

I'm Not a Tax Lawyer, but . . .

By Robert W. Wood

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Most readers of *Tax Notes* have probably heard the phrase "I'm not a tax lawyer, but . . ." Usually it is followed by some purported tax rule or analysis. Wood takes on this recurrent phenomenon and distinguishes between some of the circumstances in which those utterances give rise to liability and those in which they do not.

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"I'm not a tax lawyer, but . . ."

Most tax advisers have encountered this phrase, usually as a preface to a real zinger. It may be uttered by litigation lawyers, corporate lawyers, real estate brokers, bankers, structured settlement brokers, or other professional — or not so professional — people. It typically precedes an interesting statement, which may (or, more likely, may not) be accurate. If you are the tax lawyer in the room, it can be difficult to know how to handle these statements. Reacting can be risky, especially if the speaker is forceful, speaks with authority, and commands respect.

To be fair, the statement is most often made by lawyers. The lawyers who start a sentence that way no doubt wish to make clear that although they are about to offer tax advice, they don't want to be held accountable for it. After all, they don't have special (or sometimes any) tax expertise. They are not *tax* lawyers.

In effect, they are placing a banner-sized disclaimer on the advice they'll offer. Of course, they generally go ahead and offer the tax advice anyhow. It must be nice to be free of all the rules, restrictions, and liabilities facing tax practitioners!

In settling civil litigation, a litigator might say, "I'm not a tax lawyer, but I would be shocked if the IRS could tax this recovery." Here are others I've heard:

"I'm not a tax lawyer, but . . ."

- "I don't think putting the money in our lawyer-client trust account constitutes constructive receipt."
- "I'm pretty sure they won't be issuing a Form 1099 for this."
- "The odds are that no one will see this deduction mixed in with everything else."
- "I have to pay tax on the lawyer's fees I receive here, so the IRS can't possibly tax you on the same fees — that would be unconstitutional."
- "Your damages are for pain and suffering, and that makes them tax free."
- "In this circuit, attorney fees aren't taxed to the client but only to the lawyer."
- "The defendant cannot issue a Form 1099 to the plaintiff's lawyer for 100 percent of the settlement and another Form 1099 to the plaintiff for 100 percent, as that would be double reporting of income."

A large part of my practice is dealing with litigants and their counsel on tax issues, so I may be myopic about the "I'm not a tax lawyer, but . . ." remarks made in that context. However, the case law bears out my concern. For example, in *Stadnyk v. Commissioner*,¹ the Sixth Circuit held that settlement proceeds paid to a woman who had been unlawfully imprisoned for eight hours were not excludable from income under section 104(a)(2).

Why did she take the position that her award was tax free? According to the court: "Mrs. Stadnyk testified that her attorney, the attorney for [the defendant] Bank . . . and the mediator all advised her that the settlement proceeds would not be subject to income tax."² Of course, they all turned out to be wrong.

More recently, in *Espinoza v. Commissioner*,³ a taxpayer sued her former employer seeking actual damages, back pay, and damages based on claims of mental pain and anguish and intentional infliction

¹367 Fed. Appx. 586 (6th Cir. 2010), *Doc 2010-4364*, 2010 TNT 40-9.

²*Id.* at 589.

³2011 U.S. App. LEXIS 6371 (5th Cir. 2011), *Doc 2011-6613*, 2011 TNT 61-15.

of emotional distress. The Fifth Circuit held that her lump sum payment could not be excluded from income under section 104(a). Why did Espinoza believe the settlement was not taxable?

As the case was settling, Espinoza's personal injury lawyer advised her that the payment would be excludable from income. Similarly, after her husband told their CPA that the settlement was for medical costs, the CPA also informed the Espinozas that the settlement amount would not be taxed. The CPA then excluded the settlement payment when he prepared the couple's income tax return.

Outside the voluminous grist of settling litigation there are many other examples of the "I'm not a tax lawyer, but . . ." remark. Here are a few from family lawyers:

- "You can treat all the payments your ex-husband is making to you as property settlement and therefore not as income to you."
- "Alimony is always tax deductible when you pay it, and if you add child support to it and pay both to the spouse, that makes child support deductible, too."

Here are some from corporate practice:

- "Since you received shares in a new company and didn't get any cash, this is a nontaxable dividend."
- "You and your partner are each contributing to the new company, you with cash and property and your partner with services in the future, so there's no tax."
- "You don't need a business purpose to do a spinoff."

I expect most tax advisers have a store of such examples. It can be surprisingly difficult for tax advisers to disabuse listeners of these comments once they are uttered. Sometimes, the more blatantly wrong the statements, the more difficult they are to rebut. But does the "I'm not a tax lawyer" preface provide complete insulation from liability?

Disclaimer Efficacy

The answer to that question appears to be mixed. Disclaimers of liability are in vogue these days. In the tax realm, a type of disclaimer is required under Circular 230. Perhaps because of the ease of electronically sending documents today, it is virtually impossible to ascertain where a document will end up, or who will use the document as a basis for a lawsuit. This e-mail culture, coupled with the broad potential ambit of Circular 230, has caused attorneys and others providing tax advice to include disclaimers or legends in nearly all written messages, including private offering material, letters, memoranda, e-mails, and draft documents.

