COMMONWEALTH OF MASSACHUSETTS
SUPREME JUDICIAL COURT

Suffolk, ss: No. SJC –10209

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COMMISSIONER OF REVENUE,

Plaintiff – Appellant

v.

COMCAST CORPORATION AND CONTINENTAL TELEPORT, INC,
A/K/A CONTINENTAL HOLDING COMPANY,

Defendants – Appellees

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On Appeal from a Judgment of
The Suffolk Superior Court

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**Brief for the Amicus Curiae,**
**Multistate Tax Commission**

Shirley K. Sicilian
*General Counsel*
Sheldon H. Laskin
*Counsel*
MULTISTATE TAX COMMISION
444 No. Capital Street, NW
Suite 425
Washington, DC 20001
(202) 624 – 8699

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**IN SUPPORT OF APPELLANT -**
**COMMISSIONER OF REVENUE OF THE COMMONWEALTH OF MASSACHUSETTS**

**INTEREST OF *AMICUS CURIAE***

*Amicus Curiae* Multistate Tax Commission (Commission) files this brief in support of the Commissioner of Revenue of the Commonwealth of Massachusetts (Commissioner of Revenue or Commissioner). The Commission agrees with the Commissioner of Revenue that the decision below is incorrect and should be reversed; Massachusetts should not allow the attorney-client privilege or the attorney work product doctrine to prevent disclosure to a tax agency of tax planning documents prepared by a public accounting firm. Comcast, as successor in interest to U.S. West (West), in effect urges this Court to adopt a general accountant-client privilege under the guise of invoking the attorney-client privilege or the work product doctrine. Such a privilege would undermine the transparency essential to the taxpayer self-assessment principle of American tax reporting and would impair the Commissioner's ability to effectively administer the tax laws.

The Commission is the administrative agency for the Multistate Tax Compact (Compact), which became effective in 1967. *See* RIA All States Tax Guide ¶ 701 *et seq.*, (2005). Today, forty-seven States and the District of Columbia are members.[1] The purposes of the Compact are to: (1)

[1] Compact Member States are: Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho,

facilitate proper determination of State and local tax liability of multistate taxpayers, including equitable apportionment of tax bases and settlement of apportionment disputes, (2) promote uniformity or compatibility in significant components of tax systems, (3) facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration, and (4) avoid duplicative taxation. *See* Compact, Art. I.

Discovery privileges are to be narrowly construed in general, because the successful invocation of a privilege always impedes the ability of the judicial system to determine the true facts of a case. In the specific context of a state tax audit, it is critical to the American self-assessment policy that evidentiary privileges not be allowed to expand beyond the narrow parameters of the purposes behind those privileges. Comcast's interpretation of the attorney-client privilege and the work product doctrine, if adopted by this Court, would result in a wholly unwarranted expansion of those privileges in contravention both of the

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Kansas, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. Sovereignty Members are: Georgia, Kentucky, Louisiana, Maryland, New Jersey, West Virginia and Wyoming. Associate Members are: Arizona, Connecticut, Florida, Illinois, Iowa, Indiana, Maine, Massachusetts, Mississippi, Nebraska, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont and Wisconsin. The U.S. Supreme Court upheld the validity of the Compact in *United States Steel Corp.* v. *Multistate Tax Comm'n*, 434 U.S. 452 (1978).

general policy of full discovery of relevant evidence and of the transparency required by the self-assessment doctrine.

The Commission itself has an institutional interest in this policy of transparency. Pursuant to Article VIII of the Compact, the Commission conducts audits of multistate businesses on behalf of its member states. The Commission's ability to effectively conduct such audits and to administer the multistate audit program would be seriously compromised if Comcast's view of the attorney-client privilege or the work product doctrine were to be widely adopted by the courts.

In short, public policy does not support expansion of the attorney-client privilege or the work product doctrine as urged by Comcast. Such an expansion would needlessly impede both the ascertainment of clearly relevant facts in tax audits and the administration of state audit programs including the Commission's own audit program.

