UNITED STATES TAX COURT

WASHINGTON, DC 20217

PACIFIC MANAGEMENT GROUP, BSC LEASING, INC., TAX MATTERS PARTNER, ET AL.,	)	
Petitioners	)	Docket Nos. 6411-07, 6412-07, 6413-07, 6414-07, 6494-07, 6498-07, 6499-07, 6592-07, 6593-07, 6594-07, 6596-07, 28655-11, 29777-11, 3264-12, 13818-12, 13819-12, 13820-12, 13821-12, 13822-12, 13823-12, 13824-12, 13825-12, 13826-12, 13827-12, 5064-13, 15201-13, 15202-13, 20708-13, 20709-13, 20710-13, 21956-13, 21957-13, 21958-13, 21959-13, 21960-13, 21961-13, 21962-13, 21963-13, 21964-13, 21965-13.
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

RM

ORDER

These consolidated cases were tried at the Court's special trial session commencing January 12, 2015, in San Diego, California. On December 24, 2014, respondent filed a Motion In Limine Re Admissibility Of Records That California Franchise Tax Board Turned Over To IRS Pursuant To District Court Order Enforcing IRS Summons. On January 6, 2015, petitioners filed a related motion in limine, titled Motion in Limine to Preclude Respondent From Presenting Evidence Concerning Information Obtained By Summons Served Upon the Franchise Tax Board in the Matter of Ernest S. Ryder. On January 12, 2015, petitioners filed an

Opposition to Respondent's Motion in Limine. During trial on January 12, 2015, the parties presented testimony and oral argument on these motions.

The following facts are stated solely for the purpose of ruling on these motions and not as findings of fact in this case. See Rule 1(b); Fed. R. Civ. P. 52(a); Cook v. Commissioner, 115 T.C. 15, 16 (2000), aff'd, 269 F.3d 854 (7th Cir. 2001). Petitioners include four companies that provide engineering services. In 1999 petitioners' common shareholders met with Ernest Ryder, an attorney, who described an arrangement designed to minimize their Federal income taxes. Petitioners eventually hired Mr. Ryder to implement this structure. Respondent contends (among other things) that this structure lacked economic substance.

These motions relate to documents that were electronically stored on hard drives seized from Mr. Ryder's offices by the California Franchise Tax Board (FTB). Pursuant to an order from the United States District Court for the Central District of California, the FTB subsequently turned over this material to the IRS. The question is whether these documents are admissible at trial or, as petitioners contend, are shielded by the attorney-client privilege or the attorney work-product doctrine. We find that petitioners have waived these privileges. We will accordingly deny petitioners' motion in limine and grant respondent's motion.

On April 12, 2010, Ricardo Gomez, a Special Agent employed by the FTB's Criminal Investigation Bureau (SA Gomez), executed search warrants on Mr. Ryder's law offices and seized 93 boxes of records, including computers and associated hard drives. The computers and hard drives (among other items) were placed in Box 53. All 93 boxes were initially sealed under the supervision of a Special Master who accompanied SA Gomez.

Attorneys from Mr. Ryder's law offices subsequently examined the 93 boxes to determine what should be made available to the FTB for review and what might be privileged. This examination produced 25 boxes of allegedly-privileged documents. These 25 boxes were re-sealed and set aside for further review by a California state court to consider the privilege claims.

Box 53, which contained the computers and hard drives, was not among the 25 boxes that were thus re-sealed. Mr. Ryder made no claim of privilege with respect to the contents of Box 53. SA Gomez credibly testified that he brought Box 53 (along with the other boxes) for Mr. Ryder's team to review, but that they

did not assert the attorney-client privilege with respect to its contents by including those contents in the 25 boxes that were re-sealed.

A Special Master was appointed by the San Diego County Court to review the 25 boxes of sealed evidence. After reviewing these boxes, the Special Master determined that some of the items were not privileged, and those additional documents were then turned over to the FTB. After this review, only 23 boxes of allegedly-privileged evidence remained sealed (the "23 sealed boxes").

