ETHICS

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In the field of tax practice, an attorney must always remember not only that he is an advocate for his client, but also that there are tax laws with which his client must comply. In both the tax planning, and tax preparation stages of representing a client, and no matter whether it is income tax, or estate and gift tax in question, the attorney cannot close his eyes, or cover his ears, when he "learns" one or more facts which clearly run in conflict with the tax laws. In the tax planning stage, the attorney must not lose sight of the concept of "substance versus form" when recommending certain alternatives for consideration by his client. It must be remembered that though an attorney may prefer to describe a transaction in certain terms in attempting to obtain a specified tax result, the Internal Revenue Service may choose to look beyond the nominated terms given to the transaction, and concentrate on the substance of the transaction, in overriding the intended tax results. It is always necessary to be clear as to the identity of the client, and to whom the attorney owes

various duties. In the same manner, an attorney must always be ever mindful of his ethical obligations to his client, and his ethical obligations in conducting his law practice.

Tax practice is present in various areas of the law, whether it is in connection with how to classify a recovery in a litigation matter, planning the manner in which a transaction should be classified for tax purposes, or in the actual preparation of a tax return (no matter the type of tax return). The attorney must be aware of applicable laws, and the ramifications of a violation of his professional responsibilities when dealing with his client, third parties, and various tax agencies. Not only might the attorney find himself prohibited from representing a particular client before the Internal Revenue Service, but he may also find himself prohibited from practicing before the Internal Revenue Service on behalf of any client. Any attorney whose field of practice concerns the area of taxation should be familiar with the provisions of Treasury Department Circular 230. In addition, the attorney should be aware of opinions and proposals by the American Bar Association in the taxation area.

An attorney must always bear in mind The Code of Professional Responsibility when performing any type of legal services. In tax practice, an attorney many times finds himself dealing with only one party (who is his client), as opposed

to litigation matters, or even transactional matters, where more than one party is necessarily involved. Just because an attorney may find himself working on a matter in which only one party is involved does not excuse the attorney from keeping ever-mindful of the Code of Professional Responsibility.

It is my intent to set forth for attorneys a wide range of information in this section of the seminar dealing with the subject of Ethics. In some situations an actual case will be discussed, while in other situations certain facts will be presented, and ethical issues with which the attorney should be concerned will be set forth. It is not the purpose of this section to set forth specific "yes" and "no" responses to certain ethical issues. Rather, the purpose is to cause the attorney to realize there are ethical issues with which he should be concerned and to identify and reflect on the different ethical issues, so that in the future he, or she, will be better able to identify ethical issues which arise, and which in the past may not have been considered by the attorney.

Attorneys are not "above the law." In a decision by the Supreme Court, Appellate Division, First Department, of the State of New York in 1985, the professional consequences of criminal conduct by an attorney in the area of tax preparation (and ostensibly tax planning) and related areas is revealed. Edward A. Wagner, an attorney then licensed to practice in

New York state, was convicted in 1982 in federal court of various counts, including, "..., (2) twenty-nine counts of aiding and assisting in the preparation of false tax returns ..." In the Matter of Edward A. Wagner, 485 N.Y.S. 2d 278 (A.D. 1 Dept. 1985), at page 278. On appeal, the criminal convictions were affirmed. The Appellate Division of the Supreme Court for the State of New York thereafter confirmed a report of the referee in part and found that the actions of Mr. Wagner warranted disbarment. The Court, at page 279, stated

> Respondent has, accordingly, forfeited the right and the privilege of practicing law. When investors and/or clients secure the services of an attorney, they should do so with the confidence that they will receive legitimate counsel, not be tutored in how to violate the law. In view of the seriousness of respondent's misconduct, none of the factors which are offered in mitigation can significantly detract from his wrongdoing. Respondent is a prominent entertainment lawyer who has had an exemplary family life, no previous conflict with the law, and no prior disciplinary proceedings have been brought against him. It is particularly troublesome that despite all the benefits of such a background, he was not deterred from engaging in a thoroughly repugnant criminal scheme.

In the matter involving Mr. Wagner, a limited partnership was organized for the purpose of buying movie rights. In order to finance the acquisition of these movie rights, funds were raised from individuals. Under the tax laws of the United States then in effect, substantial deductions could be derived by individuals from their investment in such limited partnerships, and such deductions would flow through to the individual partners from the limited partnership, and could

be used by the individual partners on their individual income tax returns as an offset against their other income. However, in the matter with which Mr. Wagner was involved, the limited partnership, as opposed to operating properly under the tax laws of the United States, improperly inflated the price for its purchase of movie rights. This was accomplished by having the limited partnership write checks (allegedly for the purchase of the movie rights) in an amount greater than the movie rights actually cost. The checks which had been written for the acquisition of movie rights were endorsed by the payee, and returned to the limited partnership. The actual purchase of the movie rights was then accomplished by the transfer of cash from the limited partnership to the transferor of the movie rights, and the cash transferred was in amounts substantially less than the amounts appearing on the checks (which ostensibly represented the purchase price). Two sets of books were kept by the limited partnership, with one set indicating actual amounts, and the other set indicating the inflated amounts. As one would expect from the above recited facts, the latter set of books were used for the preparation of the U. S. Partnership Return of Income. Mr. Wagner was aware of the operations of the limited partnership. The Court, in referring to Wagner, stated at page 279