**Summary of Argument**

Comcast is urging the Court to impose a zone of silence for an otherwise disclosable tax planning document, merely because an in-house attorney asked for its preparation. If the Court agreed, the result would be the creation of a general accountant-client privilege previously unrecognized in Massachusetts. This privilege would seriously compromise both the Commissioner's authority to audit taxpayers, and the transparency required by the self-assessment structure of American tax reporting. It would

also have the perverse effect of protecting the most questionable of tax transactions from disclosure: the more questionable the tax transaction, the more reason a taxpayer might want to claim that *some day* a transaction might be challenged and lead to litigation, and thus assert more justification for privilege. Finally, it would violate the public policy of Massachusetts that G.L. c. 62C, §70 is to be construed to "most usefully further the objects for which the [Commissioner's investigative] power was given." *Commissioner of Revenue v. Boback,* 12 Mass. App. Ct. 602, 607 (1981). The Court should decline the invitation to create this wholly unwarranted expansion of the attorney-client privilege and the work product doctrine.

**Argument**

**I. The Fundamental State Tax Audit Issue is Whether the Transaction in Contention is a Sham.**

It is a basic premise of tax law that tax benefits claimed as a result of a transaction that formally complies with the letter of the law may, nevertheless, be denied if the transaction is a "sham transaction." A sham transaction is a transaction that occurs primarily to exploit a feature of the tax laws for purposes of tax avoidance. *See, e.g., Syms Corp. v. Commissioner of Revenue,* 436 Mass. 505, 765 N.E.2d 758 (2002), *Gregory v. Helvering,* 293 U.S. 465 (1935) (creation of corporation to generate capital gain rather than ordinary income upon sale of stock after dissolution "nothing more than a contrivance" benefiting stockholder

when corporation conducted no business other than the initial stock

capitalization).[2]

In determining whether a transaction is a sham, a critical question is whether the transaction had economic substance or a legitimate, non-tax business purpose. *Syms*, 436 Mass. at 511 – 512, 765 N.E.2d at 764.

The facts in this case support an inference that the transactions described above are sham transactions with no economic substance or business purpose beyond tax avoidance. Continental Teleport was reorganized as a corporate trust solely for the purpose of allowing US West to claim that the gain to be realized on its required divestiture of the TCGI shares was entirely exempt from Massachusetts tax as would otherwise be due. Continental Holding, the corporate trust, was created immediately prior to four of the five stock sales and the proceeds from such sales were then allegedly loaned to an affiliate in an effort to claim that the corporate trust held "securities" and was tax-exempt as a

[2] Although the income characterization issue in *Gregory* is different than the business trust issue in this case, the structure of the transaction the Supreme Court described as "nothing more than a contrivance" is identical to the structure in this case; the taxpayer formed a corporation entirely for tax reduction purposes, executed the transaction and then dissolved the corporation. The taxpayer in *Gregory* was seeking to reduce the tax by characterizing the income as capital gain rather than ordinary income. In contrast, US West was seeking to avoid tax on the capital gain altogether.

corporate trust holding company; the corporate trust was then dissolved after these efforts to satisfy the literal requirements for an exempt corporate trust holding company. The sale proceeds were advanced to a West affiliate, Domestic Cable, pursuant to promissory notes payable to Continental Holding. There is no record of any payments made under the notes or of their ultimate disposition.

## II. **The Memo Prepared By the Accounting Firm is Clearly Relevant and Material to the Sham Question.**

The Andersen memo at issue in this case is likely to contain information highly relevant to the determination of whether the creation of Continental Holding Company as a Massachusetts business trust was a sham. Specifically, the memo is likely to reveal whether or not Andersen suggested a preexisting plan for the creation of the trust, and subsequently assisted West in implementing the plan, solely as a tax avoidance strategy.[3] This Court has recognized that whether a taxpayer executes a transaction pursuant to a preexisting plan designed by an outside professional tax planner is material to the determination of whether the transaction is a sham. *Syms,* 436 Mass. at 507, 765 N.E. 2d at 761 (creation of trademark holding company in Delaware so as to create deductible royalty payments suggested by outside financial consultant utilizing a preexisting tax minimization plan; consultant then assisted Syms in

[3] In this regard, it is noteworthy that West established Continental Holding Company as a business trust on February 11, 1997, only four days after Andersen prepared its memo to the file.

implementing the plan). *See also, TJX Companies v Commissioner of Revenue,* 2007 Mass. Tax LEXIS 52 at **11 – 15 (MA App. Tax Bd. 2007), appeal pending Ma. App. Ct. No. 2007—P—1570(formation of intangible holding company subsidiaries to generate tax deductions proposed to TJX by Coopers & Lybrand which then assisted TJX in implementing plan; necessary corporate documents mimicked language proposed by Coopers & Lybrand); *Fleet Funding, Inc. v. Commissioner of Revenue,* 2008 Mass. Tax LEXIS at ** 10 – 17 (MA App. Tax Bd. 2008), appeal pending Ma. App. Ct. No. 2008—P—0812 (formation of real estate investment trust to avoid tax on interest earned from real estate loans proposed to Fleet Funding by KPMG Peat Marwick which then assisted Fleet Funding in implementing plan).

