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## You've Been Served: A Guide For Accountants

Law360, New York (August 07, 2009) -- It is a common scenario: A process server hands an accountant a subpoena. The subpoena appears to require the accountant to testify, produce documents, or both. The accountant must decide how to respond. This article reviews the major steps in providing a proper response, in particular to subpoenas for documents.

At a general level, the process is simple. A subpoena is a document issued in the name of a court or other authorized government entity.

In practice, a subpoena almost always is drafted and issued by a litigating or investigating attorney without a court's approval or knowledge. Despite this practice, a recipient who fails to respond properly risks being held in contempt of court.

To respond properly, the recipient must either comply with the subpoena or assert objections. If the recipient asserts objections, the party that served the subpoena must obtain a court order overruling the objections and enforcing the subpoena.

For any particular subpoena, the accounting firm and its counsel must consider a series of issues. The first step is a careful analysis of the subpoena.

### **I. Analyze the Subpoena**

A subpoena can be issued for any of a wide variety of legal proceedings: a civil case in federal or state court; a federal or state criminal case; an IRS civil or criminal investigation; a proceeding before an administrative agency — again, federal or state; or even an arbitration.

When a subpoena comes in the door, the accountant's attorney will identify the body that issued the subpoena, to determine the set of rules that governs the response.

The attorney then should determine whether the subpoena was served properly and whether it

is valid. Next, attorney and accountant should determine exactly what documents the subpoena covers.

### **A. Determine Whether Service is Valid**

1) Subpoenas often are hand delivered by private process servers or government agents. An accountant who is handed a subpoena should accept it politely, but should not talk to the process server or agent about the substance of any client matter. An accountant also might receive a subpoena by mail.

2) The accountant's attorney will determine whether the serving party made valid service. (For example, in some states a federal subpoena must be served by hand, though others permit service by mail, and some states permit service of state subpoenas by certified mail.)

### **B. Determine Whether the Subpoena is Valid**

1) The attorney also will determine whether the subpoena is valid. It is fairly common for parties to serve subpoenas that are invalid and, therefore, have no legal effect.

2) In particular, the validity of certain subpoenas is subject to various geographical limitations. For example, a state-court subpoena is valid only in the state in which it was issued.

In federal civil litigation, a subpoena generally must issue from the federal court where the deposition will be taken or the party that controls the documents is located.

### **C. Determine the Subpoena's Scope**

1) The accountant and counsel should analyze the subpoena thoroughly. It is important to pay careful attention to the exact wording.

2) The accountant and counsel should identify, in detail, the types and locations of all documents and electronic materials that appear to be covered by the subpoena. This is a critical step, because an accounting firm might be required to prove that it identified and collected all materials covered by the subpoena.

3) Often it is apparent that the party that served a subpoena does not realize the magnitude of the burden imposed by the subpoena. If so, this is a topic for discussion with that party.

### **D. Identify Possible Sources of Reimbursement for Costs**

- 1) In some circumstances, the party serving the subpoena could have an obligation to reimburse part or all of the accountant's costs. (See part V below.)
- 2) Some engagement letters between accountant and client require the client to reimburse the accountant for the cost of responding to subpoenas relating to the client.
- 3) The accountant and attorney should review possibly relevant insurance policies and give any required notice.

### **E. Notify the Client Whose Documents are At Issue.**

The accountant should notify the client whose information has been subpoenaed and discuss the subpoena's scope and possible reimbursement of costs by the client.

Involving the client at the beginning of the process reduces the possibility of disagreement with the client and enables the client to take on as much of the effort as possible.

## **II. Reach Out To The Person Behind The Subpoena**

### **A. Contact the Proper Representative**

The accountant's counsel should contact the proper representative for the party or entity that served the subpoena.

That representative might be an attorney representing a civil party, an IRS agent, a state or federal prosecutor or another government representative.

### **B. Ask About the Underlying Case or Investigation**

In these informal exchanges, the accountant's counsel should learn about the substance and scope of the underlying matter, and the timeline for responding.