> While respondent may not have been an instigator of the scheme, the evidence clearly showed that he was thoroughly knowledgeable about its fraudulent nature, participated fully in it, promoted the plan, assisted and advised investors in the preparation and presentation of fraudulent tax returns, and filed a fraudulent tax return

> himself. ..., he engaged in an ongoing deliberate course of conduct pursuant to which it was his clear intent to profit financially at the expense of the United States Government and those investors who sincerely believed that they were putting their money into a legitimate tax shelter.

There are certain disciplinary rules which every Virginia attorney should immediately recognize as having been violated by Mr. Wagner. Some of these rules include

> DR 1-102. Misconduct.
>
> (A) A lawyer shall not:
>
> (1)...
>
> (2) ...
>
> (3) Commit a crime or other deliberately wrongful act that reflects adversely on the lawyer's fitness to practice law.
>
> (4) Engage in conduct involving dishonesty, fraud, deceit, or misrepresentation which reflects adversely on a lawyer's fitness to practice law.
>
> (B) ...
>
> DR 5-101. Refusing Employment When the Interests of the Lawyer May Impair His Independent Professional Judgment.
>
> (A) A lawyer shall not accept employment if the exercise of his professional judgment on behalf of his client may be affected by his own financial, business, property, or personal interests, except with the consent of his client after full and adequate disclosure under the circumstances.
>
> (B) ...
>
> (1) ...
>
> (2) ...
>
> (3) ...

DR 7-101. Representing a Client Zealously.

(A) A lawyer shall not intentionally:

(1) ...

(2) ...

(3) Prejudice or damage his client during the course of the professional relationship, except as required under DR4-101(D).

(B) ...

(1) ...

(2) ...

DR7-102. Representing a Client Within the Bounds of the Law.

(A) In his representation of a client, a lawyer shall not:

(1) ...

(2) ...

(3) Conceal or knowingly fail to disclose that which he is required by law to reveal.

(4) Knowingly use perjured testimony or false evidence.

(5) Knowingly make a false statement of law or fact.

(6)...

(7) Counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent.

(8) ...

(B)...

(1)...

Anyone can see that, had Mr. Wagner been a Virginia lawyer

contemplating the actions he took in the case at hand, in addition to the violation of various laws for which he was convicted, there were several disciplinary rules to which his attention should have been directed.

Another case for which an attorney would have been wise to pay heed to many of the above recited disciplinary rules concerned J. Lacey Barnes, an attorney in Knoxville, Tennessee. Mr. Barnes participated in the preparation of numerous tax returns for which one consistency throughout his preparation of many of the returns was the fact that an additional exemption, one more than the number to which the taxpayers were entitled, was taken on the returns at issue. Mr. Barnes either advanced money to the taxpayers, or bought from the taxpayers the refund shown on their income tax returns, and, as the court stated, the attorney "retained the difference between the amounts he had paid to or credited to the taxpayers and the amounts actually refunded." United States v. Barnes, 313 F.2d 325, 327 (1963). Incidentally, there were indications the tax preparation work was on behalf of a loan company with which Mr. Barnes was involved, and not as part of his law practice.

Consider the situation where a client contacts you for estate planning services. You have in your employ an accountant who is experienced in estate planning matters, and you inquire of your client whether it would be satisfactory with the client

if he met directly with the accountant (who is not a lawyer), who would give advice to the client. Further, you relate to the client that you will review and direct all services to be performed. Have you run afoul of any ethical prohibition?

Attorneys involved in the field of taxation should be especially familiar with UNAUTHORIZED PRACTICE RULE 4. ESTATE PLANNING AND SETTLEMENT, and UNAUTHORIZED PRACTICE RULE 5. TAX PRACTICE.

In Unauthorized Practice of Law Opinion No. 121, rendered in 1988, an attorney inquired whether it would be permissible to have a non-lawyer (an accountant) counsel the attorney's clients' directly "in the areas of taxation, estate planning and investments." The attorney related that the clients would be notified that the individual performing the service was not an attorney, and that, in addition, the attorney would in fact "oversee all work performed." This opinion held

> It would be improper for your nonlawyer employee to directly counsel clients in the areas of taxation, estate planning and investments since this would imply that he possesses legal knowledge or skill in these areas.
>
> It is permissible under the Rule for such an employee to advise you on matters of taxation, estate planning and investments so long as the contact with, and advice given to, the client is performed by a properly licensed lawyer.

Also important to remember are the following Unauthorized Practice Considerations.

> UPC 5-4. In general, tax planning is not considered to be the unauthorized practice of law. Attempting to resolve uncertainties as to the interpretation or application of tax or general law to a particular transaction, however, involves the practice of law unless it is incidental to a tax return preparer's engagement

or the regular course of conducting a licensed business, for example, an investment business, or is limited to an analysis of merely the facts and assets of an estate.