Separately, IRS Revenue Agent Joseph Haynes (RA Haynes) was conducting an investigation to determine whether Mr. Ryder was liable for penalties under I.R.C. §§ 6700 and 6701 for promoting abusive tax shelters. RA Haynes became aware that the FTB was in possession of Mr. Ryder's records. On August 12, 2013, RA Haynes issued a summons to the FTB directing it to provide the IRS with copies of all records, in paper or electronic form, that the FTB had seized in the course of its investigation of Mr. Ryder.[1]

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[1]Petitioners provide no factual support for their contention that "[t]he use of the Summons and the information derived therefrom seems to be an end-run around the Tax Court discovery rules." Generally, where litigation in this Court has commenced, and the IRS later obtains relevant information by issuing an administrative summons with respect to a different taxpayer or a different tax period, we do not regard the IRS as having obtained that information in defiance of our discovery rules, and we do not exclude it from evidence. Ash v. Commissioner, 96 T.C. 459, 471 (1991). However, we will exercise our inherent power to exclude information from evidence if the petitioner shows that the IRS lacked a sufficient independent reason for the summons. Ibid. Here, the record established that RA Haynes was conducting an independent investigation as to whether Mr. Ryder was "promoting abusive tax shelters" to the general public within the meaning of section 6700. Petitioners presented no evidence that RA Haynes lacked an independent or sufficient reason for issuing his summons to the FTB. RA Haynes was available to testify during the trial, but petitioners did not call him. When respondent attempted to call him, petitioners objected and he did not testify. Since petitioners declined several opportunities to question RA Haynes concerning the purpose for which he issued the summons, they are in no position to assert that his purpose was improper. Because RA Haynes issued the summons in aid of a separate investigation of a different taxpayer for different tax periods,

(continued...)

Mr. Ryder received a copy of this IRS summons and filed a Petition to Quash Summons in the United States District Court for the Central District of California. He argued (among other things) that the material sought was protected by the attorney-client privilege and the work product doctrine. The IRS filed a motion for Summary Denial of Petition to Quash. After briefing by the parties, the District Court (Collins, J.) denied the Petition to Quash and ordered that all 93 boxes of documents, including the 23 sealed boxes, be turned over to the IRS. Mr. Ryder requested a stay, which Judge Collins granted. In seeking reconsideration, Mr. Ryder stated that, after the initial review of the 93 boxes, he "had re-sealed those items believed to be protected by the Privilege. * * * This review * * * resulted in a number of boxes of Files, remaining under seal, which Ryder continued to maintain were protected by Privilege." Mr. Ryder's claim of privilege to the District Court was thus limited to the 23 sealed boxes; he made no claim of privilege with respect to the contents of Box 53.

On March 4, 2014, Judge Collins issued a supplemental order finding that Mr. Ryder had waived all claims of privilege with respect to the summonsed records except for the 23 sealed boxes. The Court ordered the FTB to turn over to the IRS immediately copies of all records contained in the remaining 70 boxes, including Box 53. Mr. Ryder did not seek reconsideration of the District Court's March 4, 2014, Order, and he has not attempted to appeal that Order.[2]

Subsequently, RA Haynes and other IRS employees commenced review and reproduction of records (both paper and electronic) that were turned over to them in accordance with the District Court's March 4, 2014, Order. The records thus turned over included the hard drives contained in Box 53. Because Box 53 was not among the 23 sealed boxes, and because Mr. Ryder before the District Court

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[1](...continued)
and there is no evidence of any improper purpose, we reject petitioners' contention that the summons constituted "an end-run around [our] discovery rules."

[2]Judge Collins granted Mr. Ryder 15 days to file a privilege log as to the contents of the 23 sealed boxes. He subsequently filed a 342-page privilege log regarding the contents of the 23 sealed boxes, and Judge Collins has yet to rule on those privilege claims. Mr. Ryder did not, during the course of these further proceedings before the District Court, assert any claim of privilege with respect to the contents of Box 53.

had not claimed privilege with respect to the contents of Box 53, the FTB allowed the IRS to make electronic copies of the data on the hard drives.