In criminal matters and certain other government investigations, the accountant's counsel will determine the accountant's status in the investigation.

In civil litigation, it generally is advisable to talk to the side that did not serve the subpoena, particularly if this is the accountant's client.

### **C. Clarify the Subpoena's Scope**

As appropriate, the accountant's counsel should negotiate with the other side to clarify or narrow the subpoena.

This conversation presents an opportunity to avoid any misunderstanding about exactly what the accountant will produce, as well as to shape the response to minimize expense.

### **III. Identify Any Restrictions on Disclosure of Client Information**

The accountant's counsel also should identify any legal limitations on producing the documents requested. The following lists some of the more common limitations.

#### **A. Subpoenas Issued in Civil Litigation**

When an accountant receives a subpoena issued for civil litigation, some of the main concerns are: (1) professional accounting standards and parallel state regulations, which generally prohibit an accountant from producing client records without client approval, (2) federal law, which generally prohibits an accountant from disclosing client tax records without client approval and (3) any applicable accountant-client privilege. (4) Some documents also might be protected by the attorney-client privilege.

##### 1) Accounting Standards

- Rule 301 of the AICPA Professional Standards states that "[a] member in public practice shall not disclose confidential client information without the specific consent of the client." The rule makes an exception for, among other things, "a validly issued and enforceable subpoena or summons."

- Many states have adopted variations of this rule.

##### 2) The Internal Revenue Code.

- The Internal Revenue Code prohibits disclosure of tax information without client consent. See 26 U.S.C. § 7216.

- There are exceptions to this prohibition, although their scope is not entirely settled.

The exceptions include (a) any other provision of the Internal Revenue Code that permits disclosure, (b) a court order that compels production, (c) a subpoena issued by a federal or

state grand jury, (d) an administrative order or subpoena from any federal agency, and (e) an administrative order or subpoena from any state agency or commission charged with licensing or regulating tax return preparers.

See 26 U.S.C.A. § 7216; 26 C.F.R. 301.7216-2. These exceptions do not include a state or federal court subpoena in a civil case, though an order enforcing that subpoena should satisfy the court-order exception.

### 3) Accountant-Client Privilege

- Federal law does not recognize an accountant-client privilege, but many states do. The scope of the privilege varies by state, but the privilege typically applies to information communicated to an accountant by in connection with an accounting engagement.

- Privileges ordinarily belong to the client, not the professional, so the accountant should make sure to avoid disclosing documents that might be protected by this privilege.

### 4) Attorney-Client Privilege

Attorney-client privilege shields certain information exchanged between attorney and client. When an accountant is served with a subpoena for documents of the accountant's client, this privilege sometimes can apply. The following are the most common circumstances:

- Advice from the accountant's own attorney to the accountant. Typically, accountants have little material of this type.

- Advice from the attorney for the accountant's client to that client. Often, attorney-client privileged information that the accountant's client passes to an accountant loses its privileged status.

- Work performed by the accountant to support the rendering of legal advice. This arises most often where an accountant provides litigation-support services. (This context often is referred to by the shorthand of the Kovel rule, after *United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961).)

## **B. Subpoenas Issued by the IRS in IRS Proceedings: The Federally Authorized Tax Practitioner Privilege.**

Federal law generally requires tax practitioners to produce documents subpoenaed by the IRS.

In civil IRS matters, however, that requirement is limited by a federal version of the accountant-client privilege.

1) The basis of the tax-preparer's obligation to provide documents to the Internal Revenue Service is Treasury Department Circular No. 230. Section 10.20 of Circular No. 230 sets out the tax preparer's basic obligation to comply with an IRS demand for documents.

2) The federally authorized tax practitioner privilege.

- After the United States Supreme Court confirmed the absence of a federal accountant-client privilege, Congress created the "federally authorized tax practitioner" privilege.

This privilege is limited. It applies only in noncriminal matters before the IRS and noncriminal tax proceedings in federal court brought by or for the United States. 26 U.S.C.A. § 7525(a)(2).

