknowledged that materials "prepared for potential use in litigation if and when it should arise" had sometimes been given work-product protection, but it found "no evidence in this case that [petitioner's] work papers were prepared for such a use or would in fact serve any useful purpose for [petitioner] in conducting litigation if it arose." Pet. App. 18a-19a. Given that assessment of the record, the court correctly held that petitioner's tax-accrual workpapers were not prepared "in anticipation of litigation" within the meaning of Rule 26(b)(3).

b. For similar reasons, the court of appeals' decision is fully consistent with the policies underlying the work-product protection. Those policies are not divorced from preparation for lawsuits, as petitioner (Pet. 16-17) and certain amici (*e.g.*, Ass'n of Corporate Counsel Br. 7-8) suggest. The very work-product standard that petitioner and the amici endorse—the "because of" work-product test—was developed out of recognition that "'[p]rudent parties anticipate litigation, and begin preparation prior to the time suit is formally commenced.'" *Diversified Indus., Inc.* v. *Meredith*, 572 F.2d 596, 604 (8th Cir. 1977) (quoting 8 Wright & Miller 1970, at 198-199); accord *Martin*, 983 F.2d at 1260; *Binks*, 709 F.2d at 1118-1120; see also *In re Sealed Case*, 146 F.3d at 884 ("By ensuring that lawyers can prepare for litigation without fear that opponents may obtain their private notes, memoranda, correspondence, and other written

materials, the privilege protects the adversary process."). See generally, *e.g.*, *Hickman*, 329 U.S. at 497 (adopting work-product protection for materials prepared "by an adverse party's counsel in the course of preparation for possible litigation after a claim has arisen").[13]

Nor will providing the IRS access to a company's tax-accrual workpapers have a "chilling effect" on the creation of those documents, as petitioner (Pet. 23) and a number of its amici assert. A publicly traded company seeking an attestation that its financial statements comply with GAAP must permit its independent auditor to verify that those financial statements adequately reserve against tax contingencies. The auditor, in turn, is required by applicable auditing standards—now incorporated into federal law—to review sufficient documentation to understand the basis for the amount reserved and to verify that the reserve is adequate. *AU § 9326* ¶¶ 2.09-2.23. Petitioner's assertion that federal auditing standards do not require "the form and detail of the documents prepared here," Pet. 24 n.9 (quoting Pet. App. 32a (Torruella, J., dissenting)), is beside the point: GAAP requires the client to reserve for contingencies, and auditing standards require the auditor to review the basis for that reserve. There is no reason to suppose that the possibility of compelled disclosure to the IRS will induce publicly traded companies to breach their

[13] In *Hickman*, this Court noted that English courts had developed a work-product privilege that applied to documents generated for the purpose of "assisting the deponent or his legal advisers in any actual or anticipated litigation." 329 U.S. at 510 n.9 (internal quotation marks and citation omitted). In describing the relevant history in that manner, the Court did not suggest that it was adopting a protection more expansive than its English counterpart.

obligation to prepare tax-accrual workpapers that are both accurate and sufficiently detailed to enable auditors to verify the adequacy of company reserves. Cf. 15 U.S.C. 7242 (unlawful to mislead public company's auditor).

Indeed, this Court made a similar point in *Arthur Young*. Rejecting the argument that disclosure of the auditor's tax-accrual workpapers would discourage companies from performing candid tax-accrual analysis, the Court observed that "[r]esponsible corporate management would not risk a qualified evaluation of a corporate taxpayer's financial posture to afford cover for questionable positions reflected in a prior tax return." *United States* v. *Arthur Young & Co.*, 465 U.S. 805, 818-819 (1984). The Court explained that, if the independent auditor thought that "the scope of the examination had been limited by management's reluctance to disclose matters relating to the tax accrual reserves," then the auditor could not issue a clean opinion. *Id.* at 818. The undisputed testimony here confirms the Court's analysis (C.A. App. 43, 46-47, 282-284), as does guidance from the AICPA. See *AU § 9326* ¶ 2.09 ("The client is responsible for its tax accrual, the underlying support for the accrual, and the related disclosures. Limitations on the auditor's access to information considered necessary to audit the tax accrual will affect the auditor's ability to issue an unqualified opinion on the financial statements.").

c. The court of appeals correctly applied its standard to the facts before it and concluded that tax-accrual workpapers are prepared for a business purpose rather than for litigation. See pp. 10-11, *supra*. As the former Chief Auditor of the PCAOB testified, accounting standards compel public companies to create tax-accrual

workpapers in substantially the same form whether or not litigation is anticipated. C.A. App. 277-286, 304.[14] Petitioner admitted that its workpapers included items that it intended to concede (and therefore never litigate) if the IRS were able to discover them during the audit, and that in each audit cycle, petitioner typically agrees to hundreds of IRS adjustments without any dispute. *Id.* at 80, 83, 244-249. Indeed, petitioner has never claimed (and the district court did not find) that any of the uncertain items listed in petitioner's tax-accrual workpapers related to existing or expected litigation.[15]

5. Petitioner's argument that litigation is either the purpose or the but-for cause of its creation of tax-accrual workpapers illustrates a further reason why this case is an unsuitable vehicle to resolve any purported

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[14] Petitioner did not refute that testimony. One of petitioner's witnesses testified that the workpapers would be "blank" if petitioner "did not anticipate controversy *or* litigation *or* disputes with the IRS." C.A. App. 200 (emphasis added). Thus, his testimony was not limited to litigation. Moreover, the witness further testified that the tax-accrual workpapers must include all "uncertain tax positions," *id.* at 210, not just those for which petitioner anticipated litigation.

