The Ethics of Practicing Tax Law

JOHN M. BURMAN, JD - CONTRIBUTING GUEST WRITER

Lawyers are often asked tax questions. Many lawyers do not understand or practice tax law and are unsure about how to respond to such questions. These lawyers often defer to others, such as accountants, when tax questions arise. Many clients, both individuals and entities, have both a lawyer and an accountant, usually a certified public accountant ("CPA"). This article discusses certain issues related to the interplay between a CPA and attorney when representing a client regarding tax matters.

"PRACTICING LAW"

Before discussing ethical constraints on lawyers practicing tax law, it is important to consider whether practicing tax law is part of the practice of law. The answer is: maybe.

In most jurisdictions, lawyers are licensed by the highest appellate court in the jurisdiction and are subject to ethical standards adopted by the licensing authority. Accordingly, there is not a national set of ethical standards for lawyers. Instead, most jurisdictions adopt ethical standards based on the American Bar Association's ("ABA") ethics rules. Forty-eight U.S. states[1] have adopted ethical standards based on the ABA's Model Rules of Professional Conduct ("Model Rules").[2]

The Model Rules do not define the practice of law. The closest they come is in the commentary to Rule 5.5, which states that the practice of law "is defined by law, and varies from one jurisdiction to the next."[3] Despite this noted variation among jurisdictions, the practice of law involves three general concepts: drafting legal documents, representing someone before a tribunal, and giving legal advice. Drafting legal documents and representing someone before a tribunal are mostly self-explanatory. "Giving legal advice" is more difficult to define. When deciding whether a person is giving legal advice, courts tend to focus on the specificity of the advice, the likelihood of the advice being incorrect, and the risk of harm to the recipient if the advice is incorrect.[4]

Given the foregoing, "drafting legal documents" and "giving advice" may both involve the practice of law, and therefore be appropriate for lawyers to do. The difficulty is that others—notably CPAs—are also authorized to draft documents and give advice when dealing with tax issues, but they are not authorized to practice law.

Many lawyers focus their practice on certain areas. The Model Rules allow lawyers to indicate the fields of law in which they practice.[5] Lawyers may only indicate that they are specialists if they have been so certified by an appropriate organization.[6] A lawyer may also indicate that he or she has received a degree in tax, such as an LL.M. Outside of these narrow exceptions, lawyers can do nothing more than indicate their general licensure in a jurisdiction.

COMPETENT LEGAL REPRESENTATION

The Model Rules require lawyers to provide competent legal representation.[7] The competence required is usually that of a general practitioner.[8] Sometimes, though, the required competence will be something more.[9] One area in which additional expertise may be required is giving advice about tax.[10] The lawyer may also associate with a lawyer with the required level of knowledge,[11] or the lawyer may associate with an appropriate professional.[12] To meet the competency requirement, attorneys may need to advise a client to consult a CPA.[13] For example, it is common for a client to seek legal representation in deciding what type of business entity to adopt. To provide competent legal advice, lawyers commonly seek the involvement of a CPA in helping the client make that determination.

Whatever the required competence, lawyers should only practice law, and should not engage in other professions.[14] This is important when the representation involves tax, as the lawyer does not want to engage in accounting. While there is considerable overlap between practicing law and practicing accounting, members of both professions must be careful about acting only within the scope of their practice.[15]

OTHER ETHICAL CONSIDERATIONS

While the main ethical restriction on a lawyer who provides tax representation is that the lawyer do so competently, there are other ethical rules to which the lawyer must adhere. Rule 1.4 is entitled "Communication." Rule 1.4(b) provides that a lawyer "shall" provide information reasonably necessary to permit the client to make informed decisions. This means that the advice may need to include information about taxes. The issues of competence, discussed above, will come into play if that advice is necessary.

In addition, Rule 8.4(d) provides that it is professional misconduct for a lawyer to engage in conduct with a prejudicial effect on the "administration of justice." This broad language allows a court to apply whatever standards it wants. The only safe way to read this language is to assume that it may apply to tax matters.

Several other issues arise when a lawyer becomes involved in tax matters. Two examples include malpractice insurance coverage and the attorney-client

privilege. Regarding malpractice insurance coverage, a lawyer should confirm—by carefully reviewing the policy—that tax representation will be covered by the lawyer's malpractice insurance. If questions still remain, the lawyer should contact the insurance company.

