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Current Developments in Tax Malpractice: Basics and Beyond

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CURRENT DEVELOPMENTS IN TAX MALPRACTICE: BASICS AND BEYOND

*Jacob L. Todres**

It was always assumed that "tax malpractice" referred to a situation in which an error occurred with respect to some tax provision or in a tax-related administrative or legal proceeding. However, several recent cases have expanded this thinking, introducing the possibility that tax malpractice may also occur where damages include an increase in taxes—irrespective of whether there was an error that directly involved tax law. Beginning with a discussion of the evolving definition of that term as seen in the New York cases of Serino v. Lipper *and* Bloostein v. Morrison Cohen LLP *and whether these cases may have returned New York to its traditional negligence measure of damages in such tax malpractice situations, this Article presents a survey of current developments in the tax malpractice area.*

While the existence of damages is an essential element of a tax malpractice claim, such damages may not become evident until many years after the negligence occurred, at which point the claim may be precluded by the statute of limitations or repose. This Article focuses on several thoughtful litigation strategies attempted by plaintiffs to navigate this dilemma. Also considered is the need for clear scope of engagement agreements between tax practitioners and clients to avoid protracted litigation; but even then, services rendered beyond the scope of engagement may result is a corresponding increase in the practitioner's responsibility. Whether tax practitioners are generally required to anticipate future changes in tax law is addressed. And finally, also reviewed is a recent case that serves as a stark reminder that an egregious breach of the tax practitioner–client relationship may result in the imposition of significant punitive damages.

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INTRODUCTION

This Article focuses on several recent important and noteworthy developments in the tax malpractice area. The most significant conceptually, and the one discussed first in Part I, is the evolving definition of "tax malpractice." It was always simply assumed that tax malpractice referred to a situation where an error occurred with respect to some tax provision or in a tax-related administrative or legal proceeding. Several relatively recent cases open the possibility that tax malpractice may also aptly refer to a situation in which the resulting damages include an increase in taxes, irrespective of whether there was an error that directly involved tax law.

Apart from their possible impact on the meaning of tax malpractice, Part I also focuses on the substantive significance of these cases. These cases hold that additional taxes caused by a tax professional's malpractice are recoverable as damages in New York. These holdings return New York to longstanding tort doctrine and align New York with the majority of states that allow the recovery of additional taxes. Especially noteworthy is that these cases did not follow the path taken by several other relatively recent cases that inexplicably misapplied the fraud measure of damages in tort situations.

Part II focuses on a particularly vexing issue in tax malpractice situations. One of the elements of negligence for tax malpractice is the existence of damages. However, the damages may not become evident until many years after the error occurred, and in some states by then the statute of limitations or repose may have already run, precluding any recovery. In these states, plaintiffs need thoughtful litigation strategies to maintain the viability of such causes of action so that they may preserve the possibility of recovery. Several recent cases that addressed the viability of plaintiffs' attempts to navigate this dilemma are examined.

Part II continues its focus on statutes of limitations, considering a case that could have involved damages in the hundreds of millions of dollars. The determinative factor—which sounds almost inane—was the difference between a contractual and a statutory limitations period.

Whenever a layperson retains any professional—especially an attorney or accountant—the need for a clear and unambiguous agreement concerning the scope of services to be rendered by the professional is beyond any possible doubt. This is especially true when an

attorney or accountant is retained for a tax matter. The danger in not having such an agreement is reflected in several recent cases, one of which, surprisingly, involved a large, well-known, international financial institution and a Wall Street–type law firm. These cases are examined in Part III.

Whether a tax practitioner has an obligation to anticipate changes in the law is examined next in Part IV, based upon a relatively recent, but rather conclusory, Eighth Circuit case applying Minnesota law. Finally, brief attention is also focused in Part IV on an earlier, particularly egregious case of malpractice, where the Supreme Court of Kentucky upheld a punitive damages award of $80 million, roughly four times the amount of compensatory damages.[1]

I. DEFINITION OF TAX MALPRACTICE

Having written in the tax malpractice area for over twenty years and having had an academic interest in the area for much longer, I never imagined there would be a need to define tax malpractice. I always assumed tax malpractice involved an error made in some tax provision of either the Internal Revenue Code, a state, local, or perhaps foreign tax statute or regulation, or some tax-related procedural error like missing a filing deadline or failing to make a timely tax election. I even wrote a lengthy article analyzing the areas in which tax malpractice occurred, all of which involved such tax or tax-related areas or issues.[2] In thinking about tax malpractice, I envision three general areas where malpractice could occur: (1) tax planning;[3] (2) return preparation and filing; and (3) post-return filing work, such as representation before the Internal Revenue Service (IRS), another administrative agency, or in tax litigation. I assumed all these areas either directly involved an error of tax law, some error in a tax proceeding, or tax litigation.

I was very surprised to realize that two relatively recent cases from New York seem to have expanded the definition of tax

1. For an interesting thesis that the tax opinion of transactional tax attorneys provides some type of insurance to clients, see Heather M. Field, *Tax Lawyers as Tax Insurance*, 60 WM. & MARY L. REV. 2111, 2111 (2019).

2. *See* Jacob L. Todres, *Malpractice and the Tax Practitioner: An Analysis of the Areas in Which Malpractice Occurs*, 48 EMORY L.J. 547 (1999).

3. Investing or not investing in a tax shelter is included in this area.

malpractice.[4] Initially, I analyzed these cases as run-of-the-mill tax malpractice situations in which the courts made important jurisprudential points concerning the recovery of additional taxes as damages in New York.[5] Upon reflection, the cases seem to have expanded the definition of tax malpractice to include an increase in taxes caused by any negligence, regardless of whether the error had a tax origin. The facts of a recent California case[6] would also seem to fit within this expanded definition of tax malpractice. Though neither New York case focused on or articulated a definition of tax malpractice, both simply treated a non-tax error that resulted in increased taxes as a tax malpractice situation.[7] Before focusing on these cases, some general background concerning tax malpractice causes of action, in general, and New York's view of the recoverability of additional taxes as damages in such causes of action, in particular, is helpful to understand their contexts.