[15] Moreover, a taxpayer's assessment of its tax positions *does* have a direct bearing on the determination of its tax liability, despite contrary claims by amici (*e.g.*, Tax Executives Inst. Br. 9). Before tax benefits like those generated by petitioner's SILO shelters may be claimed on a tax return, the Internal Revenue Code and implementing regulations require taxpayers and their advisers to assess various levels of certainty that a tax position would be sustained in litigation. See 26 U.S.C. 6662, 6694 (2006 & Supp. II 2008); Dennis J. Ventry, *Protecting Abusive Tax Avoidance*, 120 Tax Notes 857, 873-874 (2008). For example, to avoid a substantial-understatement penalty, a taxpayer must demonstrate that it reasonably believed that it had a "40 percent to 50 percent level of confidence that the position would be sustained on its merits." *Id.* at 874.

conflict about documents with both nonlitigation and litigation functions.[16] Petitioner (Pet. 18) and its amici (*e.g.*, Chamber of Commerce Br. 10) treat *all* disputes with the IRS—even an audit—as a form of "litigation" within the meaning of Rule 26(b)(3). But the fact that petitioner (like all large corporations) reasonably anticipates an annual IRS audit does not mean that it reasonably anticipates litigation over any specific uncertain tax item. Gov't Supp. C.A. Br. 14-17. The IRS audit itself is not litigation, and it is intended to be cooperative rather than adversarial. *E.g., United States* v. *Frederick*, 182 F.3d 496, 502 (7th Cir. 1999), cert. denied, 528 U.S. 1154 (2000).[17]

Similarly, the fact that petitioner has previously utilized the IRS's internal dispute-resolution services (*i.e.*, the Office of Appeals) to resolve its tax liabilities in no way demonstrates that petitioner reasonably anticipates litigation over any—let alone all—of the uncertain tax items in its tax-accrual workpapers.[18] A proceeding be-

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[16] Furthermore, even if this Court were to grant certiorari and hold that petitioner's tax-accrual workpapers were prepared "in anticipation of litigation" within the meaning of Rule 26(b)(3)(A), petitioner would still be required to turn over the workpapers if the courts below found that the work-product protection had been waived by disclosure to E&Y for use in the preparation of E&Y's own workpapers. See, *e.g.*, Pet. App. 74a-78a (remanding on the waiver question); cf. p. 8, *supra* (discussing the district court's ruling that petitioner had waived other privileges).

[17] That tax-accrual workpapers assess uncertain tax positions, and not actual or expected litigation, distinguishes those documents from the litigation reserve documents discussed by petitioner (Pet. 27) and its amici (*e.g.*, Fin. Executives Int'l Br. 6-7).

[18] The panel majority placed great emphasis on petitioner's activity before the Office of Appeals, see Pet. App. 50a-51a, which the panel majority viewed as adversarial, *id.* at 58a. As the panel noted, actual

fore the Office of Appeals is both informal and nonadversarial, and it is intended to conclude administrative consideration of a taxpayer's tax liability. See, *e.g.*, *Central Valley Ag Enters.* v. *United States*, 531 F.3d 750, 758 (9th Cir. 2008).

By characterizing essentially any interaction between a taxpayer and the IRS as "litigation," petitioner and its amici fail to appreciate the dynamics of our self-assessing tax system. In an administrative tax proceeding, the "parties are not adversaries, but rather two elements of the tax regulatory regime, with one party reporting its self-assessed tax liability and the other party attempting to verify that self-assessment." Dennis J. Ventry, *Protecting Abusive Tax Avoidance*, 120 Tax Notes 857, 860 (2008). Indeed, recognizing that the IRS's interests are different from those of an ordinary litigant, FASB has explained why financial accounting standards appropriately "provide a 'roadmap' for taxing authorities." *FIN 48* ¶ B64 (explaining that one cannot "equate a taxing authority with a counterparty in a lawsuit," because "[a] counterparty in a lawsuit is acting in its own particular interest, while a taxing authority is acting in the broader public interest in regulating compliance with self-reporting income tax laws").

Petitioner and its amici also ignore the critical fact that tax assessment does not begin on a level playing field. On the contrary, the taxpayer has all the information relevant to its actual tax liability, and it may self-report its liability in a manner that minimizes its tax obligations. The IRS must then determine whether the taxpayer's self-assessment is accurate or whether some

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contested court proceedings have been very rare: in the last half century, "[petitioner] and the IRS have litigated three [tax] disputes in federal court." *Id*. at 51a.

of the many items contained in a potentially voluminous tax return (here, more than 4000 pages long) should be adjusted. The taxpayer, by contrast, already knows which issues may merit adjustment and records that analysis in its tax-accrual workpapers. By requesting those workpapers under some circumstances where the corporation has already demonstrated a willingness to engage in listed tax-shelter transactions, see p. 4, *supra*, the IRS seeks to perform its obligation to verify the self-assessment despite the information disadvantage inherent in our self-reporting tax system.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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