UPC 5-5. Only a lawyer may prepare legal instruments for others or take the necessary steps to create, amend or dissolve a partnership, corporation or other business entity. Suggesting that any such legal work should be reviewed by the taxpayer's lawyer will not cure any unauthorized practice. In general, a lawyer working for a corporation not engaged in the practice of law as a registered law corporation is not entitled in the course of his employment to provide such services for customers or patrons of his employer.

Consider the situation where an attorney drafted a Will for a client, who has recently died, and such Will appointed two individuals to serve as Executors of the decedent's estate, and also appointed one of these individuals to serve as Trustee of two testamentary trusts, with one trust for the benefit of the decedent's spouse ("QTIP trust"), and the other trust for the benefit of the decedent's children from a former marriage ("Bypass trust"). In addition, the decedent has bequeathed his holdings of stock in a closely-held corporation (Corporation X) of which he was the majority shareholder equally among his brother, and the two remaining shareholders of Corporation X. The attorney has previously represented the decedent, as well as Corporation X. The Executors and Trustee, and the decedent's spouse, meet with the attorney, and the Executors and Trustee engage such attorney to advise and represent the estate with regard to (i) probate of the Will, (ii) inventory and accounting matters arising from the estate

and for which filings will be due to the Commissioner of Accounts, and (iii) all federal and state tax filing requirements for the estate.

During the representation, the attorney becomes aware of five notes made payable to the decedent, and one note made payable to Corporation X, which are neither marked "Paid in Full" nor "Cancelled", nor carry any similar language on their face. The five notes payable to the decedent had been previously omitted from financial statements supplied by the decedent to various lending institutions. In addition, the existence of the one note payable to Corporation X was omitted from the financial statements of the closely-held corporation. These notes were all made by one of the Executors of the decedent's Will, who was the former administrative assistant to the decedent. This Executor relates to you that the notes (which were made over a period of the past three years, and in the aggregate total $325,000.00) were "previously forgiven" by the decedent and she considered them to be "gifts" from the decedent, and that it would cause a great deal of embarrassment to the decedent's spouse if she were to learn of these notes. This same Executor then asks you to turn over possession of the notes to her, and to say nothing to anyone (including the remaining Executor) about their existence. The notes payable to the decedent would equal approximately ten percent of his gross estate for federal estate tax purposes, and the note payable to the corporation would equal approximately

twenty-five percent of the assets otherwise appearing on the balance sheet of the corporation.

Should the attorney merely turn these notes over to the Executor who requests same, and ignore them for purposes of (i) estimating the decedent's probate estate at the time of the probate of his Will, (ii) completing the inventory and accounting for the estate, and (iii) completing the estate tax returns (both federal and Virginia)? Does the attorney have a duty to bring these matters to the attention of the remaining Executor (who is also the Trustee), and who is the controller of Corporation X, and to which a note is made payable? Does the attorney have a duty to recommend that gift tax returns be filed by the estate of the decedent for "prior gifts" should the attorney believe the Executor who related the notes were "forgiven"? Does the attorney have a duty to report to the board of directors of Corporation X the discovery of the note made payable to the corporation, and seek the advice of the board of directors as to its disposition, and further recommend to the board of directors that they should have their auditors review how a large amount of funds left the corporation without being reported in the financial statements of the corporation? Let us further assume that just prior to the death of the decedent, the certified public accounting firm performing an audit of Corporation X has requested from the attorney certain responses in connection with the services performed by the attorney for the corporation. Is the discovery of the note

made payable to Corporation X an item for which the attorney should supplement his prior response to the certified public accounting firm? Were the decedent to have truly "forgiven" these notes over the years, and made gifts to the maker, the Bypass Trust contained in the decedent's Will should be funded with property of a lesser value than otherwise, as the then remaining unified credit of the decedent available at his death would be less than had no gifts been made by the decedent. Therefore, is the attorney under a "duty" to discuss the issue of the notes directly with the beneficiaries of the Bypass Trust?

The attorney is faced with a number of ethical dilemmas, and this outline does not attempt to address all of these dilemmas. However, at the outset of the engagement, the attorney should have identified who the client is. Are the existence of the notes a "confidence" or a "secret" as referred to in DR4-101(A)? May the attorney reveal the discovery of the notes without the consent of the Executor who has made clear to the attorney her feelings on this matter, without running afoul of DR4-101(B)(1), and DR4-101(C)(1), (2), and/or (3)? Does the fact that one of the Executors has revealed this information preclude the attorney from bringing this to the attention of the remaining Executor? Should the attorney include the notes in the value of the decedents estate (and the value of the decedents' interest in Corporation X) at the time of probate of the Will of the decedent? Should the attorney in preparing drafts of the estate tax return for review by the

Executors (i) include the present existence of these notes, (ii) indicate gifts previously made, or (iii) ignore the existence of the notes as requested by one of the Executors?

