

# Lawyers, whether they know it or not, need tax experts

By Robert W. Wood

**D**isclaimer: This is a self-serving article. I hope you will agree you need a tax expert and that you might even hire me. But whether you hire me, one of my tax lawyer colleagues or an accountant, tax considerations in your litigated or mediated disputes are worth considering. Here's why.

Tax law may produce groans from lawyers, clients, judges and juries. But we all must pay taxes and we all know they impact the bottom line. And with recent federal and California tax increases, tax worries are at an all-time high. That means tax advice may be more valuable in litigation than you previously considered. Everyone likes tax savings.

Tax experts can be used in virtually any kind of case. The general federal rule is that an expert witness may testify where his scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue. See Federal Rule of Evidence 702. The expert's testimony must be based upon sufficient facts or data, the testimony must be the product of reliable principles and methods, and the expert must have applied the principles and methods reliably to the facts of the case.

Qualification as an expert witness depends on the type of opinion to be offered. The witness must possess an expertise based on knowledge, skill, training, education or experience regarding the particular subject on which he will opine. Once qualified, the trial court is granted broad discretion to determine whether to admit the expert's testimony.

In California state court, an expert witness' testimony must be related to a subject that is sufficiently beyond common experience so that the expert will assist the trier of fact. The expert's testimony must be based upon his special knowledge, skill, training, education and experience with respect to the matter. See California Evidence Code Section 801.

Tax experts are useful in civil disputes where their specialized knowledge may help explain tax issues central to the case or that are important in assessing and evaluating damage claims. The latter is especially broad, as virtually any money we pay and receive has tax consequences. One example of how to use a tax expert where tax issues are central to a case would be tax shelter litigation.

In a typical fact pattern, an investor enters into a transaction or buys something purporting to have a particular tax result. When the transaction fails or goes awry, what are the client's damages? A tax expert is usually necessary to make such determinations.

Far from merely crunching the numbers and testifying about the client's damages, the tax expert is likely to explain how the tax shelter was supposed to work. Given the complexity of taxes, the education function tax experts serve can be of enormous value, even when there is no dispute about the amount of damages.

Another example where taxes are central is a malpractice case against lawyers or accountants for causing higher taxes. Spoiled 1031 exchanges, muffed S corporation elections, faulty wills and trusts, messed up mergers or stock purchases, missed stock option exercises and goofed tax returns all involve central tax issues.

## Ancillary tax issues

Even if tax issues are not central to your case, there is likely a tax component to it. For example, it is becoming common for plaintiffs to seek *additional* damages based on tax consequences. Conversely, defendants often ask for tax issues to be taken into account to *reduce* damages the plaintiff might be awarded.

Suppose that a plaintiff sues a real estate broker and title company for not completing a real estate transaction within the contractual timeframe. One consequence of that failure may be that the plaintiff incurred additional income tax on the transaction. The plaintiff should claim those additional taxes as part of his damages.

Another example involves employment claims. A former employee calculating damages for a wrongful termination by his employer will often ask for a tax gross-up. Had the plaintiff been treated properly in the first place, he would have received wages payable over many years which would have been more favorably taxed. The tax gross-up may compensate the plaintiff for the negative tax impact of receiving a lump sum damage award in one year.

Jurisdictions vary in how they regard such tax-based damage claims. Not only is the type of claim relevant, but whether the case is to be tried before a judge or jury can have an impact. So, too, can the time at which the tax claim is asserted (the earlier the better).

## Competing experts

Axiomatically, when one side has an expert, the other side generally wants a rebuttal expert. In the case of tax lawyers, there is a bit more to this than merely the usual reciprocity. In fact, because of the calculation function, and particularly because of the education function, tax experts can be important in resolving such matters.

Consider the extreme case of *Baxter v. United States*, No. 1:04-CR-00371 (N.D. Illinois June 25, 2009). In this criminal case, the court vacated a two-year prison sentence given to a certified public accountant who had pled guilty to obstructing and impeding the administration of the federal tax laws. The reason for vacating the sentence? Ineffective assistance of counsel because Baxter's lawyer *did not retain a tax expert*.

Admittedly, this is an extreme case. Still, just how essential a tax expert can be is made clear by the *Baxter* opinion. It gives a thorough review of constitutional standards as well as a good bit of tax law.

## Conclusion

Tax issues are thorny and easy to get wrong. Many lawyers, judges, jurors and members of the public have a hard time with them and with the frequent grey areas that seem ever-present in our always changing tax law. And the nature of litigation can exacerbate these problems.

In many garden-variety civil disputes, the impact of tax law on a settlement or judgment can be a morass. There are special tax rules for punitive damages, structured settlements, personal injury cases, divorce and palimony cases, environmental cases and many more. Even the tax treatment of attorney fees – are they deductible and if so, how? – can be tricky.

In short, hiring a tax expert is usually money well spent. This may or may not involve a formal expert role and expert testimony. It might be hiring a tax lawyer or accountant to run some numbers before a mediation session, to run some calculations about the after-tax impact of a likely resolution, or to work up a detailed damage study. It might be to explain and educate the jury about a tax-related investment or the impact of the defendant's actions.

All in all, I'd argue that sometimes tax experts are downright *essential!*



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