Regarding privilege, all parties must understand that an attorney's meeting with a client and accountant may result in the waiver of the attorney-client privilege. The only way to answer that question is to examine the appropriate statute or rules. While the Model Rules make such a conversation confidential, they do not create a privilege.[16]

CONCLUSION

When confronted with tax questions, lawyers must observe the ethical rules of the jurisdiction in which they practice. There are several ethical considerations involved in any tax representation, such as whether the attorney possesses the requisite competence and refrains from holding himself out as a "specialist" if not certified as having that designation. With knowledge of and adherence to the relevant ethical rules, and the assistance of experienced CPAs when indicated, lawyers can more confidently handle a client's tax questions.

ENDNOTES

1 The other two states, California and New York, have done something different. California has adopted its own standards, and New York has adopted rules based on the ABA's Model Code, which was the predecessor to the Model Rules.

2 Since the Model Rules set forth general statements that have been adopted in most states, this article will refer to the Model Rules. A lawyer should check the rules in that lawyer's jurisdiction before relying on anything in this article.

3 Rule 5.5 cmt. 2.

4 See Restatement of Law Governing Lawyers.

5 Model Rule 7.5(a).

6 Rule 7.4(d).

7 Rule 1.1.

8 Rule 1.1 cmt. 1.

9 Id.

10 Rule 1.1 cmt 2 (a lawyer may obtain competence through self-study).

11 Rule 1.1 cmt 2.

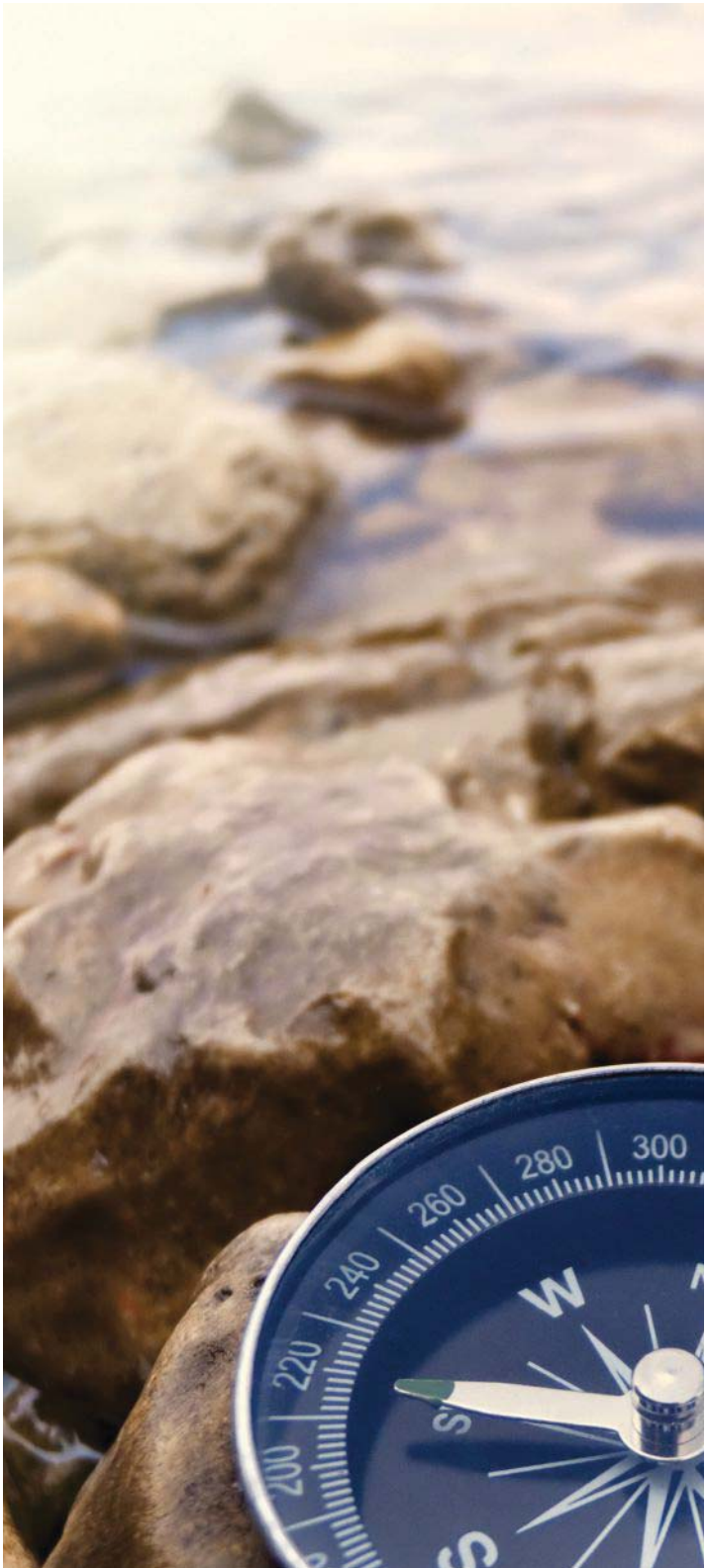
12 Rule 2.1 cmt 4.

