

News from our Tax Group

In *Textron*, First Circuit Holds That the Work Product Doctrine Does Not Protect Tax Accrual Workpapers Reflecting the Taxpayer's Prediction of the Outcome of Tax Litigation

On August 13, 2009, the U.S. Court of Appeals for the First Circuit held in *United States v. Textron Inc.*, No. 07-2631 (1st Cir. Aug. 13, 2009), that the IRS can obtain tax accrual workpapers by IRS summons. The Court voted to reverse previous lower court rulings in the same case holding that the workpapers were prepared because of potential litigation and therefore were exempt from disclosure under the so-called "work product doctrine," absent a showing of extraordinary need.

Textron has been extensively discussed and hotly disputed by tax litigators and commentators, and the First Circuit's decision was anxiously awaited. In a surprise, the First Circuit adopted a new legal standard, holding that the work product doctrine applies only to documents "prepared for use" in anticipated litigation, not documents prepared merely "because of" litigation or the prospect thereof. In other words, documents are not protected from discovery simply because they relate to a subject that might be litigated; rather, they must be useful in the litigation itself. In *Textron*, the workpapers in question were prepared for purposes of financial statement disclosures and showed *Textron's* prediction of the outcome of litigation of tax issues with the IRS. The Court held that, because these predictions were not for use in possible litigation with the IRS, they were not protected by the work product doctrine.

In the tax context, *Textron* is of particular significance for companies with a pattern of entering into transactions considered

potentially abusive by the IRS. For many years the IRS has followed a policy of restraint, requesting tax accrual workpapers only in highly unusual circumstances. In 2002, however, the IRS announced that it would seek tax accrual workpapers from companies who engaged in more than one of the transactions on the IRS's abusive list.

Importantly, the scope of the First Circuit's ruling is not limited to tax accrual workpapers or tax shelters. The reasoning of the Court could expose analysis and/or predictions of the outcome of litigation to discovery by an adversary in any case, particularly if the analysis or predictions are also used to prepare financial statement disclosures. The potential ramifications of the decision could be broad and should be of concern to litigants generally.

It seems likely that *Textron* will seek Supreme Court review. The new standard adopted in the First Circuit appears to conflict with the reasoning previously applied by other Circuit courts. Whether the Supreme Court will hear the issue is uncertain.

Cooley Godward Kronish LLP has long been recognized as one of the premier firms in the country for handling complex tax litigation, and our attorneys have litigated numerous landmark tax cases. If you have questions about *Textron* or your own tax issues, please contact one of the attorneys listed below or your Cooley tax or litigation partner. ■

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