Could the attorney have provided, prior to the engagement, for the unforeseen situation involving the notes with regard to whom he may now discuss their existence? A properly drafted engagement letter, setting out the identity of the client, and that all matters coming to the attention of the lawyer with regard to the estate of the decedent are to be brought to the attention of each of the Executors, would have addressed several of the issues facing the attorney. Assume for a moment the remaining Executor does not take seriously the issues which the attorney brings to his attention, does not investigate the matter of the notes, and whether they were or were not "forgiven", and tells the attorney to forget the existence of the notes and not to raise the issue of any gifts being made and the use of any of the prior unified credit. The Executors wish the attorney to prepare the United States Estate (and Generation Skipping) Tax Return in accordance with the instructions given in the prior sentence. May the attorney abide by the Executors' wishes to forget about the existence of the notes and complete the United States Estate (and Generation Skipping) Tax Return in accordance with their instructions?

DR 1-102. Misconduct.

(A) A lawyer shall not:

(1) Violate a Disciplinary Rule or knowingly aid another to do so.

(2) ...

(3) Commit a crime or other deliberately wrongful act that reflects adversely on the lawyer's fitness to practice law.

(4) Engage in conduct involving dishonesty, fraud, deceit, or misrepresentation which reflects adversely on a lawyer's fitness to practice law.

(B) ...

Certainly the attorney should give consideration to the above Disciplinary Rule. The certification, under penalties of perjury, required of the preparer on both the United States Estate (and Generation Skipping) Tax Return and the Virginia Estate Tax Return should prevent the attorney from completing the return based only upon the facts presented in this hypothetical, without further investigation and information. This can be illustrated by the following Ethical Consideration.

> EC 1-5. A lawyer should maintain high standards of professional conduct and should encourage fellow lawyers to do likewise. He should be temperate and dignified, and he should refrain from all illegal and ethically reprehensible conduct which reflects adversely on his fitness to practice law. Because of his position in society, even minor violations of law by a lawyer may tend to lessen public confidence in the legal profession. Obedience to law exemplifies respect for law. To lawyers especially, respect for the law should be more than a platitude.

With regard to whether the existence of the notes were a "confidence" or "secret", and whether the attorney may reveal the discovery of the notes without the consent of the Executor

who has made clear to the attorney her feelings on this matter, certain disciplinary rules need to be reviewed.

DR 4-101.Preservation of Confidences and Secrets of a Client.

(A)"Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

(B)Except as provided by DR4-101(C) and (D), a lawyer shall not knowingly:

(1) Reveal a confidence or secret of his client.

(2) ...

(3) ...

(C)A lawyer may reveal:

(1)Confidences or secrets with the consent of the client or clients affected, but only after a full disclosure to them.

(2)Confidences or secrets when required by law or court order.

(3)Information which clearly establishes that his client has, in the course of the representation, perpetrated upon a third party a fraud related to the subject matter of the representation.

(4) ...

(D)A lawyer shall reveal:

(1)The intention of his client, as stated by the client, to commit a crime and the information necessary to prevent the crime, but before revealing such information, the attorney shall, where feasible, advise his client of the possible legal consequences of his action, urge the client not to commit the crime, and advise the client that the attorney must reveal the client's criminal intention unless thereupon abandoned, and, if the crime involves perjury

by the client, that the attorney shall seek to withdraw as counsel.

(2) ...

(E) ...

As the attorney was already representing Corporation X at the time of the decedent's death, should the attorney have (i) agreed to represent the estate, or (ii) continued representing Corporation X, prior to learning of the matter of the note to such corporation? Would your response change with regard to whether to continue representation of Corporation X after you learned of the matter of the note to such corporation? Had the Executors, who now had the right to vote the decedent's shares of stock in Corporation X and which shares represented a majority position in such corporation, related to the attorney that they did not feel there was any conflict of interest in the attorney representing both the estate and Corporation X, need the attorney be concerned about the possibility of a conflict of interest?

DR 5-105. Refusing to Accept or Continue Employment if the Interests of Another Client May Impair the Independent Professional Judgment of the Lawyer.

(A) A lawyer shall decline proffered employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, except to the extent permitted under DR5-105(C).

(B) A lawyer shall not continue multiple employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected by his representation of another client, expect to the extent permitted under

DR5-105(C).

(C) In the situations covered by DR5-105(A) and (B), a lawyer may represent multiple clients if it is obvious that he can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each.

(D) ...

(E) ...

The following Ethical Considerations bear on the above fact situation.

EC 5-14. Maintaining the independence of professional judgment required of a lawyer precludes his acceptance or continuation of employment that will adversely affect his judgment on behalf of or dilute his loyalty to a client. This problem arises whenever a lawyer is asked to represent two or more clients who may have differing interests, whether such interests be conflicting, inconsistent, diverse, or otherwise discordant.

EC 5-15. If a lawyer is requested to undertake or to continue representation of multiple clients having potentially differing interests, he must weigh carefully the possibility that his judgment may be impaired or his loyalty divided if he accepts or continues the employment. He should resolve all doubts against the propriety of the representation....