One reason for the disclaimers is the harshness of Circular 230.⁴ Another is potential liability to clients and non-clients. When any of us offers guidance about something beyond our ken, it is only natural that we apprise the listener of just how far from our comfort zone we may be. For those uttering the "I'm not a tax lawyer, but . . ." refrain, the same must be true.

Yet is such a preface effective in avoiding liability for what comes next? In some instances, a disclaimer may prevent liability from attaching even to a written communication.⁵ For example, in *Mark Twain Kansas City Bank v. Jackson, Brouillette, Pohl & Kirley PC*,⁶ a lender was held not to be justified in relying on an opinion letter that specifically disclaimed any responsibility for its statements.⁷

Nevertheless, it is prudent not to rely too heavily on disclaimers and to perform some research about negligence and malpractice liability within your own jurisdiction. Disclaimers alone may not be enough.

Example: Lenny Lawyer represents a client in litigation. At the conclusion of the trial, the court ordered attorney fees paid directly to Lenny as the attorney. The opposing party is preparing to pay the judgment of \$100 to Lenny's client, plus \$80 of attorney fees to Lenny. Lenny drafts a letter to the defense counsel (copying the defendant) explaining that he is not a tax lawyer but advising the defendant to cut separate checks and issue separate Forms 1099. If that advice is wrong, can the defendant bring an action on it?

Although I find no authority directly on point, I suppose the letter could be actionable under several legal theories. There can be liability arising from advice provided to a non-client. Although we usually think of an opinion as being written, even a verbal opinion may be actionable.⁸

⁴See generally Charles P. Rettig, "Practitioner Penalties: Potential Pitfalls in the Tax Trenches," *Tax Notes*, Apr. 13, 2009, p. 207, *Doc 2009-4613*, or *2009 TNT 69-12*; Crystal Tandon, "Practitioners Demanding Clear Outlines of Circular 230's Scope," *Tax Notes*, Aug. 29, 2005, p. 977, *Doc 2005-17652*, or *2005 TNT 162-2*; Sheryl Stratton, "Circular 230 E-mails, T-Shirts Attain 'Legendary' Status," *Tax Notes*, July 4, 2005, p. 48, *Doc 2005-14211*, or *2005 TNT 127-1*.

⁵See *Conroy v. Andeck Resources '81 Year-End Ltd.*, 137 Ill. App.3d 375 (1985).

⁶912 S.W.2d 536 (Mo. Ct. App. 1995).

⁷See also *Banc One Capital Partners Corp. v. Kneipper*, 67 F.3d 1187 (5th Cir. 1995). But see *Kline v. First Western Gov't Sec.*, 24 F.3d 480 (3d Cir. 1994).

⁸See *BLM v. Sabo & Deitsch*, 55 Cal. App. 4th 823, 834 (Cal. App. 4th Dist. 1997).

Clients vs. Non-Clients

Liability to a client for what one writes to that client seems unexceptional. But liability to a client for advice outside your comfort zone that you really shouldn't be giving may be stickier. Even more amorphous is the liability of lawyers who provide advice to a person who is not a client. Frequently, such a communication may be sent to a third party at a client's request.

Not all potential plaintiffs are clients, and that expansion can be frightening. In some cases, the communication may be nothing more than a representation written to another party, such as "Joe is in good financial condition" or "there are no liens pending against Joe."

Yet in the tax area, the representations or opinions may be consequential, at least if someone acts on them. The statement, "I'm not a tax lawyer, but if I were you, I would not report this settlement as income," may incur liability despite the disclaimer. In some cases, the advice may be more technical, even if accompanied by the "I'm not a tax lawyer" lead-in. Advising that "you don't need to issue a Form 1099 to any client for this payment" may be intended to help one's own client, not to help or advise the addressee.

Indeed, the person making that statement may be adverse to the addressee. Nevertheless, there may be a risk of liability. The dangers from clients and third parties seem more consequential than the risk of liability for discipline or penalties to the IRS.

History and Privity

Attorneys generally owe a duty of care to their clients but not to third parties. It is therefore important to distinguish "I'm not a tax lawyer, but . . ." comments made to clients from those made to non-clients. Historically, lawyers have not been held liable for their negligent misconduct in suits brought by non-clients.⁹

The stated rationale for what may sometimes appear to be lawyer protectionism is actually the lack of privity of contract between the lawyer and the non-client. That lack of privity prevents those not in contract with the attorney from seeking damages in tort for the attorney's conduct.

The privity of contract doctrine dates to the 19th-century English case of *Winterbottom v. Wright*,¹⁰ in which the postmaster general contracted with the defendant to maintain mail coaches. The plaintiff was a postal employee who suffered injuries when the coach he was driving broke down. The plaintiff sued the defendant for

breaching its contract with the postmaster general, arguing that the defendant's failure to maintain the coach as required by contract caused the accident. The court refused to allow a negligence action based on the duty contained in the contract. That duty was owed solely to the postmaster general.