A. General Background

Usually in a tax malpractice situation, the cause of action asserted against the tax professional— whether attorney or accountant—is a specific application of the tort of negligence.[8] To avoid being negligent, the attorney must act as a reasonably competent and careful attorney would act in similar circumstances.[9] Similar standards apply when the defendant is an accountant, except the comparison is with how a reasonably competent and careful accountant would act in similar circumstances.[10]

The prima facie elements of the negligence cause of action are: (1) a duty owed by the defendant to the plaintiff; (2) breach of that

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4. Serino v. Lipper, 994 N.Y.S.2d 64, 71 (App. Div. 2014); Bloostein v. Morrison Cohen LLP, No. 651242/2012, slip op. at 16 (N.Y. Sup. Ct. Feb. 18, 2019).

5. I briefly commented on these cases in Jacob L. Todres, *Return to Fundamentals? Tax Malpractice Damages—Recovery of Additional Taxes*, 89 N.Y. STATE BAR ASS'N J. 32 (2017) [hereinafter Todres, *Return to Fundamentals?*], and Jacob L. Todres, *Tax Malpractice Damages—Return to Fundamentals—Another Court Gets It Right*, 92 N.Y. STATE BAR ASS'N J. 57 (2020) [hereinafter Todres, *Another Court*].

6. Fairbairn v. Fid. Invs. Charitable Gift Fund, No. 18-CV-04881, 2021 WL 754534, at *1 (N.D. Cal. Feb. 26, 2021).

7. *See Serino*, 994 N.Y.S.2d 63; *Bloostein*, No. 651242/2012, slip op.

8. BERNARD WOLFMAN ET AL., STANDARDS OF TAX PRACTICE § 601.2.1 (6th ed. 2004); *see also* LINDA GALLER & MICHAEL B. LANG, REGULATION OF TAX PRACTICE 299–302 (2d ed. 2004) (tax malpractice actions are generally based on tort—usually negligence—or contract theories).

9. WOLFMAN ET AL., *supra* note 8, § 601.2.1.

10. *Id.* § 601.2.2.

duty; (3) damages suffered by the plaintiff; and (4) proximate causation of the damages by the defendant's breach of duty.[11]

It should be noted that many other asserted causes of action are typically encountered in tax malpractice situations.[12] These include allegations of breach of contract, breach of fiduciary duty, professional malpractice, intentional or negligent misrepresentation, violation of state deceptive trade practices laws or federal securities laws, etc.[13] But generally, the tort of negligence is at the heart of the matter, and only this is addressed in this Article.[14]

Although consequential damages are often sought by injured plaintiffs, the most direct damages encountered in tax malpractice situations consist of additional taxes caused by the malpractice, interest and penalties on the additional taxes, and corrective costs incurred in attempting to eliminate or mitigate the damages resulting from the negligence.[15]

With respect to additional taxes caused by the malpractice, most states—possibly excluding New York[16]—allow the recovery of such amounts.[17] While New York has, or possibly has, a contrary view, this will be ignored for the moment since it will be examined in more detail shortly. It should be emphasized that any such recovery is limited to *additional* taxes caused by the malpractice, not all taxes.[18] For example, assume a taxpayer has long term capital gain of $100,000 that is properly taxable under the federal income tax at a rate of 15 percent. Due to an error, the return preparer reported it as ordinary income subject to a tax rate of 32 percent. If it is no longer possible to file an amended tax return to correct the error, the recoverable taxes will be the additional taxes caused by the malpractice, $17,000 (i.e., (32% minus 15%) x $100,000). The correct tax of $15,000 is not recoverable.[19]

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11. *Id.* § 601.2.1; GALLER & LANG, *supra* note 8, at 299.
12. Jacob L. Todres, *Tax Malpractice Damages: A Comprehensive Review of the Elements and the Issues*, 61 TAX L. 705, 709–10 (2008).
13. *Id.* at 710.
14. *Id.*
15. *Id.* at 712; *see* GALLER & LANG, *supra* note 8, at 304.
16. Loftin v. QA Investments, LLC, No. 03 CVS 16882, 2018 WL 691199, at *12 (N.C. Super. Ct. Feb. 1, 2018).
17. *See, e.g.*, *id.* at *13.
18. *Id.*
19. *Id.*; *see, e.g.*, DDRA Cap., Inc. v. KPMG, LLP, No. 04-0158, 2018 WL 924204, at *6 (D.V.I. Feb. 14, 2018).

There are three views on the recoverability of interest. The majority view is that, if taxes are underpaid and interest is subsequently paid on the late-paid taxes, the interest is recoverable as a direct result of the negligence just like any other damages proximately caused.[20] The minority view prohibits the recovery of interest because the plaintiff-taxpayer had use of the money that should have been paid to the IRS. If the plaintiff-taxpayer were to recover the interest paid to the IRS, he or she would have a windfall of having had interest-free use of the money.[21] A third, intermediate view allows the recovery of any interest differential—that is, the difference between the interest paid to the government and interest earned by the plaintiff on the tax underpayment.[22]

The recovery of any penalties incurred will usually be allowed whenever taxes may be recovered,[23] but they may be limited to foreseeable penalties.[24] Similarly, recovery of mitigation costs seems to be universally recognized and typically noncontroversial.[25] Occasionally, an attempt to recover the cost of an unconventional effort to mitigate damages may require careful consideration.[26]

B. Recoverability of Taxes as Damages in New York

New York is viewed as a state in which additional taxes are not recoverable in a negligence-based tax malpractice cause of action.[27] The primary authority for this view is *Alpert v. Shea Gould Climenko & Casey*.[28] For instance, in *Yung v. Grant Thornton, LLP*,[29] the defendant in a tax malpractice action against an accounting firm argued that taxes, interest, and penalties are not recoverable. The court then stated, "[a]ligned with this view, [defendant] primarily directs this

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20. *Loftin*, 2018 WL 691199, at *13; *see* Todres, *supra* note 12, at 722–31.