- Its scope also is limited. This privilege applies only to "tax advice" between a taxpayer and a "federally authorized tax practitioner."

That is, this privilege protects communications only "to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney." This protection may not, therefore, apply to the bulk of work papers involved in the preparation of a tax return.

3) The attorney-client privilege applies in this context as well. See Section 10.20 of Circular No. 230.

## **IV. Collect and Review Responsive Materials**

### **A. Collect Responsive Materials**

After developing an understanding of the exact scope of the subpoena, the accountant should identify and gather all responsive materials. This can be an extensive and time-consuming task. The collection effort must include documents that are responsive but the accountant will withhold based on privilege or a similar protection.

### **B. Pay Special Attention to Electronic Materials**

1) The search must encompass all electronic materials covered by the subpoena. These can include complete or partial sets of work papers, staff emails and personal files, and similar

materials. Often much responsive electronic material exists that was not made part of the official client file.

2) It is very important that the search for electronic materials comply with applicable legal requirements. Collection and production of electronic materials is a particularly hazardous area.

## **V. Continue the Dialogue With the Serving Party**

### **A. Reach a Specific Understanding About Compliance**

The accountant's counsel should reach an understanding with the serving party about exactly which documents and materials the accountant will produce.

### **B. Consider Seeking Reimbursement for Costs**

In civil litigation, the accountant should consider asking for reimbursement for some or all of the costs of compliance.

### **C. Document All Objections**

In most jurisdictions, a nonparty in a civil case has two primary ways to preserve objections to a subpoena. (Subpoenas served in criminal or other matters may have different procedures.)

1) Under the Federal Rules of Civil Procedure and the rules of some states, a recipient of a document subpoena can assert objections by sending the serving party a letter.

This relieves the subpoena recipient of the obligation to respond further, unless the serving party obtains a court order enforcing the subpoena. See F.R.C.P. 45(c)(2)(B).

2) Instead of sending a letter of objection and waiting for the serving party to go to court, an accountant may choose to file a motion asking the court for an order that quashes the subpoena to the extent of the objections. See F.R.C.P. 26(c); F.R.C.P. 45(c)(3)(A).

The accountant's client often will prepare the motion, and might have the right to file its own motion in order to protect its own rights.

## **VI. Obtain Any Necessary Client Consents**

Before producing any documents, the accountant usually must consult with the client whose documents are at issue. Generally, the client will consent to production of certain documents or,

if necessary, will step in and litigate any efforts to prevent or limit production.

The accountant should obtain consent from the proper client representative, and if necessary, should obtain consents from all possible representatives.

## **VII. Produce the Documents**

### **A. Produce the Documents**

The accountant should produce the documents in a manner agreed to with the serving party.

### **B. Maintain a Complete Record of the Production**

The accountant should maintain a complete record of all materials produced, including all electronic materials. As noted above, it can be especially important to work closely with counsel with knowledge of electronic discovery.

### **C. Create a Privilege Log**

Federal and some state rules of procedure require a description of privileged documents sufficient to permit the requesting party to contest the privilege claim. See, e.g., F.R.C.P. 45(d) (2).

## **A Note on Document Control and Retention**

An accounting firm cannot begin to respond properly unless it has appropriate control over all of its own materials. Therefore, every firm should review its policies governing the retention and disposal of documents, particularly electronic materials.

An appropriate policy should address all possible locations and platforms. Without an appropriate document retention policy, properly followed, an accounting firm risks problems if it receives a subpoena or finds itself in litigation.

Lack of an appropriate policy substantially increases the cost of document search and collection and invites allegations that responsive documents have been overlooked or improperly destroyed. Accounting firms should consult counsel about this critical undertaking.

## **Conclusion**

Responding to a subpoena for client documents is not a mere administrative task: It presents a series of traps for the unsuspecting. The above outline identifies some of the more common considerations, but it cannot identify all of the issues that any particular subpoena might raise.

An accountant or firm that receives a subpoena should consult with counsel and — using this outline as a description of the typical steps in the process — follow counsel's guidance about how to respond.

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