## III. Evidentiary Privileges Are to be Narrowly Construed Such That Relevant Materials Ordinarily Should Be Subject to Disclosure.

Comcast is claiming the Andersen memo is not subject to disclosure because it is protected by the attorney client privilege and the attorney work product doctrine. Neither applies in this case.

### A. Attorney Client Privilege Does Not Prohibit Discovery in this Case.

The attorney client privilege applies when a client has made a confidential communication to counsel. Its purpose is to encourage full and frank communications with counsel so that counsel can effectively represent his or her client. But in this case, the Commissioner is not seeking to require Comcast to divulge any communications, confidential or

otherwise, between West and its in-house counsel. In requesting Andersen to render non-legal tax professional services to West, counsel merely acted as a conduit between West and Andersen in making that request. If the Andersen memo had been prepared at the request of a West corporate officer who was not an attorney, there would be no serious issue that the document is subject to disclosure during the tax audit. Comcast therefore is seeking to immunize the Andersen memo from disclosure, not on the basis of the memo's contents, but simply because of the identity of the individual who requested its production. The question this Court must therefore decide is whether clearly relevant material can be insulated from disclosure merely by having counsel, rather than a non-attorney, request the accountant to prepare the document.

The effect of a ruling that the Andersen memo is not subject to disclosure would be to create a general accountant/client privilege whenever an attorney asks an accountant to prepare business planning documents on behalf of the attorney's client. Such a ruling would be contrary to the general public policy that "the investigation of truth and the enforcement of testimonial duty demand the restriction, not the expansion, of [the attorney-client privilege and the work product doctrine]." 8 J.H. Wigmore, *Evidence* § 2192, at 73 (McNaughton rev. 1961).

It is important to keep in mind what is *not* at issue in this case. This case does not involve a communication,

confidential or otherwise, between an attorney and his or her client. Rather, this case concerns accounting and tax planning advice rendered by Arthur Andersen at the request of in-house counsel for West. The purpose of the request was to obtain Andersen's professional accounting and tax planning services in assisting West in divesting itself, without incurring a state tax liability, of all of the TCGI stock it was to acquire in purchasing Continental Cablevision. West's in-house counsel did not engage Andersen to provide legal services and Andersen did not provide such services. R. 443 – 447, 461 – 466, 474.[4]

In short, all the record discloses is that, but for the fact that it was in-house counsel and not a non-attorney, that requested Andersen to prepare its tax planning memo, that memo would clearly be disclosable and not subject to privilege. Merely running the request through counsel ought not to produce a different result. As the New York Court of Appeals has said regarding the application of the attorney-client privilege to in-house counsel;

> In that the privilege obstructs the truth-finding process and its scope is limited to that which is necessary to achieve its purpose, the need to apply it cautiously and narrowly is heightened in the case of corporate staff counsel, lest the mere participation of an attorney be used to seal off disclosure.

[4] Although one of the Andersen accountants who provided tax planning services to West was licensed to practice law, he conceded that he was barred from doing so while employed by an accounting firm. R. 445 – 446. See Mass. R. Prof. Conduct 5.4.

*Rossi v. Blue Cross and Blue Shield,* 540 N.E. 2d 703 at 705 (N.Y. 1989).

