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Should You Listen to Tax Advice From Nontax Advisers?

by Robert W. Wood

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In this article, Wood looks critically at tax advice from nontax advisers, the effect of disclaimers, and liability to non-clients.

This discussion is not intended as legal advice.

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Not everyone wants to be a tax specialist. Most lawyers are not tax lawyers (and have no wish to be), nor do they even dabble in tax. And although we think of accountants as preparing tax returns, some of them primarily handle auditing and financial statements. They may not be tax specialists either. Of course, when it comes to taxes, perhaps like sports, everyone claims to know at least something.

Some folks have considerable tax knowledge, perhaps putting some tax professionals to shame. However, some other people who seem to have barely any knowledge of tax law make some of the boldest and most assertive comments about our tax system. In my experience, nontax *lawyers* may be among the worst offenders, but tax gaffes in the form of free advice can come from real estate brokers, bankers, insurance brokers, and various other professionals. If you are the tax adviser in the room, it can be difficult to know how to react, especially if the speaker is forceful, speaks with authority, and commands respect (at least about other topics).

Sometimes a disclaimer precedes a bold tax statement that may not be accurate: "I'm not a tax adviser, but . . ." may introduce a zinger. They may want 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're placing a disclaimer on any advice they'll offer.

Of course, they generally go ahead and offer the tax advice anyway. A lawyer might say, "I'm not a tax lawyer, but I would be shocked if the IRS could tax this recovery." Here are some other ones I've heard:

- "I'm not a tax adviser, but it's obvious that the IRS can't tax the same income twice; that's unconstitutional."
- ". . . but I don't think putting the money in our lawyer/client trust account constitutes constructive receipt."
- ". . . but I'm pretty sure they won't be issuing a Form 1099 for this."
- ". . . but the odds are no one will see this deduction mixed in with everything else."
- ". . . but I have to pay tax on the lawyer's fees I receive, so the IRS can't possibly tax you on the same fees; that would be unconstitutional."
- ". . . but your damages are for emotional distress, and that makes them tax free."
- ". . . but in this circuit, attorney fees are taxed only to the lawyer and not to the client."
- ". . . but 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."

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Mistakes can multiply. In *Stadnyk*,[1] the Sixth Circuit ruled 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] They all turned out to be wrong.

In *Espinoza*,[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 of emotional distress. The Fifth Circuit ruled 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 her income. Similarly, after Espinoza's husband told their CPA that the settlement was for medical costs, the CPA also informed the Espinozas that the settlement would not be taxed. The CPA excluded the settlement when he prepared the couple's income tax return.

There are many other examples of the exculpatory "I'm not a tax adviser, but . . ." remark. Here are some from family lawyers:

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

Here are some from corporate practice:

- " . . . but since you received shares in a new company and didn't get any cash, this is a nontaxable dividend."
- " . . . but 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."
- " . . . but you don't need a business purpose to do a spinoff."

I expect most tax advisers have heard similar disclaimers. It can be surprisingly difficult 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 adviser" preface provide complete immunity?

Do Disclaimers Work?

The answer appears to be mixed. Disclaimers of liability were in vogue under old Circular 230. The ubiquity of email, coupled with the broad ambit of Circular 230, made disclaimers and legends appear on nearly everything[4] with the intent of avoiding potential liability to clients and non-clients.

Especially when we offer guidance about something beyond our ken, it is expected that we apprise the listener of just how far afield from our comfort zone we are. For those uttering "I'm not a tax adviser, but . . ." the same should be true.

However, is the disclaimer actually effective for avoiding liability? In some cases, it may prevent liability from attaching, even to a written communication.[5] For example, in *Mark Twain Kansas City Bank*,[6] a lender was found to be unjustified 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.

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[1] *Stadnyk v. Commissioner*, 367 F. App'x 586 (6th Cir. 2010).

[2] *Id.* at 589.

[3] *Espinoza v. Commissioner*, 636 F.3d 747 (5th Cir. 2011).

[4] *See generally* Charles Rettig, "Practitioner Penalties: Potential Pitfalls in the Tax Trenches," *Tax Notes*, Apr. 13, 2009, p. 207; Crystal Tandon, "Practitioners Demanding Clear Outlines of Circular 230's Scope," *Tax Notes*, Aug. 29, 2005, p. 977; Sheryl Stratton, "Circular 230 E-Mails, T-Shirts Attain 'Legendary' Status," *Tax Notes*, July 4, 2005, p. 48.