In October 2014, as part of the informal discovery process, respondent provided petitioners with an electronic copy of the data taken from the hard drives. On October 14, 2014, respondent filed Requests for Admission asking petitioners to admit the authenticity of several documents, some of which were marked "privileged" and were stated to be have been obtained from Mr. Ryder's computer. In their response, petitioners provided respondent with signed copies of these documents and asserted no claim of privilege with respect to them.

On October 16, 2014, respondent deposed petitioner Richard Boultinghouse. During this deposition, respondent questioned Mr. Boultinghouse about four documents, which respondent stated had been obtained from Mr. Ryder's computer. Despite this fact, and despite the fact that at least two of the documents bore the legend "Confidential Attorney-Client Communication and Tax Advice," neither Mr. Ryder nor his co-counsel--both of whom were present at the deposition--asserted any claim of privilege with respect to these documents. Nor did they raise any question, more generally, about respondent's possession of Mr. Ryder's computer records.

On October 20, 2014, respondent filed a Motion to Disqualify Mr. Ryder based on conflict of interest, along with a memorandum of points and authorities in support thereof. Exhibits B, C, and D attached to respondent's memorandum were documents obtained from Mr. Ryder's computer. The documents are unsigned letters; each document bears a "path" to Mr. Ryder's computer directories (e.g., G:\ESR\Boultinghouse\factor letter.wpd), and each document was Bates stamped by respondent as "ERCOMP 000XXX." In his response, filed November 10, 2014, Mr. Ryder asserted his belief that these "documents may have been turned over 'inadvertently' by the FTB to the IRS."

Respondent deposed Mr. Ryder on November 6, 2014. During this deposition, respondent questioned Mr. Ryder about numerous documents generated from the hard drives that the FTB had supplied to the IRS. Mr. Ryder's attorney made the following standing objection:

> But to the extent that any privileged documents have been provided to the IRS as part of that summons, I believe two things: First, that

> providing those documents may have violated the present court orders in the summons proceeding, and, two, that there could be ethical problems for the IRS, taking documents that they know or should have known are privileged and reviewing them without getting a court approval to do that. I would like to state that for the record. * * * I don't think for the most part here it's going to be an issue, because I believe [Mr. Ryder's] client has waived attorney-client with respect to this deposition.

Despite making this objection, neither Mr. Ryder's attorney, nor petitioners, nor Mr. Ryder have made any effort to "claw back" the allegedly-privileged documents. Neither Mr. Ryder nor petitioners have gone to the District Court to seek reconsideration of its Order dated March 4, 2014, or to seek, in any forum, return of any materials that the District Court ordered to be turned over to the IRS.

Section 7453 provides in pertinent part that Tax Court proceedings are conducted in accordance with the rules of evidence applicable to trials without a jury in the United States District Court for the District of Columbia. The Federal Rules of Evidence, which incorporate the common law rules of privilege, apply to such proceedings. See Fed. R. Evid. 501, 1101.

The attorney-client privilege applies to communications made in confidence (1) by a client to an attorney for the purpose of obtaining legal advice, and (2) by an attorney to a client, where the communication contains legal advice or reveals confidential information relating to such advice. Upjohn Co. v. United States, 449 U.S. 383, 390 (1981); Bernardo v. Commissioner, 104 T.C. 677, 682 (1995); Hartz Mountain Indus. v. Commissioner, 93 T.C. 521, 525 (1989). The work product doctrine protects materials prepared in anticipation of litigation. Ratke v. Commissioner, 129 T.C. 45, 49-50 (2007). The burden of establishing that the privileges apply to particular communications or documents rests with the party asserting the privilege. See Bernardo, 104 T.C. at 682; Federal Trade Commission v. Lukens Steel Company, 444 F. Supp. 803, 806 (D.D.C. 1977).

The attorney-client and work-product privileges may be waived if they are not properly asserted or if the relevant information or documents are voluntarily disclosed to third parties. See Bernardo, 104 T.C. at 684; Moore v. Commissioner, T.C. Memo. 2004-259, 88 T.C.M. (CCH) 443, 446; United States v. Nobles, 422 U.S. 225, 239 (1975); Hartz Mountain Industries v. Commissioner, 93 T.C. 521, 527 (1989); In re Sealed Case, 676 F.2d 793, 811, 818 (D.C. Cir. 1982) (protection

afforded by the work product doctrine to 'opinion work product' may be waived). We find that Mr. Ryder and his co-counsel, on behalf of petitioners, have waived these privileges.