21. *Loftin*, 2018 WL 691199, at *13.

22. *Id.*

23. *Id.*; *DDRA Cap.*, 2018 WL 924204, at *6; Todres, *supra* note 12, at 731–33.

24. *See DDRA Cap.*, 2018 WL 924204, at *7–8.

25. *See* Todres, *supra* note 12, at 733–36.

26. In *Porter v. Ogden, Newell & Welch*, the plaintiff sought recovery for the cost of lobbying the Florida legislature to change its laws so as to eliminate a potential problem created in a trust drafted by the defendants. 241 F.3d 1334, 1337 (11th Cir. 2001).

27. *See, e.g.*, *Loftin,* 2018 WL 691199, at *12; *DDRA Cap*, 2018 WL 924204, at *5; Yung v. Grant Thornton, LLP, 563 S.W.3d 22, 57–58 (Ky. 2018).

28. 559 N.Y.S.2d 312 (App. Div. 1990).

29. 563 S.W.3d 22 (Ky. 2018).

Court to *Alpert*."[30] Similarly, in *Loftin v. QA Investments, LLC*,[31] in the course of deciding whether additional taxes are recoverable in a professional negligence cause of action in North Carolina, the court examined the law in other jurisdictions. In its analysis the court stated, "[the defendant] relies heavily on New York's minority rule that back taxes are never recoverable."[32] The court then cited *Alpert*.[33]

While *Alpert* does hold that taxes are not recoverable, the problem is that it involved a fraud cause of action, not a negligence cause of action.[34] Under traditional New York law there are very different measures of damages in fraud and negligence causes of action, with fraud damages being much narrower.[35]

The most recent reiteration by the New York Court of Appeals of the state's traditional fraud measure of damages, the "out-of-pocket" rule, is contained in *Lama Holding Co. v. Smith Barney Inc.*[36]:

> In an action to recover damages for fraud . . . "[t]he true measure of damage is indemnity for the actual pecuniary loss sustained as the direct result of the wrong" or what is known as the "out-of-pocket" rule. Under this rule, the loss is computed by ascertaining the "difference between the value of the bargain which a plaintiff was induced by fraud to make and the amount or value of the consideration exacted as the price of the bargain." Damages are to be calculated to compensate plaintiffs for what they lost because of the fraud, not to compensate them for what they might have gained. Under the out-of-pocket rule, there can be no recovery of profits which would have been realized in the absence of fraud.
>
> . . . .
>
> Nor does the out-of-pocket rule allow for recovery of the payment of taxes, couched as consequential damages or

30. *Id.* at 57.
31. No. 03 CVS 16882, 2018 WL 691199 (N.C. Super. Ct. Feb. 1, 2018).
32. *Id.* at *12.
33. *Id.* The court also cites *Gaslow v. KPMG LLP*, 797 N.Y.S.2d 472, 473 (App. Div. 2005). However, *Gaslow* is a conclusory two paragraph opinion that seems to involve primarily a fraud cause of action. *Gaslow*, in turn, cites only *Alpert* and another fraud case, *Lama Holding Co. v. Smith Barney*, 668 N.E.2d 1370 (N.Y. 1996).
34. Alpert v. Shea Gould Climenko & Casey, 559 N.Y.S.2d 312, 314 (App. Div. 1990).
35. *See* Jacob L. Todres, *New York's Law of Tax Malpractice Damages: Balanced or Biased*, 86 ST. JOHN'S L. REV. 143, 160–70 (2012).
36. 668 N.E.2d 1370 (N.Y. 1996).

> otherwise. This case is similar to *Alpert v. Shea Could Climenko & Casey* . . . .[37]

This fraud measure of damages goes back over a century.[38]

New York's traditional negligence measure of damages is broader than the fraud measure of damages, allowing an injured plaintiff to recover his or her expectancy.[39] This measure of damages also has roots going back more than one hundred years. In *Flynn v. Judge*,[40] the plaintiffs were removed as executors and trustees of their father's estate. They sued their attorney for damages, claiming his negligent advice caused them to lose their positions and the related income.[41] In reviewing the lower court's dismissal of the plaintiffs' causes of action, New York's Second Department held: "the measure of damages is the difference in the pecuniary position of the client from what it should have been had the attorney acted without negligence."[42] Quoting from a contemporary treatise, the court added, "the plaintiff is entitled to be in the same position as if the attorney had done his duty."[43]

In 1990, the New York Court of Appeals addressed the proper measure of damages in an attorney malpractice situation.[44] In addressing the measure of damages, the majority of the court held "[t]he object of compensatory damages is to make the injured client whole. Where the injury suffered is the loss of a cause of action, the measure of damages is generally the value of the claim lost."[45] While the majority's opinion is not specific about what it means to make the injured client "whole," the concurrence by Judge Kaye is much more explicit:

> In lawyer malpractice cases, as in all negligence cases, the focus in damages inquiries must be on the injured plaintiff . . . the objective being to put the injured plaintiff in as good a position as she would have been in had there been no breach of duty.[46]

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37. *Id.* at 1373–74 (citations omitted).
38. *See* Reno v. Bull, 124 N.E. 144 (N.Y. 1919); Hotaling v. A.B. Leach & Co., 159 N.E. 870 (N.Y. 1928); Sager v. Friedman, 1 N.E.2d 971 (N.Y. 1936).
39. *See* Todres, *supra* note 35, at 166–70.
40. 133 N.Y.S. 794 (App. Div. 1912).
41. *Id.* at 794.
42. *Id.* at 796.
43. *Id.*
44. Campagnola v. Muholland, 555 N.E.2d 611 (N.Y. 1990).
45. *Id.* at 613.
46. *Id.* at 615.

