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# How certain is accountant-client privilege?

By Kaimee Tankersley, JD, CPA; Beth Stetson, JD, PhD, CPA; and Aubree Walton, JD, CPA

The ongoing legal battle between the New York Attorney General (NYAG) and ExxonMobil offers a reminder of the limitations of accountant-client privilege. In 2015, NYAG Eric Schneiderman began a fraud investigation to determine whether the Texas-based company misled investors about the impact of climate change on the company's performance.<sup>1</sup> As part of the investigation, Schneiderman subpoenaed accounting records from Exxon's auditor, PricewaterhouseCoopers (PwC).<sup>2</sup> Exxon interceded, arguing that Texas' accountant-client privilege law shielded the records from discovery.<sup>3</sup> The claim of privilege presented several legal issues for the court. First, under a choice of law analysis, did Texas law (which provides for accountant-client privilege) or New York law (which does not recognize accountant-client privilege) control the privilege issue? Second, if Texas law controls the privilege, did it protect the documents at issue in this case?

## Multistate litigation: Which state's privilege law maintains control?

State courts use different legal tests for resolving choice of law concerns in privilege matters.<sup>4</sup> A majority of states apply the law of the state that has the most significant relationship with the communication.<sup>5</sup> The remaining states utilize a territorial approach, a hybrid test or have yet to specify which choice of law standard governs evidentiary privilege disputes.<sup>6</sup>

New York uses the territorial test, applying the privilege law of the state where the legal proceeding occurs (i.e. the state where evidence is introduced or where the discovery proceeding occurs). Because New York does not provide an accountant-client privilege, PwC's records were not protected from discovery.<sup>7</sup> This result reinforces the tenuous nature of accountant privilege, highlighting unique concerns for clients engaged in multistate transactions.

Oklahoma has not yet specified a choice of law standard for privilege issues.<sup>8</sup> If the state elects to follow the territorial standard, parties could reasonably expect litigation in Oklahoma courts to be governed by Oklahoma's privilege

law. If, however, the most significant relationship test is adopted, litigating in Oklahoma does not guarantee accountant-client privilege will be available.

## Evidentiary versus non-evidentiary state privilege statutes

Even if Texas law had prevailed in conflict analysis, does the statutory text offer the protection sought by Exxon? The New York trial court did not believe so. Although the Texas statute is titled Accountant-Client Privilege, it is a non-evidentiary statute that accomplishes little more than reciting a professional obligation to maintain client confidentiality.<sup>9</sup> Confidentiality does not equate to privilege. In states with non-evidentiary privilege, accountants must carefully read statutory text to determine the parameters of protection. Texas law specifies seven instances for which accountants must produce client information to external parties, including demands pursuant to a court order.<sup>10</sup>

Other states, including Oklahoma, Florida and California, have passed evidentiary accountant-client protections that shield privileged communications in a manner similar to attorney-client privilege.<sup>11</sup> In these states, disclosure is protected from court order. To avoid unintentional waiver of the privilege, accountants are well-advised to consult with their legal advisors and clients before complying with third party requests.

## Oklahoma's accountant-client privilege statute

Enacted in 2009, Oklahoma's accountant privilege law has yet to receive judicial interpretation, leaving considerable uncertainty regarding the act's scope and limitations. The law states "a communication between an accountant and a client of the accountant is confidential if not intended to be disclosed to third parties other than: (a) those to whom disclosure is in furtherance of the rendition of accounting services to the client, and (b) those reasonably necessary for the transmission of the communication."<sup>12</sup>

The statute identifies an accountant as

either a C.P.A. or a public accountant.<sup>13</sup> Client is defined as one who consults with an accountant to procure accounting services.<sup>14</sup> However, because the statute does not define accounting services, the legislature has left room for judicial interpretation regarding the scope of covered communication.

Several statutory exceptions create limitations to the privilege. First, the standard crime-fraud exception eliminates the privilege in any circumstance where an accountant's services were sought or utilized to perpetuate a crime.<sup>15</sup> Second, the privilege is unavailable in litigation that alleges breach of duty between accountant and client.<sup>16</sup> Third, no privilege exists in civil cases between clients "when a communication is relevant to a matter of common interest."<sup>17</sup>


It is important to remember that privilege statutes protect communication, not documents or facts. For example, the privilege may protect an accountant's email or letter that provides tax advice on future sales transactions, but it won't shield the facts or transactional documents related to the sale. And, only confidential communication is protected. The privilege is generally waived through disclosure to third parties. In a case of unintentional disclosure, the privilege can be saved if the "holder" (i.e. client) acted reasonably by implementing both pre-disclosure preventative measures and post-disclosure corrective measures.<sup>18</sup> Oklahoma statute also provides a specific waiver exception for compliance with government requests, whereby communication required by a government regulatory, investigative or enforcement action will not waive the privilege as to nongovernmental entities.<sup>19</sup>

As a state privilege, it only applies to investigations by state agencies or in litigation occurring in state court. Commentators speculate state privilege could apply in Federal courts exercising diversity jurisdiction. However, the Northern District of Oklahoma refused to apply Oklahoma's privilege in a 2016 federal diversity case, noting federal courts do not recognize state-created accountant privilege.<sup>20</sup>