13 Rule 2.1 cmt 4.

14 Rule 2.1 cmt. 4.

15 While the Model Rules do not define the practice of law, they do suggest areas that are "law-related services." "Accounting" and "tax preparation" are law-related services. A lawyer who provides such services, directly or indirectly, may be subject the Model Rules. See Rule 5.7(b) cmt. 9.

16 Rule 1.6 cmt. 3.



Letter from the Ethicist

KRISTIN YOKOMOTO, MBA, JD, LLM, LLM
WealthCounsel Member since 2008

AVOIDING MALPRACTICE BY IDENTIFYING AND HANDLING CONFLICTS OF INTEREST

This ethics column deals with the ever-so-important topic of conflicts of interest. Lawyers who practice estate planning, business planning, and trust administration are constantly faced with conflicts of interest. Legal conflicts come in many forms, some of which may not be readily apparent. The consequences of failing to spot and properly address a conflicts issue can be significant, if not grave, ranging from injuring a grantor, beneficiary, or family member, to fines, sanction, or disbarment. Due to the trickiness of conflicts their frequent basis for malpractice claims, it is imperative that lawyers develop a system to identify conflicts and properly address them.

Conflicts of interest are an ethics issue because they stem from the ethical duties of loyalty and confidentiality. Because each state has adopted its own form of ethics rules, lawyers should refer to their own state and local ethics rules for guidance on handling conflicts. If your state has adopted the Model Rules of Professional Conduct, the conflict rules are embedded within Rules 1.7 through 1.11. In California, the current ethics rules are codified in the Rules of Professional Conduct that prohibit a lawyer from representing more than one client in a matter in which the interests of the clients potentially or actually conflict without the informed written consent of each client.[1] This prohibition stems from the fact that a lawyer may be challenged to fulfill the lawyer's duty of loyalty to both clients if their interests oppose one another.[2]

Ethics rules also prohibit a lawyer from accepting employment adverse to a client or former client where, by reason of the representation of the client or former client, the lawyer has obtained confidential information material to the employment, unless there is informed written consent of each client.[3] This prohibition has roots in the duty of confidentiality, which

continues to exist even after services have been performed and the attorney-client relationship has been terminated.[4] The rules further prohibit a lawyer from accepting or continuing to represent a client, without written disclosure and consent, if the lawyer has or had a legal, business, financial, professional, or personal relationship with a potential or existing client.[5]

Note that the prohibition on representing clients with potential or actual conflicts or if the lawyer has had a relationship with a potential or existing client is not an absolute bar; the rules allow the lawyer to obtain informed written consent. Consent is "informed" if it is obtained after full disclosure. If disclosure is inadequate, the lawyer may be disqualified,[6] disciplined,[7] or stripped of fees.[8] Of course, there may be times when the conflict does not allow for representation even with client consent because it would be a clear breach of the either the duty of loyalty or confidentiality. There may also be times when a potential conflict may be waived, but then an actual conflict arises and the lawyer must resign and not continue to represent either client.

Some common conflicts that arise in the estate planning and trust administration fields include:

REPRESENTATION OF HUSBAND AND WIFE FOR A JOINT ESTATE PLAN

Lawyers must obtain their clients' informed written consent when preparing a joint estate plan and must also inform the couple that there will be no protection of secrets.

I have often faced this awkward situation: One spouse calls or emails with a secret that the other spouse does not (and should not) know about. It's important to handle this situation delicately and with respect. My practice is to remind the disclosing spouse that I informed her in the initial meeting that there is no duty of confidentiality between them and that I have a duty to inform the other spouse of all information and, if necessary, point to the provision in the engagement letter where she agreed that there would be no secrets. I then give the telling spouse the opportunity to disclose the secret to her spouse before I do.

That process generally works. But if the secret is significant and the telling spouse refuses to cooperate, the lawyer should recommend separate counsel, resign, or both. If these situations arise it may not turn out well for the lawyer, especially if the secret affects property ownership and disposition.

Representing a husband and wife can be particularly tricky for those who practice in a community property state. Be careful if there is significant separate property that may be transmuted to community property, or if the spouses disagree as to which property constitutes separate or community property.

MULTIGENERATIONAL ESTATE PLANNING

Parents often refer their children to the same lawyer who did the parents' planning. Because the child is likely a beneficiary of the parents' trust and may be named as a successor trustee, there is potential for a conflict and waivers could be required.