First, based on the testimony of SA Gomez, we find that counsel for petitioners waived the relevant privileges by not asserting them as to the contents of Box 53 upon completing their initial review of the 93 boxes. SA Gomez credibly testified that he brought Box 53 forward for review and that Mr. Ryder's team did not assert a privilege claim with respect to its contents by placing those contents into a sealed box. Nothing prevented Mr. Ryder from placing the hard drives into a sealed box.

Second, the District Court has ruled that Mr. Ryder waived privilege as to all of the summonsed material except for the 23 sealed boxes (which did not contain the hard drives). In its March 4, 2014, Order, the District Court stated:

> The universe of documents that Ryder turned over to the FTB for which the government now seeks access totals 93 boxes. The Court has reviewed the Special Master's two declarations, which identify 11 boxes deemed privileged in the first review and 12 boxes deemed privileged in the second review. As a result, 70 boxes have been produced to the FTB and 23 boxes have been withheld as privileged. Ryder does not dispute the Court's finding that privilege has been waived as to the 70 boxes. Thus, those 70 boxes should be produced to the government immediately in accordance with the Court's Order.

Despite having been apprised that the IRS was seeking summons enforcement to obtain both paper and digital records, Mr. Ryder voluntarily waived privilege as to all records other than those contained in the 23 sealed boxes. Mr. Ryder did not dispute the District Court's finding, set forth above, that he had waived privilege as to everything in the remaining 70 boxes. And he explicitly acknowledged that waiver in subsequent pleadings filed with the District Court. As a result, the contents of the remaining 70 boxes, including Box 53, were turned over to the IRS in strict compliance with the District Court's Order. Petitioners'

argument that this material was turned over in violation of that Order, or that the IRS acted improperly in using the material, is simply incorrect.[3]

To the extent the District Court's Order is deemed a final order, cf. United States v. Jose, 519 U.S. 54, 56-57 (1996), it is binding under the doctrine of collateral estoppel. The matter was fully litigated by a court of competent jurisdiction; the issue is the same; petitioners are in privity with Mr. Ryder; and the controlling facts and law are unchanged. Cf. Peck v. Commissioner, 90 T.C. 162, 166-167 (1988), aff'd, 904 F.2d 525 (9th Cir. 1990). Even if the District Court's Order is not binding under collateral estoppel, we would defer to it as a precedential ruling of a sister court. See Rollins v. Commissioner, T.C. Memo. 1993-118 (deferring to district court rulings concerning propriety of summons); cf. Estate of Duvall v. Commissioner, T.C. Memo. 1993-319; Clymer v. Commissioner, T.C. Memo. 1984-203; Gracia v. Commissioner, T.C. Memo. 2004-147 ("Giving due regard to principles of judicial comity, we discern no reason to second-guess the bankruptcy court's assertion of jurisdiction over petitioner in the partnership's chapter 11 bankruptcy case."). Respecting the District Court's resolution of the privilege issue is consistent with the conservation of judicial resources and the promotion of certainty in and reliance on judicial action. We will not permit petitioners to claim privilege as to this material when Mr. Ryder himself failed to do so on two prior occasions--at the state level with the Special Master and in the District Court proceeding.

Third, if the attorney-client privilege had not previously been waived, it was waived in October 2014 when petitioners became aware that the IRS possessed

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[3]Petitioners contend that RA Gomez reached a tacit agreement with Mr. Ryder's team that the FTB would begin reviewing paper documents from the unsealed boxes first, deferring examination of the hard drives until a later date. Petitioners have not explained how such an agreement, if it existed, could equate to an assertion of privilege over the contents of Box 53. The attorney-client privilege must be claimed explicitly. Cf. United States v. Gurtner, 474 F.2d 297, 299 (9th Cir. 1973) ("In addition, the failure to assert the privilege when the evidence was first presented constituted a voluntary waiver of the right. Once the subject matter is disclosed by a knowing failure to object there is nothing left to protect from disclosure."); Zenith Radio Corp. v. Radio Corp. of Am., 121 F.Supp. 792, 795 (D. Del. 1954) ("Of course, the privilege must be claimed."). In any event, Mr. Ryder advanced no such argument to the District Court.

