WINSTON & STRAWN LLP

CLIENT ALERT

Fifth Circuit Rejects Law Firm's Identity Privilege Claim

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On April 24, 2020, the Fifth Circuit in *Taylor Lohmeyer Law Firm PLLC v. United States* upheld a ruling issued by the Western District of Texas enforcing a John Doe summons issued by the Internal Revenue Service (the "IRS") demanding the identity of certain clients represented by the Taylor Lohmeyer Law Firm (the "Firm").[1] On May 15, 2019, the Western District of Texas rejected the Firm's petition to quash the summons, instead granting the Government's petition to enforce. In doing so, the Court rejected the Firm's argument that the attorney-client privilege protected the client names.[2]

Background

In *Taylor Lohmeyer*, the Fifth Circuit denied the Firm protection when it sought to shield the identities of its clients under the auspices of the attorney-client privilege. The IRS had served the Firm with a John Doe summons,[3] seeking documents for unnamed taxpayers "who, at any time . . . used the services of [the Firm] . . . to acquire, establish, maintain, operate, or control (1) any foreign financial account or other asset; (2) any foreign corporation, company, trust, foundation or other legal entity; or (3) any foreign or domestic financial account or other asset in the name of such foreign entity."[4] This broad demand was part of an IRS investigation to determine "identity and correct federal income tax liability of U.S. taxpayers for whom [the Firm] acquired or formed any foreign entity, opened or maintained any foreign financial account, or assisted in the conduct of any foreign financial transaction."[5]

This IRS investigation arose in the wake of an audit conducted on a specific client of the Firm. The client, the IRS found, had used the Firm to form offshore entities in tax haven jurisdictions for the purpose of assigning income to those entities, avoiding income tax. The client eventually reached a settlement with the IRS in which the client admitted to earning unreported income in excess of five million dollars, resulting in an unpaid income tax liability of more than two million dollars. With this in mind, the IRS targeted other clients for which the Firm created or maintained foreign bank accounts or foreign entities, with the suspicion that such entities and accounts also may not have been properly disclosed on tax returns.

The Firm moved to quash the summons on the grounds that the identities of its clients are protected by the attorney-client privilege. The Court, narrowly construing the privilege doctrine, ultimately ruled in favor of the IRS and enforced the summons.

Legal Analysis

Client identities, while generally not covered by the attorney-client privilege, do receive protection when disclosure of the client identity would itself reveal a confidential communication.[6] The privilege applies when an identity is "*connected inextricably* with a privileged communication", such that disclosure of the identity reveals the "confidential purpose" for which the client consulted the attorney.[7] The privilege also applies when so much of the actual communication between client and attorney has been established that disclosure of the client's name would disclose the "essence" of a confidential communication.[8]

The Firm contended that the IRS agent investigating the case already knew the content of the legal advice that the Firm afforded its clients. Thus, the identity of the clients, it argued, would provide the "essence" of the confidential communication when combined with the already-revealed substance of the communication.

The Fifth Circuit disagreed. First, the Court concluded that revealing the identities would not disclose the "motive" that those clients had for engaging the Firm as legal counsel.[9] Whereas in *Reyes-Requena II*, exposing the identity of the client (who was paying for his attorney to represent a defendant in a drug case) would have exposed his confidential motive for retaining the attorney, here, exposing the identities of all the different clients who had retained the Firm would not itself expose those clients' presumably numerous different motives for retention.[10]

Second, the actual substance of the communications between clients and the Firm was unknown to the IRS. In *Liebman*, the IRS knew not only the subject matter of the communication, but its substance: not simply that the attorneys had discussed tax deductions in general with their clients, but specifically that the attorneys had advised those clients (incorrectly) as to the deductibility of certain expenses.[11] That knowledge, if coupled with the identity of the client, would have revealed a confidential communication protected by the attorney-client privilege.