EC 5-16. In those instances in which a lawyer is justified in representing two or more clients having differing interests, it is nevertheless essential that each client be given the opportunity to evaluate his need for representation free of any potential conflict and to obtain other counsel if he so desires....

EC 5-17 Typically recurring situations involving potentially differing interests are those in which a lawyer is asked to represent ..., and beneficiaries of the estate of a decedent. Whether a lawyer can fairly and adequately protect the interests of multiple clients in

these and similar situations depends upon an analysis of each case....

EC 5-18. A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity. In advising the entity, a lawyer should keep paramount its interests and his professional judgment should not be influenced by the personal desires of any person or organization. Occasionally a lawyer for an entity is requested by a stockholder, director, officer, employee, representative, or other person connected with the entity to represent him in an individual capacity; in such case the lawyer may serve the individual only if the lawyer is convinced that differing interests are not present.

EC 5-19. A lawyer may represent several clients whose interests are not actually or potentially differing. Nevertheless, he should explain any circumstances that might cause a client to question his undivided loyalty. Regardless of the belief of a lawyer that he may properly represent multiple clients, he must defer to a client who holds the contrary belief and withdraw from representation of that client.

Consider the situation where an attorney has prepared the 1990 U.S. Individual Income Tax Return for his client, a self-employed maintenance repairman. The client reported gross receipts of $30,000.00 on his Schedule C. The client contacts the attorney to represent him in connection with an audit of his income tax return. On the audit notice, the Internal Revenue Service has notified the taxpayer that it questions the amounts he reported as his gross receipts on his Schedule C and some miscellaneous expenses. During a conference with the attorney just prior to the meeting with

a representative of the Internal Revenue Service, the client informs the attorney that he did not report to the attorney an additional $25,000.00 of gross receipts ($20,000.00 received in cash, and $5,000.00 he received by check, but for which he did not receive a Form 1099) to be included on his Schedule C. At the conference, which starts immediately thereafter and at which the client is present, the agent for the Internal Revenue Service relates to the attorney and taxpayer she has discovered an additional $5,000.00 of gross receipts the taxpayer should have included in income, and that she has seen a check from a real estate management company paid to the taxpayer in this amount. She reviews other items for which she has questions, and asks the taxpayer if the $5,000.00 represented by the check is the only income he failed to report on Schedule C. The client answers in the affirmative, and relates his attorney "knows" this is the only amount which was not reported on the income tax return. The agent for the Internal Revenue Service relates if the attorney says this is true, she can make the adjustments and close the case, and will be sending the adjustments to the attorney for review and signature. Should the attorney immediately speak to the agent, and relate this is not the case? Should the attorney ask to speak to his client privately, and thereby possibly raise the suspicions of the agent? Should the attorney do nothing?

Two Disciplinary Rules which have previously been discussed and which are appropriate for review at this point

are the following:

DR 1-102. Misconduct.

(A) A lawyer shall not:

(1)...

(2) ...

(3) Commit a crime or other deliberately wrongful act that reflects adversely on the lawyer's fitness to practice law.

(4) Engage in conduct involving dishonesty, fraud, deceit, or misrepresentation which reflects adversely on a lawyer's fitness to practice law.

(B) ...

DR 4-101. Preservation of Confidences and Secrets of a Client.

(A) "Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

(B) Except as provided by DR4-101(C) and (D), a lawyer shall not knowingly:

(1) Reveal a confidence or secret of his client.

(2) ...

(3) ...

(C) A lawyer may reveal:

(1)...

(2) Confidences or secrets when required by law or court order.

(3) Information which clearly establishes that his

client has, in the course of the representation, perpetrated upon a third party a fraud related to the subject matter of the representation.

(4) ...

(D) A lawyer shall reveal:

(1) The intention of his client, as stated by the client, to commit a crime and the information necessary to prevent the crime, but before revealing such information, the attorney shall, where feasible, advise his client of the possible legal consequences of his action, urge the client not to commit the crime, and advise the client that the attorney must reveal the client's criminal intention unless thereupon abandoned, and, if the crime involves perjury by the client, that the attorney shall seek to withdraw as counsel.

(2) ...

(E) ...

May the attorney, by remaining silent, give approval to the representation of his client to the agent from the Internal Revenue Service? Perhaps more importantly, should the attorney deal with the situation immediately, or speak to the client after the agent from the Internal Revenue Service leaves? Should the attorney be so concerned with his professional standing with the Internal Revenue Service, that he immediately speaks up in front of the agent, without giving his client the opportunity to retract his statement on his own in front of the agent at a later date? If the attorney speaks up immediately, is he in violation of DR4-101(D)(1)?

Consider the situation where an attorney, as an investor,

is a shareholder in a closely-held interior decorating business. The attorney is not active in the business, but sits on the board of directors of the corporation. The remaining shareholder, who is actively involved in the business of the corporation, was previously involved with another interior decorating business, which closed due to financial difficulties. This individual has requested you represent him in a matter involving unpaid withholding taxes which the Internal Revenue Service is asserting he owes as a responsible party of the corporation with which he was formerly employed. The individual, who has guaranteed notes of the present corporation of which you are a shareholder, relates if he has to pay the Internal Revenue Service he will go bankrupt on his other obligations. Should you consider representing this taxpayer?