While not citing *Flynn*, the measure of damages is clearly the *Flynn* measure of damages.[47]

A subsequent lower court decision involving attorney malpractice spells out what it means to make an injured party whole: "damages for malpractice are also limited to pecuniary loss—i.e., the difference between the actual result achieved and that which should have been accomplished, and the financial loss thereby sustained."[48]

Under the negligence measure of damages, avoidable additional taxes seem to be recoverable, while they do not seem to be recoverable under the fraud measure of damages. *Alpert*, a fraud case, explains why they are not recoverable in fraud damages.

In *Alpert*, the plaintiffs invested in a tax shelter the main attraction of which was the immediate deduction of advance royalty payments for the right to mine coal in the future.[49] The shelter turned out to be invalid.[50] As a result, the plaintiffs paid substantial back taxes and interest.[51] They sought recovery of these amounts from the defendant attorneys who opined the shelter was valid.[52] They also sought to recover lost profits and the tax benefits they would have obtained had they instead invested in a valid tax shelter.[53] The asserted cause of action in *Alpert* was for fraudulent misrepresentation—i.e., fraud.[54]

The lower court granted the defendants' motion for partial summary judgment dismissing the plaintiffs' claim for back taxes.[55] In affirming this portion of the lower court's opinion, *Alpert* held:

> The IAS court was correct in rejecting plaintiffs' damage claims for back taxes. The recovery of consequential damages naturally flowing from a fraud is limited to that which is necessary to restore a party to the position occupied before commission of the fraud. . . . [I]n the instant case, recovery of back taxes would place plaintiffs in a better position than had they never invested in the [tax shelter].

47. *See Flynn*, 133 N.Y.S. at 796.
48. Sanders v. Rosen, 605 N.Y.S.2d 805, 810 (Sup. Ct. 1993).
49. Alpert v. Shea Gould Climenko & Casey, 559 N.Y.S.2d 312, 313 (App. Div. 1990).
50. *Id.*
51. *Id.*
52. *Id.* at 314.
53. *Id.*
54. *Id.*
55. *Id.*

> It is also well settled that the victim of fraud may not recover the benefit of an alternative agreement overlooked in favor of the fraudulent one. Hence, plaintiffs' argument that but for the fraud they would have invested in some other tax shelter must fail.[56]

As is evident, the *Alpert* court is clearly addressing the fraud measure of damages and is simply adhering to the traditional New York fraud measure of damages. When the New York Court of Appeals later restated the out-of-pocket fraud measure of damages in *Lama Holding*, it cited *Alpert* with approval.[57]

The intriguing question is how traditional New York jurisprudence became so upended that New York's negligence measure of damages is being defined by reference to *Alpert*, an inapplicable fraud case.

As I argued previously,[58] the answer seems to be that between 2007 and 2014, several cases[59] simply, and unthinkingly, applied *Alpert*'s fraud measure of damages to negligence causes of action. I imagine these courts viewed *Alpert* simply as a tax malpractice case that defined the scope of recoverable damages in all tax malpractice situations. The courts never focused on New York's traditional difference between the fraud and negligence measures of damages. For instance, *Menard M. Gertler, M.D., P.C. v. Sol Masch & Co.*[60] involved an action for professional malpractice by an accountant. The opinion never mentioned fraud. In affirming the trial court's verdict dismissing the complaint, New York's First Department, citing only *Alpert*, held: "taxes . . . are not recoverable under New York law."[61] While the *Gertler* court said so, there simply was no such rule in the negligence area.

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56. *Id.* at 314–15 (citations omitted). It should be noted that *Alpert* also established that interest on a tax underpayment is not recoverable in New York. *Id.* at 315; *see* Todres, *supra* note 35, at 179.

57. Lama Holding Co. v. Smith Barney Inc., 668 N.E.2d 1370, 1374 (N.Y. 1996).

58. *See* Todres, *Another Court*, *supra* note 5, at 58; Todres, *Return to Fundamentals?*, *supra* note 5, at 33–34; Todres, *supra* note 35, at 171.

59. *See, e.g.*, Menard M. Gertler, P.C. v. Sol Masch & Co., 835 N.Y.S.2d 178 (App. Div. 2007); Chen v. Huang, No. 3847/12, slip op. at *2 (N.Y. Sup. Ct. Mar. 14, 2014); Solin v. Domino, No. 08 Civ. 2837(SCR), 2009 WL 536052 at *3 (S.D.N.Y. Feb. 25, 2009), *aff'd*, 501 Fed. App'x. 19 (2d Cir. 2012); Apple Bank for Savs. v. PricewaterhouseCoopers, LLP, No. 603492/06, 2009 WL 1363026 at *7 (N.Y. Sup. Ct. Apr. 14, 2009), *rev'd on other grounds* 895 N.Y.S.2d 361 (App. Div. 2010) (lower court relied on *Alpert*, but limited it).

60. 835 N.Y.S.2d 178 (App. Div. 2007).

61. *Id.* at 178 (citation omitted).

Similarly, in *Solin v. Domino*,[62] a federal district court sitting in diversity and applying New York law simply applied the fraud out-of-pocket rule as the measure of damages for a negligence and malpractice cause of action.[63] On appeal, the Second Circuit affirmed, relying on fraud precedent—i.e., *Lama Holding* and *Gertler*.[64]

Chen v. Huang[65] involved an allegation by the plaintiff that the defendant attorney failed to effectuate a valid exchange of properties under Internal Revenue Code (IRC) section 1031 despite undertaking to do so.[66] As a consequence, the plaintiff was unable to defer immediate recognition of gain incurred on the property given up in the exchange.[67] Causes of action were asserted for breach of contract, breach of fiduciary duty, and malpractice.[68] Notably, not for fraud! The court upheld the defendant's assertion that taxes are not recoverable as damages in New York. As authority, the court relied upon *Gertler*, *Alpert*, and *Lama Holding*.[69] *Alpert* and *Lama Holding* are fraud cases. While *Gertler* was a negligence case, it contained no reasoning, just a conclusory and incorrect reliance on *Alpert*.