In contrast, the Fifth Circuit reasoned here that the IRS did not "know" the substance of the legal advice given to every client. The IRS had issued a robust and comprehensive summons, such that the IRS had a colorable argument that it was not contending that every client whose identity it sought had received the exact same advice. Shrewdly, rather than identifying "specific substantive legal advice . . . [and demanding] the identities of clients who received that advice," the IRS sought "documents reflecting *any* U.S. clients at whose request or on whose behalf [the Firm] ha[s] acquired or formed *any* foreign entity, opened or maintained *any* foreign financial account, or assisted in the conduct of *any* foreign financial transaction; *[a]ll* books, papers, records, or other data . . . concerning the provision of services to U.S. clients relating to setting up offshore financial accounts; and *[a]ll* books, papers, records, or other data . . . concerning the provision of services to U.S. clients relating to the acquisition, establishment or maintenance of offshore entities or structures of entities."[12]

According to the Court, the Firm's own statements supported the IRS' argument. Fred Lohmeyer, a named partner of the Firm, had stated that the Firm's other clients had gotten different advice than had been given to the audited client who had committed tax fraud. He claimed that the Firm "never advised any other client with respect to the treatment of earned income as income earned by a foreign corporation." Therefore, by Lohmeyer's own admission, the IRS did not "know" the substantive legal advice given to the clients.[13]

But still, to issue the John Doe summons in the first instance, the IRS had to prove that a "reasonable basis" existed for believing that the clients failed to comply with the Code. The IRS had shown this during an *ex parte* proceeding, and the validity of the summons thereafter was not subject to challenge.[14] Yet again, the IRS did not base the summons request on its finding that a specific client of the Firm had committed tax fraud in a specific way under the advice of the Firm; instead, it contended that it sought those clients with offshore accounts and entities "because offshore tax evasion usually involves a foreign financial account and an offshore entity controlled by nominee directors to hide the taxpayers' beneficial ownership."[15]

So, the Court threaded the needle: while some amount of certainty as to the existence of tax fraud was required for issuance of the summons in the first place, too much certainty as to whether the client had been advised to commit tax fraud could have taken this into privilege territory. By claiming that the Firm gave its other clients different, non-fraudulent advice, the Firm allowed the IRS to assert that it therefore did not know the content of the

communications. Without knowledge of the substantive communication, the communication of identity would not reveal the "essence" of a confidential communication, and thus would not breach the attorney-client privilege.

Looking to the Future

The *Taylor Lohmeyer* decision sustained the IRS' broad powers to investigate the identity of law firm clients if the IRS finds that just one client has committed tax fraud. The decision allows for an unintended narrowing of the attorney-client privilege by allowing the IRS to make broad requests to law firms to circumvent the traditional formulation of the identity privilege.

[1] 125 AFTR 2d 2020-1844 (5th Cir. 2020), *aff'g* 385 F. Supp. 3d 548 (W.D. Tx. 2019).

[2] Winston & Strawn LLP is counsel to a potential amicus in connection with this litigation.

[3] *See* IRC Section 7609(f). A John Doe summons may only be issued if (1) the summons relates to the investigation of a particular person or ascertainable group or class of persons; (2) the IRS has a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and (3) the information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

[4] *Taylor Lohmeyer Law Firm PLLC*, 125 AFTR 2d at 2020-1845.

[5] *Id.*

[6] *Id.* at 2020-1847 (citing *In re Grand Jury Subpoena for Attorney Representing Criminal Defendant Reyes-Requena*, 926 F.2d 1423, 1431 (5th Cir. 1991)).

[7] *Id.* (emphasis in original) (citing *Reyes-Requena II*, 926 F.2d at 1431).

[8] *Id.* (citing *United States v. Liebman*, 742 F.2d 807, 809 (3rd Cir. 1984)).

[9] *Id.* at 2020-1848.

[10] *See id.* at 2020-1847-2020-1848 (citing *Reyes-Requena II*, 926 F.2d at 1428).

[11] *See id.* at 2020-1848 (citing *Liebman*, 742 F.2d at 809-10).

[12] *Id.* (emphasis and alterations in original).

[13] Of course, Lohmeyer was caught between a rock and a hard place: he certainly could not have admitted that he had also advised his other clients to commit tax fraud.

[14] *Taylor Lohmeyer Law Firm PLLC v. United States*, 385 F. Supp. 3d 548, 552 (W.D. Tx. 2019).

[15] *Id.*

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