The following Disciplinary Rule, which has been previously reviewed, should be looked at in connection with the present matter.

DR 5-101. Refusing Employment When the Interests of the Lawyer May Impair His Independent Professional Judgment.

(A) A lawyer shall not accept employment if the exercise of his professional judgment on behalf of his client may be affected by his own financial, business, property, or personal interests, except with the consent of his client after full and adequate disclosure under the circumstances.

(B) ...

(1) ...

(2) ...

(3) ...

Suppose the facts were changed so that while representing the client in the unpaid withholding tax litigation, the client approaches you about being an investor in a closely-held corporation, of which the client will be the active party. The client has financing arranged for the new business, and will depend upon you to decide whom among you needs to guarantee the debt.

DR 5-104. Limiting Business Relations with a Client.

(A) A lawyer shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise his professional judgment therein for the protection of the client, unless the client has consented after full and adequate disclosure under the circumstances and provided that the transaction was not unconscionable, unfair or inequitable when made.

(B) ...

Consider the situation where an attorney in a real estate practice receives a telephone call from a prospective client (Whitney Smooth), who wishes to speak to you about a tax matter. At a conference shortly thereafter, Mrs. Smooth brings you her 1991 U.S. Individual Income Tax Return (which was filed jointly with her husband, Dr. Matthew Smooth). The Schedule C items from the return represent the income and deductions from her husband's medical practice, while the Schedule E items from the return represent the net loss from the rental activities

of a partnership (PainterHands Partnership) in which Dr. Smooth owns a sixty percent (60%) interest. You do not prepare the U.S. Partnership Return of Income for PainterHands Partnership. However, you do represent the certified public accountant who prepared the partnership return, Justin Foot, and remember you previously drafted some notes for use by Mr. Foot with regard to some borrowings by Mr. Foot in the past two years.

Whitney Smooth relates to you she has "discovered" the bookkeeper for her husband's medical practice has not reported all the income from the medical practice. The bookkeeper, Jennifer Hands (whose husband Joshua is a partner in PainterHands Partnership), set up a non-interest bearing checking account ("Dummy Account"), in the name of Dr. Smooth, to which Jennifer was depositing personal checks made payable to Dr. Smooth on outstanding medical bills. Dr. Smooth, who reported a net income from his Schedule C of $185,000.00 in 1991, had at least $52,000.00 omitted as income from his Schedule C, which equals the deposits made to Dummy Account during 1991. Further, there were also deposits made to this account in 1990 of $22,000.00 (a year in which Dr. Smooth reported a net income from Schedule C of $125,000.00). Funds deposited to the Dummy Account in 1990 and 1991 were thereafter used by Jennifer Hands as contributions for her husband to the PainterHands Partnership, and as loans to her brother, Justin Foot.

Whitney Smooth has come to you for legal advice as to whether she must amend her joint 1990 or 1991 federal and

Virginia income tax returns. Justin Foot, the accountant who prepared the aforementioned tax returns for Matthew and Whitney Smooth, told Whitney Smooth that she cannot amend her income tax returns - - that IT WAS THE LAW that she could not amend.

In determining whether to accept the engagement, two disciplinary rules should immediately come to the attention of the attorney. The attorney should immediately review DR 6-101 and DR 5-105.

DR 6-101. Competence and Promptness.

(A) A lawyer shall undertake representation only in matters in which:

(1) The lawyer can act with competence and demonstrate the specific legal knowledge, skill, efficiency, and thoroughness in preparation employed in acceptable practice by lawyers undertaking similar matters, or

(2) The lawyer has associated with another lawyer who is competent in those matters.

(B) ...

(C) ...

(D) ...

DR 5-105. Refusing to Accept or Continue Employment if the Interests of Another Client May Impair the Independent Professional Judgment of the Lawyer.

(A) ...

(B) A lawyer shall not continue multiple employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected by his representation of another client, except to the extent permitted under

DR5-105(C).

(C) In the situations covered by DR5-105(A) and (B), a lawyer may represent multiple clients if it is obvious that he can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each.

(D) ...

(E) ...

With regard to DR 6-101, several Ethical Considerations merit attention.

EC 6-1...., a lawyer.... He should strive to become and remain proficient in his practice and should accept employment only in matters which he is or intends to become competent to handle.

EC 6-3. While the licensing of a lawyer is evidence that he has met the standards then prevailing for admission to the bar, a lawyer generally should not accept employment in any area of the law in which he is not qualified. However, he may accept such employment if in good faith he expects to become qualified through study and investigation, as long as such preparation would not result in unreasonable delay or expense to his client. ... A lawyer offered employment in a matter in which he is not and does not expect to become so qualified should either decline the employment or, with the consent of his client, accept the employment and associate a lawyer who is competent in the matter.

EC 6-4.... If a lawyer has accepted employment in a matter beyond his competence but in which he expects to become competent, he should diligently undertake the work and study necessary to qualify himself. ...

