How the Discoverability of AI Conversations Could Affect Tax Cases

by Kimberly Tyson

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In this post, Tyson discusses the recent memorandum by Judge Jed S. Rakoff in *Heppner* (S.D.N.Y.) about the required disclosure of AI prompts and generative AI "conversations" over objections that the material was protected by the attorney-client privilege and the work product doctrine and the implications of that ruling in the tax arena.

On February 10, in *United States v. Heppner*, No. 1:25-cr-00503 (S.D.N.Y.), Judge Jed S. Rakoff ruled, in what appeared to be an issue of first impression, that artificial intelligence conversations in connection with a pending criminal investigation were discoverable. The AI conversations were not protected by either the attorney-client privilege or the work product doctrine. A week later, Judge Rakoff supplemented his bench ruling with a memorandum explaining his analysis. (ECF 27, herein "Memo.") This post discusses Judge Rakoff's analysis and how it might apply in civil tax disputes.

Background

The defendant, Bradley Heppner, was indicted and charged with crimes related to securities activities. The FBI searched his property and seized documents and electronic devices, which included documents and 31 AI conversations between Mr. Heppner and the AI platform Claude. Mr. Heppner prompted the conversations with Claude after receiving a grand jury subpoena and after he was clearly a target of an investigation. Independent from his counsel and in anticipation of the criminal charges, Mr. Heppner used Claude to outline his defense strategy and his potential factual and legal arguments.

Mr. Heppner asserted that the AI documents were protected by the attorney-client privilege and work product doctrine for three reasons: (1) because his prompts included information he learned from his counsel, (2) because he created the AI documents to prepare for obtaining legal counsel, and (3) because he subsequently shared the contents of the AI documents with counsel. Judge Rakoff noted that Mr. Heppner's counsel did not direct him to generate the AI documents.

Attorney-Client Privilege

The court defined the well-established attorney-client privilege that attaches to and protects from disclosure communications (1) between a client and his or her attorney, (2) that are intended to be, and in fact were, kept confidential, (3) for the purpose of obtaining or providing legal advice. Memo. at 4 (quoting *United States v. Mejia*, 655 F.3d 126, 132 (2d Cir. 2011)). The attorney-client privilege is narrowly construed because it is an exception to the rule that all relevant proof is essential for a complete record and for confidence in the fair

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administration of justice. Memo. at 5 (quoting *In re Six Grand Jury Witnesses*, 979 F.2d 939, 943 (2d Cir. 1992); *Calvin Klein Trademark Trust v. Wachner*, 198 F.R.D. 53, 55 (S.D.N.Y. 2000)).

As applied to the facts, the AI documents were not protected by the attorney-client privilege for three independent reasons. First, the communications were not between Mr. Heppner and his counsel: Claude is not an attorney; discussions between nonattorneys are not protected by the attorney-client privilege. Second, the AI conversations were not confidential; Mr. Heppner had no reasonable expectation of confidentiality in his communications with Claude. Memo. at 6-7. Claude's privacy policy stated that data about users' inputs and Claude's outputs are collected to train Claude and that the data can be disclosed, including to governmental regulatory authorities. More generally, AI users do not have substantial privacy interests in their conversations with an AI platform. The court distinguished the AI conversations from confidential notes a client prepares, intending to share them with an attorney, because Mr. Heppner essentially shared those notes with a third party (Claude). Third, Mr. Heppner did not communicate with Claude to obtain legal advice. Mr. Heppner did not consult Claude *at the suggestion or direction of his counsel*. The court left open the possibility that if counsel directed Mr. Heppner to use Claude, then Claude might arguably have functioned as a lawyer's agent, but that as applied to the facts, Mr. Heppner intended to obtain legal advice *from Claude* and that it did not matter that he later shared Claude's outputs with his counsel. The court recognized that Claude disclaims providing legal advice and that nonprivileged communications do not become privileged once shared with counsel. Memo. at 7-8. The court also noted that if Mr. Heppner's prompts to Claude included information given by his attorneys, then Mr. Heppner waived the privilege by sharing that information with Claude, just as he would have waived the privilege by sharing the information with any other third party. Memo. at n.3.

Work Product Doctrine

The work product doctrine shelters the mental processes of attorneys to provide a privileged area for an attorney to analyze and prepare a client's case. The work product doctrine provides qualified protection for materials prepared by or at the request of counsel in anticipation of litigation or for trial. Memo. at 8-9. Like the attorney-client privilege, work product protection does not shield materials in an attorney's possession that neither the attorney nor their agents prepared. This protection depends upon a real concern of exposing the thought processes of the attorney. Here, even assuming that the Claude prompts were prepared in anticipation of litigation, they were not prepared at the behest of counsel and did not reflect counsel's strategy. Memo. at 9-10.

