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Is the Tax Adviser Privilege a Trap for the Unwary?

February 19, 2012

As we approach April 15th many taxpayers will meet with professional tax advisers and some may be under the impression that communications between a taxpayer and a tax adviser are privileged. This assumption is wrong as demonstrated by a case now on appeal from the Ninth Circuit to the U.S. Supreme Court (Edwards v. The United States of America).

In Edwards a taxpayer believed that his communications with his non-attorney tax adviser was a protected communication and that his tax adviser could not be compelled to testify against him. The trial court and the Ninth Circuit Court of Appeals found that the privilege protecting communications was subject to two important limitations which limit the privilege to NON-CRIMINAL matters or proceedings. In spite of Edward's objection the trial court and appellate court found that the privilege did not apply and Edward's tax adviser was called before the grand jury and gave testimony against him based upon communications that Edwards made or provided to the tax adviser. Partly as a result of the tax adviser's testimony, Edwards was charged criminally as a result of an indictment issued by a federal grand jury. Edwards pled guilty to a single count of a five count indictment and was sentenced to twenty-one months, which was stayed pending his appeal to the United States Supreme Court. In his petition to the Supreme Court Edwards asserts that the government has created a "trap for the unwary" by limiting the non-attorney tax adviser communication privilege to what amount to only non-criminal matters. The odds of the Supreme Court granting a hearing on the case are very slim, so it certainly worth considering the lesson from Edwards.

First, who is affected? All taxpayers who provide information to their tax advisers which could lead to criminal charges. This includes communications about previously unreported financial assets (such as: Reports of Foreign Bank Accounts, "[FBAR](#)'s"). It is a far better approach for a client with undisclosed foreign financial assets to be referred to tax counsel where an attorney-client privilege including exists including, in criminal matters, than for the tax adviser to become a witness against his or her own client.

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When should clients be referred to tax lawyers? As soon as the client reveals information about under reported income, undisclosed foreign financial assets, unreported foreign gifts or bequests, use of dummy vendors or other schemes to hide assets. This will become very important as taxpayers must now complete Form 8938, in order to report specified foreign financial assets.

What is the exposure of the tax adviser for failing to make a referral? This gets to standard of care issues, and is a very complex issue, but it would not be unreasonable to expect a client to blame his tax adviser for failing to provide competent advice (and not alerting him or her of the lack of privilege) and seek recovery of legal fees and expenses and other damages, particularly if the client is acquitted.

What is clear from Edwards is that the “trap for the unwary” is now out in the open and all tax advisers should be aware of the consequences of their actions and advise their clients of those possible consequences.

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