Alpert's holding that taxes may not be recovered as damages in a fraud cause of action is correct under traditional New York fraud jurisprudence. However, its unexplained, and seemingly unthinking, extension to negligence causes of action is perplexing.

C. Serino *and* Bloostein *Cases*

When both *Serino v. Lipper*[70] and *Bloostein v. Morrison Cohen LLP*[71] were decided, New York law on the issue of whether additional taxes caused by a tax professional's negligence are recoverable was, as described, very confusing. However, both cases finally seemed to

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62. No. 08 Civ. 2837(SCR), 2009 WL 536052 at *3 (S.D.N.Y. Feb. 25, 2009).

63. *Id.* at *3.

64. Solin v. Domino, No. 11-2514, 501 F. App'x 19 (2d Cir. 2012).

65. No. 3847/12, slip op. (N.Y. Sup. Ct. Mar. 31, 2014).

66. *Id.* at 1.

67. *Id.* at 3. Normally when property is disposed of, gain or loss is immediately recognized under the Internal Revenue Code. I.R.C. §§ 61(a)(3), 165(a). However, if there is a valid exchange of properties under I.R.C. section 1031, there is no immediate gain or loss recognition, such recognition being deferred until the replacement property is disposed of.

68. *Chen*, slip op. at 2. The court ultimately dismissed the breach of contract and breach of fiduciary duty causes of action as being duplicative of the legal malpractice cause of action. *Id.* at 5.

69. *Id.* at 3.

70. 994 N.Y.S.2d 64 (App. Div. 2014).

71. No. 651242/2012, slip op. (N.Y. Sup. Ct. Feb. 18, 2019).

correctly apply the traditional New York law and hold that *Alpert* was not determinative of the negligence measure of damages. Initially, I viewed both cases as run-of-the-mill tax malpractice situations that properly recognized the misapplication of *Alpert*'s fraud measure of damages in the negligence arena. However, apart from this long overdue and welcome examination of *Alpert* and traditional New York law on the fraud and negligence measures of damages, upon closer examination, I believe each court has expanded the definition of tax malpractice.

I previously described *Serino* as follows:

> *Serino* arose from alleged malfeasance by the auditor, PricewaterhouseCoopers (PWC), of an investment company and its hedge funds in not detecting the overvaluation by at least $130 million of securities owned by the hedge funds. *Serino* involved cross claims by the owner of the investment company, Lipper, against PWC arising from the overvaluation.
>
> In addition to performing services for the investment company and the hedge funds involved, PWC also prepared Lipper's personal tax returns and provided him with personal financial advice, for which Lipper personally paid. One of the claims asserted was that in rendering personal advice to Lipper, PWC utilized the inflated value of the hedge funds' securities, thereby overstating Lipper's net worth. Relying on the inflated values, in connection with his divorce, Lipper agreed to make certain gifts to his daughters, and incurred more than $6 million in gift taxes. One of the cross claims asserted by Lipper against PWC was to recover the gift taxes paid. Causes of action for recovery of the gift taxes were asserted in fraud, negligence/malpractice, breach of contract, breach of fiduciary duty and negligent misrepresentation.
>
> In reversing the lower court's dismissal of all asserted causes of action for the recovery of the gift taxes, the First Department held that recoupment of taxes paid under the fraud and negligent misrepresentation claims was barred by New York's out-of-pocket damages rule. However, the court went on to hold that the out-of-pocket damages rule did not bar the recovery of such damages in connection with the

> cross claims for negligence/malpractice, breach of contract or breach of fiduciary duty. The court thus properly distinguished negligence/malpractice damages from the more limited fraud out-of-pocket measure of damages and held that additional gift taxes paid may be recovered in negligence/malpractice causes of action.[72]

At the heart of the cross claim the First Department reinstated in *Serino* is the claim by Lipper that had he known his true net worth rather than the inflated number presented by PWC, he would not have elected to make the gifts to his daughters that caused him to incur over $6 million in gift tax.[73] The error here is purely one of valuation. There is no direct tax advice error. As such, the implicit assumption by the court seems to be that so long as there is additional tax incurred, it is a tax malpractice situation. It should be noted that the court never explicitly mentioned "tax malpractice" in the opinion.[74] However, *Serino* did focus on the additional gift taxes paid as potentially recoverable damages and cited several tax malpractice cases in its discussion of this issue.[75] The court also specifically focused on the anomaly in the law of tax malpractice damages and correctly distinguished between the fraud and negligence/malpractice measures of damages.[76]

As with *Serino*, at the heart of the case, *Bloostein* also involved a non-tax error as the alleged negligence.[77] Without noting that the negligence did not directly involve any tax law, the court simply treated the matter as a tax malpractice situation and, after detailed analysis, declined to accept the defendant's argument that, based on *Alpert*, taxes may not be recovered as damages in New York.[78] *Bloostein* is complex both factually and procedurally. The plaintiffs were the owners of small- to mid-sized businesses who hired the defendant law firm, Morrison Cohen LLP, and its attorney Brian Snarr to represent them in connection with a structured transaction that was a tax

72. Todres, *Return to Fundamentals?*, *supra* note 5, at 35.

73. *Serino*, 994 N.Y.S.2d. at 68.

74. *Id.* at 66–71.

75. *Id.*at 70–71. The court cited *Gaslow v. KPMG LLP*, 797 N.Y.S.2d 472, 473 (App. Div. 2005) and *Fielding v. Kupferman*, 885 N.Y.S.2d 24, 28 (App. Div. 2009). *Serino*, N.Y.S.2d at 70–71.

76. *Serino,* N.Y.S.2d at 71.