Judge Rakoff noted that his decision deviated from *Shih v. Patel Card Inc.*, 565 F. Supp. 557 (S.D.N.Y. 2021), in which a magistrate judge permitted withholding communications with an individual who became Ms. Shih's husband and who was also a lawyer (despite a lack of attorney-client relationship or direction by the attorney of the work). Memo. at 10-11. According to Judge Rakoff, *Shih* undermines the policy that the work product doctrine preserves a zone of privacy in which a lawyer can prepare and develop legal theories and strategy with an eye toward litigation. Although the work product doctrine may apply to materials created by nonlawyers, Judge Rakoff reiterated that the purpose of the doctrine is to protect lawyers' mental processes. Memo. at 11. Here, because the AI conversations were not prepared at the request of Mr. Heppner's counsel and because they did not disclose the strategy of Mr. Heppner's counsel, they were not protected by work product. Memo. at 12.

Considerations

Although *Heppner* is a criminal case based on activities in the securities industry, its impact can extend to any controversy work, including tax. Some considerations follow:

- **Evaluate the expectation of privacy in the AI system being used.** If the AI platform is part of an open system (that is, inputs and outputs are collected and can be disclosed), the user likely has no expectation of privacy (and therefore no expectation of protection under the attorney-client privilege or work product doctrine). This point is important

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not just for clients, but also lawyers using AI. Thus, the content of the AI provider's disclosure policies is exceptionally important.

- **Consider the right to privacy in the Taxpayer Bill of Rights.** The principles of this case are not limited to litigation in the criminal context. The AI prompts exposed Mr. Heppner's inner thoughts. The IRS has no announced policy of restraint (similar to the tax accrual workpaper policy where the IRS self-regulated the conduct of its employees) about requesting AI information. A policy of restraint aligns with the "Right to Privacy" in the Taxpayer Bill of Rights, codified in section 7803(a)(3)(G). Under that right, taxpayers have the right that an IRS inquiry, examination, or enforcement will be no more intrusive than necessary and will respect due process rights. Privacy and taxpayer rights groups should consider conversations with IRS leadership about balancing the agency's need for information with the taxpayer right to privacy in the context of AI conversations.
- **Counsel clients about intentionality of AI use.** In addition to counseling clients about being aware of their online profile generally, clients should also be counseled about being intentional with AI use. Consider including this in an item on your intake paperwork and in your firm's engagement letter. Anticipate that in an exam, a revenue agent's information document request might ask for AI conversations. In litigation before the U.S. Tax Court, the IRS attorney might request (informally, in a *Branerton* request, or in formal discovery) AI conversations (or at least requests to preserve AI conversations).
- **The Tax Court's rules include the "substantial need" exception for disclosing work product.** In cases before the U.S. Tax Court, the scope of discovery must be proportional to the needs of the case. Tax Court Rule 70(b)(1). Discovery of documents and tangible things prepared in anticipation of litigation or for trial by or for another party or its representative requires a showing of substantial need. Tax Court Rule 70(c)(3). The language in Tax Court Rule 70(c)(3)(A) about documents and tangible things prepared in anticipation of litigation stems from Rule 26(b)(3) of the Federal Rules of Civil Procedure and includes the exception to the work product privilege provided upon a showing of "substantial need." 139 T.C. 539. The court has considered "substantial need" in a few cases with mixed results. Compare *Ratke v. Commissioner*, 129 T.C. 45, 50-53 (2007) (slip op.) (finding no showing of substantial need for the IRS to disclose an attorney's memo and redacted portions of a second memo that prepare legal theories and plan strategy for the case), and *Montgomery-Alabama River LLC v. Commissioner*, Docket Nos. 9254-19, 12049-19, 12718-19 (Order Nov. 20, 2023) (denying a motion to reconsider, noting that the court cannot compel discovery of nonexistent information and will not sanction fishing expeditions), with *Sterling Trading Opportunities LLC v. Commissioner*, T.C. Memo. 2007-339 at 6-7 (slip op.) (finding a showing of substantial need of fact-based work product consisting of notes made eight years prior about the purpose, structure, parties, and fees of a transaction made by attorneys when the IRS's efforts to obtain the information from the memory of others who attended the meeting were futile). When evaluating a request for AI conversations, consider proportionality: If the request is disproportionate to the needs of the case, then no substantial need showing has been met. This is a fact-specific determination; relevant facts would likely include the content of the search, the issues in the case (and specifically whether the issues require state of mind), the other evidence available, whether the AI use is on a closed system, and the extent to which an attorney was involved or directing the search.
- **To what extent would the result change had counsel directed the searches?** Judge Rakoff stated more than once that Mr. Heppner's attorney did not tell Mr. Heppner to initiate the AI conversations. The

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implication is that if counsel directed the prompts, the AI platform might have functioned as the attorney's agent (setting aside the fact that Mr. Heppner was using an open system). Judge Rakoff noted that work product protection can apply to materials created by nonlawyers so long as they are protecting the lawyers' mental processes. Similarly, the attorney-client privilege extends to nonlawyers retained to assist the attorney in providing better legal advice. The roots for this extension of the attorney-client privilege to nonlawyers is in *United States v. Kovel*, 296 F.2d 918, 922-923 (2d Cir. 1961) (extending the attorney-client privilege to conversations with an accountant retained to assist the attorney for the attorney to provide better legal advice).

While the first to consider discovery of AI conversations, Judge Rakoff's order will most certainly not be the last. ■

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