The reason for caution in applying the attorney-client privilege to corporate communications with in-house counsel is to prevent immunizing business discussions from disclosure merely by having counsel participate in those discussions. *Teltron, Inc. v. Alexander,* 132 F.R.D. 394, 396 (E.D. Pa. 1990); *Avianca, Inc. v. Corriea,* 705 F. Supp. 666, 676 (D.D.C. 1989); *United States v. Davis,* 131 F.R.D. 391, 401 (S.D.N.Y. 1990) ("In-house counsel's law degree and office are not to be used to create a 'privileged sanctuary' for corporate records."). It would be a truly anomalous result if this Court were to rule that otherwise disclosable communications with an accounting firm can be shielded from disclosure merely by having in-house counsel, instead of a non-attorney corporate officer, initiate those communications. Such a rule would create a "zone of silence" merely because of the presence of counsel during non-legal business discussions. Massachusetts does not recognize a general privilege for communications from a client to an accountant.[5] The rule Comcast urges this Court

[5] G.L. c. 62C, §74 creates a limited privilege for information obtained by a tax return preparation business in the conduct of such business. The Andersen memo was prepared for purposes of tax planning in reference to a contemplated transaction and not in the course of rendering advice during the preparation of a return. More fundamentally, G.L. c. 62C, §74 does not prevent the Commissioner, acting pursuant to G.L. c. 62 C, §70 from obtaining tax preparation information from the *taxpayer*; he is simply barred from obtaining it from the *tax preparer.*

to adopt would in effect create such a privilege, masquerading as an exercise of the attorney/client privilege.

Furthermore, to apply the attorney-client privilege in this case would be to distort the purpose of the privilege – to protect disclosure of confidential communications *from the client* to the attorney. Not only does the Andersen memo not reflect any communications, confidential or otherwise, from West to its in-house counsel, the memo also does not reflect any communications *from* West or in-house counsel for West, to Andersen. Rather, the memo memorializes tax planning advice created by Andersen at the request of West's in-house counsel. Tax planning strategies prepared by outside professionals at the request of in-house corporate counsel are not subject to the attorney-client privilege, even if counsel needs the professional's expertise in order to render legal services to his or her client. *United States v. Ackert*, 169 F. 3d

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The Commissioner is not seeking to obtain the Andersen memo from Andersen.

136 (2d Cir. 1999).[6]

### B. Attorney Work Product Doctrine Does Not Prohibit Discovery in this Case

The attorney work product doctrine applies to immunize materials prepared by or on behalf of counsel in anticipation of litigation. Unlike the attorney-client privilege, the work product doctrine is not unqualified. Even where the doctrine would otherwise apply, the adverse party may obtain attorney work product if it can make a good faith showing of relevance and can establish that substantially the same information could not be obtained elsewhere. *Ward v. Peabody*, 380 Mass. 805 (1980), at 818.

Comcast's reliance on the work-product doctrine is particularly inappropriate in this context, because the Andersen memo was prepared, not by or on behalf of counsel, but by a public accounting firm for the purpose of designing and implementing a tax minimization strategy by which West could seek to divest itself of the TCGI stock on a tax-free basis. If the possibility that the state might challenge

[6] There is a limited exception to the rule that a communication of an outside tax professional to in house counsel in response to counsel's request for professional services to be rendered to counsel's client is not subject to attorney client privilege. If counsel requires the service of an outside accountant or other tax professional to understand or "translate" a transaction executed or proposed by the client, the courts recognize a derivative privilege for such translation communications. *Kovel v. United States,* 296 F. 2d 918 (2d Cir. 1961). *Kovel* is inapplicable in this case, because at the time the Andersen memo was created, West had neither engaged in nor proposed any tax transaction that required translation by Andersen. Instead, it was the Andersen memo that initiated the subsequent tax transaction that West later implemented.

this strategy is held to create a reasonable anticipation of litigation, any document prepared during business planning would be so protected if the document contemplated taking an action that the state might later challenge.

Granting work product protection to aggressive tax planning by public accounting firms would mean that the less substantial the transaction, the more the taxpayer would assert that litigation is to be anticipated. If the courts were to adopt Comcast's interpretation of the work product doctrine, the doctrine would have its greatest force in the most questionable of transactions. This perverse result would undermine the foundations of the American self-assessment system of tax reporting and increase taxpayer noncompliance because the very documents necessary to establish the insubstantiality of the transaction would be protected from disclosure precisely because they would establish the insubstantiality of the transaction.[7]

Even if the work product doctrine were applied, this Court has recognized that tax planning documents are highly relevant and material to the determination of whether a transaction is a sham. When the Commissioner deposed two of