Though an attorney may educate himself in different areas of the law, it would appear that in this instance the attorney is not presently qualified to handle this engagement. Further,

the attorney should be aware that the notes he drafted for Mr. Foot may be called into evidence with regard to any future proceedings Dr. and Mrs. Smooth may entertain to recover funds misappropriated from Dr. Smooth's medical practice by the bookkeeper.

What do you feel is the proper response which the attorney should give to his client as to whether they should amend their 1990 and 1991 income tax returns? Do you feel that advising the client not to file an amended income tax return would be akin to a violation of DR 7-102 (A)(7) or (8)?

DR7-102. Representing a Client Within the Bounds of the Law.

(A) In his representation of a client, a lawyer shall not:

(1) ...

(2) ...

(3) ...

(4) ...

(5) ...

(6) ...

(7) Counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent.

(8) Knowingly engage in other illegal conduct or conduct contrary to a Disciplinary Rule.

(B) ...

(1) ...

Several Ethical Considerations of interest are as follows:

EC 7-5. A lawyer as adviser furthers the interest of his client by giving his professional opinion as to what he believes would likely be the ultimate

decision of the courts on the matter at hand and by informing his client of the practical effect of such decision.... A lawyer should never encourage or aid his client to commit criminal acts or counsel his client on how to violate the law and avoid punishment therefor.

EC 7-6. Whether the proposed action of a lawyer is within the bounds of the law may be a perplexing question when his client is contemplating a course of conduct having legal consequences that vary according to the client's intent, motive, or desires at the time of the action....

EC 7-8.... Advice of a lawyer to his client need not be confined to purely legal considerations. A lawyer should advise his client of the possible effect of each legal alternative. A lawyer should bring to bear upon this decision-making process the fullness of his experience as well as his objective viewpoint. In assisting his client to reach a proper decision, it is often desirable for a lawyer to point out those factors which may lead to a decision that is morally just as well as legally permissible....In the event that the client in a nonadjudicatory matter insists upon a course of conduct that is contrary to the judgment and advice of the lawyer but not prohibited by Disciplinary Rules, the lawyer may withdraw from the employment.

Confidentiality

Attention has been previously given to Disciplinary Rule 4-101. The Ethical Considerations following this Disciplinary Rule should be reviewed. Some Ethical Considerations which I would like to highlight for you are as follows:

EC 4-1. Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidences and secrets of one who has employed or sought to employ him....

EC 4-2.... A lawyer must always be sensitive to the rights and wishes of his client and act scrupulously

in the making of decisions which may involve the disclosure of information obtained in his professional relationship. Thus, in the absence of consent of his client after full disclosure, a lawyer should not associate another lawyer in the handling of a matter; nor should he, in the absence of consent, seek counsel from another lawyer if there is a reasonable possibility that the identity of the client or his confidences or secrets would be revealed to such lawyer. Both social amenities and professional duty should cause a lawyer to shun indiscreet conversations concerning his clients.

EC 4-4. The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client.... A lawyer should endeavor to act in a manner which preserves the evidentiary privilege; for example, he should avoid professional discussions in the presence of persons to whom the privilege does not extend.

EC 4-6. The obligation of a lawyer to preserve the confidences and secrets of his client continues after the termination of his employment....

DISCIPLINARY RULE FOR REVIEW

DR 2-104. Specialists; Limitation of Practice.

(A) A lawyer shall not hold himself out publicly as, or imply that he is, a recognized or certified specialist except in accordance with either DR2-101, DR2-102 or DR2-103, or except as follows:

(1) A lawyer admitted to practice before the United States Patent and Trademark Office ...

(2) ...

(B) A lawyer may state, announce or hold himself out as limiting his practice to a particular area or field of law so long as his communication of such limitation of practice is in accordance with the standards of DR2-101, DR2-102, or DR2-103, as appropriate.

The attorney who limits his practice to the tax field should neither state nor imply that he is a "recognized or certified tax specialist." (See Legal Ethics Opinion No. 923) If professionals in fields other than law (such as certified public accountants or insurance professionals) refer to the attorney as a "recognized or certified tax specialist," the attorney should immediately correct this misidentification. The attorney may choose to hold himself out as limiting his practice to the field of tax law. This can be best illustrated by the following Ethical Consideration.

> EC 2-16. In some instances a lawyer confines his practice to a particular field of law. In the absence of state controls or other standards to insure that the public is not misled about the existence of special competence, a lawyer should not hold himself out as a specialist or as having official recognition as a specialist, other than in the fields of admiralty, trademark, and patent law where a holding out as a specialist historically has been permitted. A lawyer may, however, indicate, in public announcements and personal communications, if it is factual, a limitation of his practice or that he practices in one or more particular areas or fields of law, which will assist laypersons in selecting counsel and accurately describe the limited area in which the lawyer practices.