77. *See* Bloostein v. Morrison Cohen LLP, No. 651242/2012, slip op. at 4 (N.Y. Sup. Ct. Feb. 18, 2019).

78. *Id.* at 1–2.

shelter.[79] The tax savings sought were not realized and the ultimate issue was whether the plaintiffs could recover the lost tax savings from the defendants.[80] The defendants moved for summary judgment to dismiss the claims based on *Alpert*.[81]

The transaction involved in *Bloostein* was a variation on an IRC section 1042 transaction.[82] A simple section 1042 transaction involves the owner of a corporation that has no outstanding securities that are publicly traded.[83] The shareholder sells some of his shares to the corporation's employees through the corporation's employee stock ownership plan (ESOP).[84] The shareholder then reinvests the proceeds in qualified replacement property (QRP) of his choice.[85] Any long term capital gains on the sale of the corporation's stock to the ESOP will be subject to tax only when the QRP is sold.[86] If less than the entire proceeds are reinvested, any excess is subject to immediate taxation.[87] As a result, the original shareholder has diversified his investment in his corporation's securities without incurring any immediate tax. However, the owner has not gained any liquidity, unless he did not reinvest all the proceeds in the QRP and incurred some immediate tax.

The transaction involved in *Bloostein* was promoted by Stonebridge Capital and designed to enable the corporate shareholder to obtain liquidity by borrowing funds indirectly secured by the QRP.[88] Stonebridge formed Stonebridge Trust, which borrowed funds from Nomura International PLC.[89] These funds in turn were re-lent to an LLC formed by each plaintiff–business owner.[90] The LLC used the borrowed funds and additional funds contributed by the owner to purchase the QRP.[91] The QRP was pledged as security for the loan from

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79. *Id.*

80. *Id.* One of the plaintiffs, Bloostein, managed to avoid losing his tax savings by finding substitute financing. He was seeking to recover the additional costs incurred in connection with the substitute financing. *Id.* at 15–16. For ease of discussion, he will be ignored, and the discussion will assume all plaintiffs were seeking to recover their additional taxes as damages.

81. *Id.* at 8.

82. I.R.C. § 1042(a).

83. *Id.*

84. *Id.* § 1042(b)(1)(A).

85. *Id.* § 1042(d).

86. *Id.* § 1042(e).

87. *Id.*

88. Bloostein v. Morrison Cohen LLP, No. 651242/2012, slip op. at 2 (N.Y. Sup. Ct. Feb. 18, 2019).

89. *Id.*

90. *Id.*

91. *Id.*

Stonebridge Trust, which, in turn, pledged the LLC's notes secured by the QRP to Nomura.[92] The QRP was required to be insured by an insurance company and to maintain a minimum Moody's credit rating.[93]

Several days before the closing of the transactions, there was a change in one of the events of default under the loan agreement with Nomura.[94] The original provision provided that if the credit rating of any bond that was included as QRP fell below a certain Moody's rating, the loan could be called.[95] This provision was revised to provide that there would be a default if the Moody's credit rating of either the bonds or the insurance company insuring the bonds fell below the required minimum rating.[96] The defendant attorney agreed to the change without informing any of the plaintiffs. Sure enough, shortly after the transactions closed, the Moody's rating of the insurance company, but not of the bonds,[97] fell below the required level and Nomura exercised its right to call in the loan.[98] This caused a sale of all the QRP bonds that were the ultimate security for the Nomura loans.[99] This, in turn, caused the plaintiffs to lose the tax deferral that was the purpose of the entire plan and to incur immediate, large capital gains taxes.[100]

While the *Bloostein* court correctly analyzed whether additional taxes may be recovered in a negligence-based malpractice situation, interestingly, as in *Serino*, the court never focused on the fact that the alleged negligence (agreeing to the revised default provision) did not involve any tax or tax-related error.[101] Though the damages incurred involved additional taxes, the error was purely a matter of contract—a change in what constitutes a default under the loan agreement.[102]

Another similar scenario in which a non-tax error could result in additional taxes is illustrated by *Fairbairn v. Fidelity Investments Charitable Gift Fund*.[103] In *Fairbairn*, the plaintiffs donated

92. *Id.*
93. *Id.* at 3.
94. *Id.*
95. *Id.*
96. *Id.* The revised event of default provision was not drafted very clearly. Defendant Snarr believed it was unenforceable. *Id.* at 4. However, the provision was upheld in a separate litigation. *See* Stonebridge Cap., LLC v. Nomura Int'l. PLC, 891 N.Y.S.2d 56, 58 (App. Div. 2009).
97. *Bloostein*, slip op. at 8.
98. *Id.* at 4.
99. *Id.*
100. *Id.*
101. Serino v. Lipper, 994 N.Y.S.2d 64, 68 (App. Div. 2014).
102. *Id.*
103. No. 18-CV-04881, 2021 WL 754534 (N.D. Cal. Feb. 26, 2021).

approximately 1.93 million shares of stock in a small company, Energous, to their donor advised fund[104] at Fidelity, the defendant.[105] The defendant sold all 1.93 million Energous shares in 2.5 hours on December 29, 2017, the last trading day of the year.[106] The plaintiffs alleged that the defendant was negligent (and also breached certain representations it made to the plaintiffs) in selling all the shares in one day, thereby depressing the price of the stock, instead of spreading the sale over several days.[107] This resulted in reducing both the amount available for distribution to qualified charities and the plaintiffs' charitable contribution deduction,[108] which was based on the average share price of the stock on the day of the donation.[109] Although the court held the defendant's actions in selling all the shares of stock on one day likely did depress the share's price,[110] it nevertheless held that Fidelity did nothing wrong and rendered judgment in its favor.[111]

However, in this type of situation, if a defendant was negligent in selling such a large block of stock in one day or was negligent in some other way in disposing of donated stock, thereby reducing the donor's charitable contribution deduction, could this be treated as a tax malpractice situation? As in *Serino* and *Bloostein*, this involves a non-tax error that has negative tax repercussions.