The harder situation to analyze is if the parents subsequently call the lawyer to amend their trust to disinherit the child. Clearly, this would be a conflict and the lawyer likely could not prepare such an amendment because it would be awkward to ask for the child's consent. The question then becomes, does the lawyer have a duty to the child to inform him of the parents' desire to change their plan? Probably not.

What if the conflict involves a husband and wife? Suppose a husband calls you and requests that you change his beneficiary to exclude his wife if he dies first and instead distribute his share directly to his children. The husband does not want his wife to have any access to income or principal, and he doesn't want his wife to find out. Would the lawyer have a duty to tell his wife?

REPRESENTING A BUSINESS AND SHAREHOLDERS

Typically a lawyer will represent the entity, with the engagement letter signed by an authorized officer. There may be a conflict if the lawyer also represents one or all of the owners. This situation requires the informed written consent of all parties. The same would be true if one of the owners asks the lawyer to draft his estate plan.

Note that there are always inherent conflicts for the

lawyer who represents the entity and is asked to prepare an Operating Agreement, Shareholders' Agreement, or Buy-Sell Agreement. In this scenario, each owner should obtain independent counsel.

REPRESENTING CO-TRUSTEES

Trust administrations that involve co-trustees are more challenging because inevitably one co-trustee is more familiar with the grantor's assets or has more time. Communications with the more knowledgeable or available co-trustee often do not include the other co-trustee. Unless there are specific reasons to name co-trustees (other than the children will feel unfairly treated), co-trustees only increase fees and costs, slow down the process, and create constant conflicts.

DRAFTING LAWYER AS A TRUSTEE

When a client asks the lawyer to be the trustee, the lawyer has an inherent conflict. Many lawyers simply decline. Others take on the risk. If a lawyer serves as trustee, she should first review her malpractice policy to ensure that trustee services would be a covered and then carefully draft the engagement letter with clear compensation provisions. Will the lawyer be compensated to draft the trust, to act as trustee, or to act as the lawyer for the trustee? Clearly, the lawyer cannot be doubly compensated.

DRAFTING LAWYER AS A BENEFICIARY

In California, the drafting lawyer is disqualified from being a beneficiary of the trust unless blood-related to the grantor. This is also a conflict and the gift will be deemed void unless another lawyer attests by an independent certificate of review that the grantor understands the nature of his dispositions and that there are no signs of undue influence.

COMMUNICATING WITH NON-CLIENTS

Estate planning lawyers are often asked to lead or attend a family meeting regarding the parent's or grandparent's estate plan. While this may be important to the family and serve a useful purpose, the lawyer must carefully explain the potential conflict to the clients. The lawyer should also communicate in writing to the non-clients that the lawyer does not represent the non-client. Otherwise, the lawyer may be deemed to represent the non-client. The same would apply when a lawyer represents the successor trustee and communicates with a beneficiary.

One question that commonly arises: If the lawyer determines there is a conflict that cannot be waived, can the lawyer refer the asking client to another lawyer? There are legal opinions and case law that suggest that the lawyer may do so, but caution is warranted. The lawyer should analyze whether the referral is a breach of loyalty to a current client or breach of confidentiality to a former client.

Legal conflicts in estate planning, business planning, and trust administration are inevitable. But with attention to detail and consideration of conflicts that may arise between existing and former clients, lawyers can spot and address conflicts within ethical bounds. Drafting an engagement letter with the required disclosure and proper consent provisions is important, as is developing a solid conflict check system that can help to avoid dangerous situations. It can also be very helpful to contact a colleague and discuss the situation with them.

ENDNOTES

1 *California Rules of Professional Conduct Rule 3-310(C).*

2 *Flatt v. Super. Ct., 9 Cal. 4th 275 (1994) (lawyers have duty of loyalty to current clients that precludes them from taking on adverse matters or taking action that is adverse to the current client). "Simply put, an attorney (and his or her firm) cannot simultaneously represent a client in one matter while representing another party suing that same client in another matter." Certain Underwriters at Lloyd's, London v. Argonaut Ins. Co., 264 F. Supp. 2d 914, 919 (N.D. Cal. 2003).*

3 *California Rules of Professional Conduct Rule 3-310(E).*

4 *"If the former client can establish the existence of a substantial relationship between representations, the courts will conclusively presume the attorney possesses confidential information adverse to the former client." H.F. Ahmanson & Co. v. Salomon Brothers, Inc., 229 Cal. App. 3d 1445, 1452 (1991).*

5 *California Rules of Professional Conduct Rule 3-310(B).*

6 *Zador Corp. v. Kwan (1995) 31 Cal. App. 4th 1285.*

7 *California Business and Professions Code § 6077.*

8 *Mardirossian & Associates, Inc. v. Ersoff (2007) 153 Cal. App. 4th 257.*