allegedly-privileged documents, but took no action to claw them back within a reasonable period of time. If privileged material is disclosed inadvertently or by mistake, a court may decline to find waiver if the privilege holder has made efforts "reasonably designed" to protect the privilege. See Transamerica Computer v. Int'l Bus. Machs., 573 F.2d 646, 650 (9th Cir. 1978). Conversely, a court may deem the privilege waived if the privilege holder fails to pursue all reasonable means of preserving the confidentiality of the communications. Failure to take such steps may allow "the mantle of confidentiality which once protected the document[ ]" to be "irretrievably breached." Permian Corp. v. United States, 665 F.2d 1214, 1220 (D.C. Cir. 1981) (quoting In re Grand Jury Investigation of Ocean Transp., 604 F.2d 672, 675 (D.C. Cir.), cert. denied, 444 U.S. 915 (1979)).

Mr. Ryder has known at least since October 2014 that respondent possessed and was deploying documents generated from his computer hard drives. Respondent's attorneys questioned Mr. Ryder and petitioners about these documents over the course of several months. If petitioners believed that these documents had been turned over to the IRS in violation of the District Court's order, they should have sought immediate relief from the District Court. If they believed that these documents had been turned over to the IRS inadvertently, they should have taken immediate steps to claw them back from the IRS. By doing neither, they waived the privilege in October 2014 if they had not waived it previously.

Fourth, petitioners during discovery voluntarily supplied respondent with paper copies of attorney-client documents that the IRS had accessed electronically via the hard drives. Since petitioners voluntarily disclosed these documents, they are no longer privileged. See Moore v. Commissioner, T.C. Memo. 2004-259, 88 T.C.M. (CCH) 443, 446 ("[A]t the point where attorney-client communications are no longer confidential, i.e., where there has been a disclosure of a privileged communication, there is no justification for retaining the privilege."). Moreover, "any voluntary disclosure by the client to a third party breaches the confidentiality of the attorney-client relationship and therefore waives the privilege, not only as to the specific communication disclosed, but often as to all other communications relating to the same subject matter." In re Sealed Case, 676 F.2d 793, 809 (D.C. Cir. 1982). All of the documents at issue seemingly relate to the same subject matter, namely, the tax-minimization arrangements that Mr. Ryder designed for petitioners.

Finally, petitioners contend that they are not subject to penalties in these cases because they made "a concerted and good faith effort to comply with the

provisions of the Internal Revenue Code" and that "[a]ny failure to so comply is attributable to reasonable cause." By putting their subjective intent into issue, petitioners have forfeited the right to keep confidential the advice Mr. Ryder gave them about his tax-minimization strategy and about the manner in which he implemented that strategy for them. See Ad Inv. 2000 Fund LLC v. Commissioner, 142 T.C. 248, 257-258 (2014) ("[B]y placing the partnerships' legal knowledge and understanding into issue in an attempt to establish the partnerships' reasonable legal beliefs in good faith arrived at * * * , petitioners forfeit the partnerships' privilege protecting attorney-client communications relevant to the content and the formation of their legal knowledge, understanding, and beliefs.").

For these reasons, we find that petitioners have waived all privileges claimed with respect to the documents at issue, including the attorney-client privilege and the work product doctrine. It is therefore

ORDERED that respondent's Motion In Limine Re Admissibility Of Records That California Franchise Tax Board Turned Over To IRS Pursuant To District Court Order Enforcing IRS Summons By Resp, filed December 24, 2014, is granted. It is further

ORDERED that petitioners' Motion in Limine to Preclude Respondent From Presenting Evidence Concerning Information Obtained By Summons Served Upon the Franchise Tax Board in the Matter of Ernest S. Ryder, filed January 6, 2015, is denied.

(Signed) Albert G. Lauber
Judge

Dated: Washington, D.C.
May 18, 2015