Legal Ethics Opinions for Review

Legal Ethics Opinion 1156 of the Virginia State Bar from January 31, 1989 (involving Disciplinary Rules 5-105(D) and 7-103(A)(2)), concerned a situation where an attorney

represented one spouse (wife) in a divorce matter, and did not know whether the other spouse was represented by counsel previously in the divorce action (not yet completed). The client supplied her attorney with a joint income tax return prepared by the accountant for her husband, and following review by the attorney, a suggestion was made by the attorney that separate income tax returns (as opposed to a joint filing) should be made. The attorney prepared the separate income tax return of each spouse. The attorney inquired whether it would be proper to continue representing one spouse in the divorce action, or had an attorney-client relationship been established with the other spouse from the preparation of the income tax returns for both spouses (filing separately). The Committee related

> ...preparation of tax returns under the circumstances you have described may be construed to constitute the practice of law and may create an attorney/client relationship to the extent that the lawyer is providing advice and service for another which requires his use of legal knowledge or skill. However, assuming that the husband is an unrepresented party, the preparing of the tax return by the wife's attorney with the consent of both parties may be ethically permissible providing that the unrepresented party is advised that the aforementioned attorney represents the interests of the wife whose interests are or may be differing to those of the husband, and that the husband may secure separate counsel.
>
> The Committee is of the opinion that even if the preparation of the husband's separate tax return did create an attorney/client relationship, the representation of the wife in the no-fault divorce proceeding is not substantially related to the tax preparation and, therefore, no conflict exists in continuing the divorce representation of the wife.

However, consider the situation where the parties do not

obtain a no-fault divorce, and, rather, a bitter divorce battle follows, along with a fight over the division of property. The situation could be envisioned, depending upon the income, deductions, losses and credits of the spouses, where the attorney may have gained an unfair advantage over the spouse of his client by having the other spouse make certain elections, or forego same, on his separately filed return, as well as acquire information which may not have been as readily available. It appears to me the better course would be not to prepare income tax returns of both spouses where you represent one of the spouses in a divorce matter.

Legal Ethics Opinion 1091 of the Virginia State Bar from June 14, 1988 (involving Disciplinary Rules 5-105(B), 5-105(C) and 5-105(D)) concerned a situation where an attorney represented a married couple on a tax matter, and such representation included representing the married couple at the appeals level of the Internal Revenue Service. During the course of the attorney's representation, it was brought to the attorney's attention that a then new rule (the innocent spouse rule) may be available to one of the attorney's clients. The attorney was concerned with

1. Whether there is a conflict of interest in representing both taxpayers and arguing the "innocent spouse rule" for the one spouse;
2. Even if there is a conflict in continuing to represent both taxpayers and arguing the "innocent spouse rule," whether this disclosure to the client and consent to further representation is sufficient to continue the representation of both; and

3. If continued representation of both taxpayers is not permissible, whether it would be permissible to continue to represent the taxpayer who is not the beneficiary of the "innocent spouse rule."

The Committee related as to issue 1.

...that unless disclosure is made to both clients and both clients consent to the representation, it would be improper for you to continue the multiple representation.

with regard to issue 2., the Committee related

..., continued representation of both would be proper only if disclosure is made to both clients and both client's consent.

with regard to issue 3., the Committee related the attorney

...must obtain the consent of the former client before proceeding in your representation of the other client.

FINAL CASE FOR REVIEW

It is recommended that attorneys review the case of United States of America v. Richard M. Hirschfeld, 964 F.2d. 318 (4th Cir. 1992). The Court of Appeals for the 4th Circuit affirmed the convictions (including "... aiding in the preparation of his fraudulent income tax return..." at page 319) of defendant Mr. Hirschfeld (an attorney). One of several interesting points from this case had to do with a discussion of "proper venue." The defendant alleged that none of the acts with regard to a violation of Section 7206 of the Internal Revenue Code took place in the Eastern District of Virginia, in that his "... tax return for 1984 was prepared in California, mailed from Charlottesville, Virginia (located in the Western District

of Virginia), and filed at the IRS Center in Memphis, Tennessee." at page 321. The Appeals Court recited a list of items which the defendant undertook in the Eastern District of Virginia, and stated at page 321

> Hirschfeld reads § 7206(2) too narrowly in focusing only on where the return was prepared, mailed, and filed. The prohibition by its own terms reaches conduct which consists of aiding and assisting in the preparation of a false return. ...
>
> Because Hirschfeld, while in the Eastern District of Virginia, participated actively in assisting and preparing his 1984 return, which he knew included fraudulent deductions, the Eastern District of Virginia was a proper venue for the prosecution of the offense.

There are other interesting matters in this case for the reader to review.

The various Disciplinary Rules and Ethical Considerations quoted in this outline have come from the Virginia Code of Professional Responsibility, and were taken from the August 1993 issue of the VIRGINIA LAWYER REGISTER. The Unauthorized Practice Rules mentioned and the Unauthorized Practice Considerations quoted in this outline were taken from the August 1993 issue of the VIRGINIA LAWYER REGISTER. The Legal Ethics Opinions and the Unauthorized Practice of Law Opinion in this outline were taken from the volume titled Legal Ethics and Unauthorized Practice Opinions of the Code of Virginia, 1950.