II. STATUTE OF LIMITATIONS

A. *Ripeness to Litigate Versus Accrual of Statute of Limitations*

In deciding when to commence a tax malpractice litigation, as in many other life situations, timing is crucial. It is necessary to wait long

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104. The court defines a donor advised fund as:

> [A] special type of financial account that individuals open at a [§] 501(c)(3) nonprofit organization that has usually been created by a for-profit financial institution. When donors contribute to their DAF account, the nonprofit organization takes legal title to the assets, but the donors retain the right to advise how the donated funds are invested and ultimately distributed to charitable organizations. A DAF enables a donor to get an immediate tax deduction but defer the actual donation of the funds to individual charities until later.

Id. at *2.

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at *4.

110. *Id.* at *11.

111. *Id.* at *12.

enough until all the elements of the cause of action exist and the claim is ripe for adjudication but not to wait so long that the statute of limitations expires or a statute of repose bars the claim. If the litigation is instituted prematurely, it likely will be dismissed for either failing to state a cause of action or for not yet being ripe for adjudication.[112] Waiting so long that the statute of limitations or repose runs will preclude any possibility of obtaining redress for the injury suffered. In the tax malpractice area, navigating the time constraints is especially difficult because of the inherent uncertainty around both when a cause of action is ripe and when the statute of limitations or repose starts running.[113] If multiple states are involved and there is also a need to determine which of the states' choice of law provisions govern, the uncertainty is magnified.[114]

With respect to when a tax malpractice cause of action is ripe for adjudication, it should be recalled that the cause of action for malpractice is usually a specific application of the negligence tort. One of the elements of this cause of action is damages.[115] Frequently, the existence (and certainly the precise amount) of damages incurred may not become known for an extended period.[116] For instance, even for a relatively common negligent error made on an annual tax return, the error and damages may not become known for many years. Assuming the tax return is the annual federal tax return, the return likely will not be audited until one to two years after filing. Protracted discussions or negotiations with the IRS may ensue. Eventually, unless the case is settled, there will be a final IRS determination of the amounts owed. At this point, before payment, litigation in the Tax Court is possible. Alternatively, the amount may be paid, followed by a suit for refund in federal district court or the United States Court of Claims. Regardless of where litigated, appeals may follow. For instance, in *Head v. Gould Killian CPA Group, P.A.*,[117] the final amounts of tax due for the

112. See, for example, *Bobo v. Frost*, No. 1:17cv227, 2018 WL 9945015 (S.D. Miss. 2018), in which the defendant moved to dismiss the complaint in an accountant's malpractice case involving errors on various tax returns on the grounds of lack of federal subject matter jurisdiction because the case was not ripe for review due to there being no final IRS determination of the amount due.

113. *See* GALLER & LANG, *supra* note 8, at 309–10.

114. *See id.* at 310–11.

115. *See* WOLFMAN ET AL., *supra* note 8, § 601.2.1; GALLER & LANG, *supra* note 8, at 299.

116. *See, e.g.*, Head v. Gould Killian CPA Grp., 812 S.E.2d 831 (N.C. 2018).

117. 812 S.E.2d 831 (N.C. 2018).

2006 through 2009 tax years were finally resolved in late 2012.[118] And *Head* did not involve any litigation over the amounts due.[119]

If, instead of a tax return error, the error involved the structuring of a transaction or estate plan, the error itself may not be discovered (or discoverable) for many years.

It seems obvious and most appropriate that the statute of limitations and the statute of repose should not start to run until the underlying cause of action is ripe for filing.[120] However, just because this seems so logical does not mean it generally is correct. Initially, "there is very little meaningful case law on when such actions are ripe."[121] Also, it has been suggested that, since statutes of limitations and repose are governed by statutory law (subject to tolling by judicial doctrines) and the ripeness doctrine is entirely judicial, the ripeness doctrine does not necessarily correlate with the statute of limitations.[122]

Apart from the lack of correlation, when the statute of limitations (and probably also the statute of repose) commences to run varies widely among states.[123] It can start at the time of breach, when the breach is discovered (or discoverable), or when an actual injury is suffered.[124] I previously noted "the statute of limitations can commence as early as when the faulty tax advice is given and as late as when a final settlement is reached with the IRS or even after litigation is completed; a span that could easily cover many years."[125]

Although there are exceptions,[126] there generally does not seem to be any linkage of the accrual of the statute of limitations with when a malpractice case may first be brought. While elements necessary for ripeness may still be pending, the statute of limitations may already have commenced running. For instance, in *Aaron v. Deloitte Tax*

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118. *Id.* at 833.

119. *See id.*

120. *See, e.g.*, Khan v. BDO Seidman, LLP, 948 N.E.2d 132, 169–73 (Ill. App. Ct. 2011) (statutes of limitations and repose accrue when the tax is assessed or there is a settlement); CDT, Inc. v. Addison, Roberts & Ludwig, C.P.A., P.C., 7 P.3d 979, 985–86 (Ariz. Ct. App. 2000) (statute of limitations accrues when tax is assessed).

121. GALLER & LANG, *supra* note 8, at 311; *see* Jay A. Soled, *Tax Shelter Malpractice Cases and Their Implications for Tax Compliance*, 58 AM. U. L. REV. 267, 320–21 (2008).

122. GALLER & LANG, *supra* note 8, at 311.

123. *Id.* at 309–10.

124. *Id.* at 309.

125. Jacob L. Todres, *Investment in a Bad Tax Shelter: Malpractice Recovery from the Tax Advisor Is No Slam-Dunk*, 107 TAX NOTES 217, 225 (2005).

126. *See, e.g.*, Khan v. BDO Seidman, LLP, 948 N.E.2d 132, 169–73 (Ill. App. Ct. 2011); CDT, Inc. v. Addison, Roberts & Ludwig, C.P.A., P.C., 7 P.3d 979, 985–86 (Ariz. Ct. App. 2000).