[7] Applying the work product doctrine to tax planning documents would also raise a plethora of procedural issues. For example, how long prior to the transaction can tax planning occur before it is no longer reasonable for the taxpayer to assert that the document was prepared in anticipation of litigation? This and other jurisprudential housekeeping issues would constantly entangle the courts in trying to apply the doctrine to documents that are routinely prepared during the course of business and not necessarily immediately implemented.

the Andersen partners who were instrumental in advising West in regards to the Continental Teleport reorganization and in creating the Andersen memo, Comcast objected to questions regarding the consultation and memoranda on grounds of attorney-client privilege. R. 439, 454 – 459, 469, 476 – 479. Consequently, if the Andersen memo is not produced the state would have no means whatsoever of securing this evidence that is highly relevant to its sham transaction investigation. Therefore, the Court should direct that the memo be produced.

## IV. In The Context of a State Tax Audit, Public Policy Strongly Favors Disclosure of Tax Planning Documents Prepared By an Accounting Firm.

Finally, in the specific context of a state tax audit, public policy strongly supports enforcement of an administrative subpoena issued by the Commissioner of Revenue to obtain material information. A privilege rule supporting nondisclosure would be contrary to the strong public policy articulated in G.L. c. 62C, §70 which is to be construed to "most usefully further the objects for which the [Commissioner's investigative] power was given." *Commissioner of Revenue v. Boback*, 12 Mass. App. Ct. 602, 607 (1981).

The American system of tax reporting is based principally on a taxpayer's self-assessing its taxable income.

> The American system of taxation is based upon self-assessment in the initial filing of the return and calculation of the tax. Such a system can operate only through the self-enforcement of "strict filing

> standards." Truthfulness on the part of the taxpayer is most imperative.

Kenneth H. Ryesky, *Of Taxes and Duties: Taxing the System With the Public Employees' Tax Obligations,* 31 Akron L. Rev. 349 at 353 (1998), citations omitted.

Of course, the duty to self-assess does not require any taxpayer to automatically acquiesce to the revenue department's position that a specific transaction is subject to tax. But what that duty does require is that, when a transaction is the subject of an audit, the taxpayer must fully cooperate with the state in ascertaining all the facts that are material to that transaction. And that duty should be at its greatest in a case where the state's ability to independently determine the facts is at its lowest. A case that raises the sham transaction issue is such a case.

At bottom, a sham transaction case significantly turns on why a transaction was structured one way rather than another. Phrased in more technical terms, the sham transaction doctrine seeks to determine whether tax avoidance was the reason for structuring the transaction or whether there was a legitimate, non-tax business reason for the manner in which the transaction was structured. Such information is peculiarly within the knowledge of the taxpayer. While the taxpayer's books and records will ordinarily document *what* occurred, they will not typically reveal *why.* As cases such as *Syms, TJX* and *Fleet Funding* make clear, that information is often contained in documents prepared by outside tax professionals.

Comcast's position, if adopted by the Court, would shield from disclosure the very documents that are required to determine whether the transaction was a sham, as long as their preparation was requested by counsel. Such an unwarranted extension of either the attorney-client privilege or the work product doctrine would hamstring the ability of state tax departments to determine the facts in tax planning cases, at a time when sophisticated tax minimization strategies developed by large accounting firms press formal tax rules to their limits and are marketed to corporations, sometimes for a fee based on the tax savings. *See,* Richard D. Pomp, *The Future of the State Corporate Income Tax: Reflections (And Confessions) of a Tax Lawyer,* in The Future of State Taxation (David Brunori ed., 1998), at 52 (discussion of the widespread use of preexisting tax minimization strategies in current tax planning). A privilege that shields these tax minimization strategies from disclosure to the Commissioner would convert what are intended to be narrow exceptions to the policy favoring full discovery in litigation into a general license to hide what is often the only evidence of those strategies – the tax planning documents that explain the strategies.

## CONCLUSION

The Court should reverse the decision of the trial court and remand with directions that the trial court direct Comcast to produce the Andersen memo in response to the Commissioner's subpoena.

Respectfully submitted,

SHIRLEY K. SICILIAN
*General Counsel*

SHELDON H. LASKIN
*Counsel of Record*

MULTISTATE TAX COMMISSION
444 No. Capitol Street, NW
Suite 425
Washington, DC 20001 – 1538
(202) 624 – 8699

Date: October 15, 2008