### Federal accountant-client privilege

Accountant privilege is not recognized by federal common law.<sup>21</sup> In 1998, Congress provided a limited statutory privilege in the Internal Revenue Code (IRC). According to IRC § 7525, communication regarding tax advice between a taxpayer and a federally authorized tax practitioner (including an accountant) holds the same privilege as exists between client and attorney.<sup>22</sup> There are several important limitations to IRC § 7525. First, it applies only to tax advice, and does not protect communications to an accountant solely for purposes of return preparation.<sup>23</sup> Tax advice is difficult to outline, though by statute it includes any advice the authorized tax practitioner provides within his authority.<sup>24</sup> A second significant limitation is that it only applies to noncriminal, federal tax matters: (1) before the Internal Revenue Service or (2) in Federal court by or against the United States.<sup>25</sup> Federal investigations of non-tax matters are not privileged, and the privilege does not apply in state court or in subnational investigations. A third qualification on the tax preparer privilege is that it does not protect communication regarding tax shelters.<sup>26</sup> Because tax shelter is broadly defined in IRC § 6662(d), many accountants have inadvertently lost the federal privilege.<sup>27</sup>

In addition to accountant-client privilege under state and federal law, communications may be separately covered by attorney-client privilege. The accountant must be hired as an advisor or interpreter for the attorney with the purpose of aiding the attorney's legal representation of the client.<sup>28</sup> Attorney privilege will not protect communication associated with the provision of accounting services or tax preparation.<sup>29</sup> As a form of attorney-client privilege, it is effective in state or federal court, in criminal or civil matters.

Though some progress has occurred in extending evidentiary privilege to the accounting profession, considerable uncertainty remains. In the words of Supreme Court Justice William Rehnquist, "[a]n uncertain privilege, or one which purports to be certain but results in widely varying application by the courts, is little better than no privilege at all." 

### References

<sup>1</sup> Justin Gillis & Clifford Krauss, ExxonMobil Investigated for Possible Climate Change Lies by New York Attorney General, *New York Times* (November 5, 2015), <https://mobile.nytimes.com/2015>.

<sup>2</sup> David Hasemyer, Exxon's Auditor Could Hold Key Piece of Climate Fraud Investigation, *Inside Climate News* (March 7, 2017), <https://insideclimatenews.org/news/07032017/exxonmobil-climate-change-research-rex-tillerson-ny-attorney-general-pwc>

<sup>3</sup> Id.

<sup>4</sup> E. Todd Presnell & James A. Beakes, The Application of Conflict of Laws to Evidentiary Privileges, in *Evidentiary Privileges for Corporate Counsel*, 161-167 (2008).

<sup>5</sup> Id. at 163.

<sup>6</sup> Id. at 162-163.

<sup>7</sup> *Matter of People of the State of New York v. PriceWaterhouseCoopers, LLP*, Supreme Court of New York, New York County No. 451962/16, 2016 BL 360889 (Sup. Ct. Oct. 26, 2016)

<sup>8</sup> Todd Presnell, In-House Counsel Beware: Conflicts of Law May Spoil Your Privileges, 23 *In-House Litigator* 1, 6 (2009).

<sup>9</sup> Pilar Mata & Melissa J. Smith, Demystifying Accounting-Client Privileges in State Tax Litigation, *Tax Analysts* (April 4, 2012), <http://www.taxhistory.org/www/features.nsf/Articles/C55488CE4BD01FE0852579D60061414E?OpenDocument>

<sup>10</sup> Texas Occ. Code § 901.457(b).

<sup>11</sup> Mata & Smith, *supra* note 9.

<sup>12</sup> 12 O.S. § 2502.1(A)(3)

<sup>13</sup> Id. at § 2502.1(A)(1)

<sup>14</sup> Id. at § 2502.1(A)(2)

<sup>15</sup> Id. at § 2502.1(D)(1)

<sup>16</sup> Id. at § 2502.1(D)(2)

<sup>17</sup> Id. at § 2502.1(D)(3)

<sup>18</sup> Id. at § 2502.1(E)

<sup>19</sup> Id. at § 2502.1(F)

<sup>20</sup> *Jeter v. Bullseye Energy, Inc.*, 2016 U.S. Dist. LEXIS 156777, at \*10 (N.D. Okla. Aug. 11, 2016).

<sup>21</sup> *Couch v. U.S.*, 409 U.S. 322, 335 (1973).

<sup>22</sup> I.R.C. § 7525(a)(1)

<sup>23</sup> Jared T. Meier, Understanding the Statutory Tax Practitioner Privilege: What is Tax Shelter "Promotion"? 78 *Univ. Chi. L. Rev.* 671, 678 (2011).

<sup>24</sup> I.R.C. § 7525(a)(3)(B).

<sup>25</sup> I.R.C. § 7525(a)(2).

<sup>26</sup> I.R.C. § 7525(b).

<sup>27</sup> Meier, *supra* note 23, at 679-680.

<sup>28</sup> Seth Kossman, CPAs and Privileged Communications, *The Tax Adviser* (October 1, 2013), <https://www.thetaxadviser.com/issues/2013/oct/tpp-oct2013-story-03.html>.

<sup>29</sup> Id.