

Asserting Your Privilege

Kovel agreements can help you protect clients' confidential information

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You are constantly exposed to your clients' proprietary and confidential information through your role as a strategic advisor and through regular, day-to-day accounting operations. Obviously, you would never carelessly disclose your clients' confidential information, but protecting this information from a subpoena or court order is much more difficult, and often impossible, without advance planning.

Though some states have passed laws creating an accountant-client privilege, federal courts often do not recognize this privilege. However, confidential information disclosed to an accountant can still be protected in federal court through a Kovel agreement.

THE ACCOUNTANT-CLIENT PRIVILEGE

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Historically, courts did not recognize an accountant-client privilege, but a number of states have passed laws creating an accountant-client privilege, including Arizona, Colorado, Florida, Georgia and Pennsylvania. Though they vary from state to state, accountant-client privilege laws typically shield confidential conversations between accountants and their clients from disclosure in state-court proceedings, and they were passed to allow open communication and, therefore, better representation by the accountant.

The privilege is not absolute, however, and may be waived by the client.

For example, because the privilege only protects confidential communications, a client can waive the privilege by disclosing the information publicly or to a third party. Once disclosed to a third party, the information is no longer confidential and cannot be protected by the accountant-client privilege.

There are two exceptions to the accountant-client privilege. First, accountant-client communications related to future illegal or fraudulent activity are not protected because of the "crime-fraud" exception to the accountant-client privilege, though communications occurring after a fraud or crime has occurred are privileged.

The second is the "joint-representation" exception, where two or more clients are represented by the same accountant in the same matter. In this situation, neither the clients nor the accountant may assert the privilege against each other in subsequent litigation.

NO FEDERAL PRIVILEGE

Federal law does not recognize a general accountant-client privilege, and the only federal statutory protection available to accountants is the Federally Authorized Tax Practitioner Privilege, codified in 26 U.S.C. Section 7525, which protects communications between a taxpayer and a federally authorized tax practitioner regarding tax advice. However, Section 7525 is extremely limited - it does not apply in criminal cases or in civil cases in which the U.S. government is not a party. Further, Section 7525 only protects communications regarding "tax advice," with the exception of written communications promoting participation in tax shelters.

Federal courts will only apply a state enacted accountant-client privilege if the communications relate to a state-law claim or defense.

For example, if a suit is brought in federal court for fraud, which is typically based on the law of the state where the purported fraud occurred, a federal court will typically apply the accountant-client privilege if the state has adopted the privilege. However, a federal court will not apply a state-based accountant-client privilege to any criminal matter or to a civil matter based on a federal law.

KOVEL AGREEMENTS

Because there is no federal accountant-client privilege, accountant-client communications are often not protected from disclosure in federal courts. Thus, accountants should take affirmative steps to protect them in federal courts, and a Kovel agreement is a key tool to help protect these communications.

Under the Kovel doctrine, accountant-client communications are protected by the attorney-client privilege if the requirements of the attorney-client privilege are met. The attorney-client privilege generally applies to communications that are:

- Confidential;
- Made for the purpose of seeking legal advice; and,
- With a professional legal advisor in his capacity as a legal advisor.

The privilege can be waived, and because the attorney-client privilege only applies to confidential communications, it can be destroyed if a third party is present when the communication is made or the confidential information is later communicated to a third-party.

In 1961, the U.S. Second Circuit Court of Appeals extended the attorney-client privilege to accountants in *United States v. Kovel*, holding that "the presence of an accountant ... while the client is relating a complicated tax story to the lawyer, ought not destroy the privilege." (296 F.2d 918, 922 (2nd Cir. 1961))

The Kovel court analogized the role of an accountant to that of an interpreter, recognizing that, "[A]ccounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases." Reasoning that "the presence of the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer," the court held that accountant-client communications are protected by the attorney-client privilege where all elements of the attorney-client privilege are met.

Thus, the attorney-client privilege protects communications from a client to her accountant, even when the attorney

is not present, if the communication was made confidentially as part of obtaining legal advice from a lawyer. This protection applies in both criminal and civil cases in state and federal court.

In general, to protect communications under the Kovel doctrine, a lawyer should engage an accountant in a written document known as a Kovel agreement. The agreement is important because the party claiming the privilege has the burden of proving that each element of the attorney-client privilege was satisfied, including that the client was seeking legal, rather than accounting, services - thus, if there is no formal agreement memorializing the attorney-accountant-client relationship, the communications will be more difficult to protect.

Accordingly, Kovel agreements must be carefully drafted to establish each element of the privilege, and the parties must observe formalities throughout the representation to show that the attorney-accountant-client relationship exists for the purpose of seeking legal advice, and that the communications are confidential.

When properly executed, though, Kovel agreements can be a very effective and important tool for securing the confidentiality of accountant-client communications in all courts.

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