Several decades later, the U.S. Supreme Court brought privity to our side of the Atlantic in *National Savings Bank v. Ward*.¹¹ There, a bank loaned money for the purchase of real estate, in reliance on a title report prepared by the defendant attorney. The defendant certified the title even though the land had previously been sold. Because the defendant was not in privity with the plaintiff, the court denied liability.

Over the course of the first half of the 20th century, the privity of contract doctrine was enforced with little question. Courts and business people found it predictable and efficient. Over time, however, courts eroded the privity doctrine.¹²

One of the seminal cases, *Glanzer v. Shepard*,¹³ involved a bean counter (not an accountant, but a literal bean counter) who failed to count carefully. A bean seller employed a public weigher (aka bean counter) to certify the weight of beans sold. The buyer sued the public weigher, claiming negligence in being overcharged for beans.

The court found that despite the lack of privity of contract with the buyer, the law imposed a duty of care on the public weigher. The court noted the public nature of the weigher's role. Because the weigher provided a certificate directly to the buyer, the bean counter was aware of the risk of misperformance.¹⁴

Other theories for imposing liability even outside privity of contract include the tort of misrepresentation and a third-party beneficiary theory. In fact, these and other legal theories may give a non-client a cause of action against an attorney rendering legal advice. Most states have fashioned their own versions of these rules, frequently intertwining theories.¹⁵ Commentators have attempted to establish a

¹¹100 U.S. 195 (1879).

¹²See generally *MacPherson v. Buick Motor Co.*, 217 N.Y. 382 (1916) (manufacturers owed a duty of care to consumers if the article sold was reasonably certain to be dangerous if negligently made despite lack of privity); *Mentzer v. Western Union Tel. Co.*, 93 Iowa 752 (1895) (telegraph company owes a duty of care to addressee of intended telegraph despite lack of privity).

¹³233 N.Y. 236 (1922).

¹⁴But see *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931), for limitations on *Glanzer*.

¹⁵See *Trask v. Butler*, 123 Wash. 2d 357 (1992); *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536 (1985); *Citizens State Bank v. Timm, Schmidt & Co.*, 113 Wis. 2d 376 (1983).

⁹*National Savings Bank v. Ward*, 100 U.S. 195, 205-206 (1879).

¹⁰152 Eng. Rep. 109 (Ex. 1842).

unifying theory, but courts have not yet embraced one.¹⁶ Some states even codify attorney liability to a non-client.¹⁷

Some states have their own rules for legal malpractice distinct from misrepresentation or negligence liability. Legal malpractice may be appropriate to plead in the alternative to other theories. In contrast, some states, notably California, do not allow non-clients to sue for “legal malpractice” at all, although suits in other guises are permitted.¹⁸

Does Liability Attach?

There may be no way to eradicate the “I’m not a tax lawyer, but . . .” remark. As long as our tax laws are complicated, we will keep hearing it — especially because how to reduce or avoid taxes seems almost to be an American pastime.

There may be no way to lessen the annoyance we may feel at having to defend against or contradict our colleagues’ inaccurate statements. But it may be some consolation that some of the remarks will bring liability to the lawyers, and possibly to non-lawyers, who utter them.

For example, suppose a real estate lawyer is hired by a client to handle real estate deals, and says, “I’m not a tax lawyer, but I know we can do a 1031 exchange of your personal residence for a

small office building.” Let’s assume that this real estate lawyer has occasionally advised on those tax topics. Here, there should plainly be liability.

First, the tax advice is plainly wrong. Second, the disclaimer seems not intended as a disclaimer, but rather appears designed to show off the special knowledge of the speaker. Here the “I’m not a tax lawyer, but . . .” sounds as if the tax advice is that much more certain because it is so obviously true.

On the other hand, the same kind of utterance would surely not import liability if it were followed by, “I advise you to get advice from a qualified tax professional — something I am not — before you act on my two cents’ worth.” Lawyers commonly make forays into other areas of law, sometimes by necessity. The nature and purpose of these forays should be considered in any later dissection of our actions, as should the degree to which we purport to actually be giving advice on which we expect the client to act.

The tenor of a comment, its tone, and the setting in which it is uttered surely also matter. At a cocktail party, a lawyer might remark, “I’m not a tax lawyer, but I think all personal living expenses should be deductible.” That is surely not meant as advice to anyone and surely cannot import liability. In contrast, some of the other statements I’ve mentioned are not so clear.

For me, “I’m not a tax lawyer, but . . .” will remain an annoyance. It is mostly to be reviled, yet is a strangely attractive phrase, quite clearly suggesting that tax lawyers know *something* worth knowing. Here’s hoping it keeps producing work for those who *are* tax lawyers.

¹⁶See Kevin H. Michels, “Third-Party Negligence Claims Against Counsel: A Proposed Unified Liability Standard,” 22 *Geo. J. Legal Ethics* 143 (2009); Ellen S. Eisenberg, “Attorney’s Negligence and Third Parties,” 57 *N.Y.U. L. Rev.* 126 (1982).

¹⁷Ark. Code Ann. Sec. 16-22-310 (Supp. 1997).

¹⁸See, e.g., *Biakanja v. Irving*, 49 Cal. 2d 647 (Cal. 1958).