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

[6] *Mark Twain Kansas City Bank v. Jackson, Brouillette, Pohl & Kirley PC*, 912 S.W.2d 536 (Mo. Ct. App. 1995).

[7] *See also Banc One Capital Partners Corp. v. Kneipper*, 67 F.3d 1187 (5th Cir. 1995). *But see Kline v. First Western Government Securities Inc.*, 24 F.3d 480 (3d Cir. 1994).

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Example: Lenny Lawyer represents a client in litigation. At the conclusion of the trial, the court ordered that attorney fees be 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 is advising the defendant to write 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. Liability can arise 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]

Clients vs. Non-Clients

Liability to a client for what is said in writing to that client seems unexceptional. But liability to a client for advice outside the practitioner's comfort zone may be stickier. Even more amorphous is the liability of lawyers who provide advice to a person who is not a client. Frequently, these communications are sent to a third party at a client's request.

Not all potential plaintiffs are clients, and that expanded pool of litigants 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. "I'm not a tax adviser but if I were you, I would not report this payment as income" may give rise to liability even though it is a disclaimer. Sometimes the advice is intended to help or advise the attorney's client even though it was sent to someone else; the practitioner and the addressee may even be adversaries. 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.

Clients and Duties

Attorneys generally owe a duty of care to their clients but not to third parties. It is therefore important to distinguish between disclaimers 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. It prevents those not contracting 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*.[10]

In *Winterbottom*, the postmaster general contracted with the defendant to maintain mail coaches. The plaintiff was a postal employee who drove one of the coaches and suffered injuries when it 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 specified in the contract. That duty was owed solely to the postmaster general.

Several decades later, the U.S. Supreme Court introduced the privity of contract doctrine to our side of the Atlantic in *Ward*.[11] In that case, a bank lent money for the purchase of real estate in reliance on a title report prepared by the defendant attorney. The defendant certified title even though the land had previously been sold. Because the defendant was not in privity of contract with the plaintiff, the court denied liability.

Over the first half of the 20th century, the privity of contract doctrine was enforced with little question. Courts and business people found

[8] *See B.L.M. v. Sabo & Deitsch*, 55 Cal. App. 4th 823, 834 (Cal. App. 4th Dist. 1997).

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

[10] *Winterbottom v. Wright*, 152 Eng. Rep. 109 (Ex. 1842).

[11] *Ward*, 100 U.S. at 200.

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it predictable and efficient. Over time, however, the courts eroded the privity doctrine.[12]

One seminal case, *Glanzer*,[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 a 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 despite the lack of 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 by intertwining theories.[15] Commentators have attempted to establish a 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 as an 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]

When Does Liability Attach?

There may be no way to eradicate the "I'm not a tax adviser, but . . ." remark. As long as our tax laws are complicated, we will keep hearing it. This seems especially true because reducing or avoiding taxes seems to be practically an American pastime.

Yet some disclaimers will bring liability to the lawyers who utter them, and possibly even to some non-lawyers. For example, suppose a real estate lawyer is hired by a client to handle real estate deals. He says to his client, "I'm not a tax adviser, but I know we can do a 1031 exchange of your personal residence for a small office building." Let's assume that occasionally in the past this real estate lawyer has advised on this topic. However, there should plainly be liability in this case.

First, the tax advice is plainly wrong. Second, the disclaimer seems intended not as a disclaimer, but to show off the special knowledge of the speaker. Here the disclaiming language makes it sound as if the tax advice is obviously true.

By contrast, the same kind of utterance would surely not result in liability if it were followed by the warning that "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 those incursions should be considered in any later dissection of our actions. So too 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 that "I'm not a tax adviser, but I think all personal living expenses should be deductible." That is surely not meant as advice to anyone and cannot import liability. Isn't that right? I'm not a tax adviser, but it sure seems true to me. How could it be otherwise? ■

[12] *See 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 Telegraph Co.*, 93 Iowa 752 (1895) (telegraph company owes a duty of care to addressee of intended telegraph despite lack of privity).

[13] *Glanzer v. Shepard*, 233 N.Y. 236 (1922).

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

[15] *See 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).

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

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

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

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