LLP,[127] the court held the statute of limitations for a cause of action against an accountant for crafting an estate plan began to run on the date the taxpayer signed the last document that was part of the estate plan.[128] This follows New York's very rigid view that malpractice claims arising from faulty tax advice accrue when the advice is given, even if no injury is yet obvious:

> A malpractice cause of action sounds in tort and, therefore, absent fraud, accrues when an injury occurs, even if the aggrieved party is then ignorant of the wrong or injury. . . .
>
> In the context of a malpractice action against an accountant, the claim accrues upon the client's receipt of the accountant's work product since this is the point that a client reasonably relies on the accountant's skill and advice and, as a consequence of such reliance, can become liable for tax deficiencies.[129]

Although the *Ackerman v. Price Waterhouse*[130] court went on to state, "[t]his is the time when all the facts necessary to the cause of action have occurred and an injured party can obtain relief in court,"[131] it seems quite unlikely that any plaintiff would be aware of the existence of a cause of action at this time. In *Aaron*, if the testator had not died shortly after the estate plan was effectuated, the problems with the plan and certainly the existence of any damages would likely have remained unknown for an extended period. Even when the testator died within seven weeks of completion of the last estate plan transaction (March 13, 2009),[132] the initial IRS Notice of Deficiency was served over four years later (May 2013),[133] and a final settlement was approved by the Tax Court over six years later (July 2015).[134]

Starkly, the possibility that a plaintiff may not even become aware of the existence of a cause of action until the limitation period has run is the law in North Carolina. In *Carle v. Wyrick, Robbins, Yates &*

127. 50 N.Y.S.3d 279 (App. Div. 2017).
128. *Id.* at 280; *see infra* Section III.B.
129. Ackerman v. Price Waterhouse, 644 N.E.2d 1009, 1012 (1994) (citations omitted).
130. 644 N.E.2d 1009 (1994).
131. *Id.* at 1012.
132. Aaron v. Deloitte Tax LLP, No. 653203/2015, 2016 WL 4430495, at *5 (N.Y. Sup. Ct. Aug. 11, 2016).
133. *Id.* at *5–6.
134. *Id.* at *6.

Ponton, LLP,[135] the issue was whether a claim for legal malpractice was barred under North Carolina law.[136] North Carolina has both a two-year statute of limitations with a discovery rule that could extend the statute of limitation by one year and a statute of repose expiring four years "from the last act of the defendant giving rise to the cause of action."[137] In describing how absolute and unyielding the statute of repose is, the court stated:

> "This statute creates, among other things, a statute of repose which is not measured from the date of injury, but [from] the date of the last act of the defendant giving rise to the cause of action or from substantial completion of some service rendered by defendant."
>
> "Regardless of when plaintiffs' claim might have accrued, or when plaintiffs might have discovered their injury because of the four-year statute of repose, their claim is not maintainable unless it was brought within four years of the last act of defendant giving rise to the claim." Continued representation after the last act giving rise to the claim does not toll or extend the statute of repose. . . . "If the action is not brought within the specified period, the plaintiff literally has *no* cause of action. The harm that has been done is *damnum absque injuria*—a wrong for which the law affords no redress."[138]

In *Head*, the court—relying on the same cases as cited in *Carle* in the quote above—affirmed this unyielding nature of the statute of repose.[139] The court stated the statute of repose "serves as an unyielding and absolute barrier that prevents a plaintiff's right of action even before his cause of action may accrue."[140]

The dire consequences of missing the statute of limitations or repose deadline undoubtedly encourage plaintiffs to commence actions earlier rather than later. A leading textbook observes that such "malpractice actions—particularly in the tax shelter area—have clearly

135. 738 S.E.2d 766 (N.C. Ct. App. 2013).
136. *See id.* at 771.
137. N.C. GEN. STAT. § 1-15(c) (2022).
138. *Carle*, 738 S.E.2d at 770 (citations omitted).
139. Head v. Gould Killian CPA Grp., 812 S.E.2d 831, 838 (N.C. 2018).
140. *Id.*

been filed sometimes before they seem to be ripe."[141] The authors then suggest that the uncertainty surrounding the applicable statute of limitations and how it applies is likely a major reason for the premature filings.[142] The authors also suggest that the premature filing may be necessary to enable discovery, which could be used to determine the facts needed to establish more precisely when the statute of limitations will begin to run and whether tolling may be available.[143] In any event, this is an area that requires careful attention by plaintiffs' counsel.

In re Shulman[144] illustrates a plaintiff's attempt to navigate these issues in Texas. The tax issue in *Shulman* involved a divorce between spouses who jointly owned a Bahamas corporation.[145] A settlement agreement between the parties provided the corporation would transfer a house and $1.645 million to the wife.[146] The means of transfer were not specified in the agreement, though a nontaxable transfer was contemplated.[147] If the transfer turned out to be taxable by either the United States or the Bahamas, the wife, Georgia, was to pay the tax.[148] After signing the settlement agreement, Georgia hired defendant attorney Shulman to provide tax advice.[149] Shulman believed the transfer of the property to Georgia might be taxable.[150] He also concluded that a stock redemption seemed the most logical way to characterize the transfer.[151] Georgia did not accept or follow Shulman's advice.[152] She retained another attorney who suggested a different approach to avoid creating a taxable event.[153]

The divorce was finalized in February 2014 and incorporated the settlement agreement.[154] An arbitration between Georgia and her husband ensued in which the principal issue was the means by which the house and cash would be transferred.[155] At the arbitration, Shulman

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141. GALLER & LANG, *supra* note 8, at 312.
142. *Id.*
143. *Id.*
144. 544 S.W.3d 861 (Tex. App. 2017).
145. *Id.* at 865.
146. *Id.*
147. *Id.*
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.*

appeared as part of the husband's team.[156] Ultimately, the arbitrator ruled the transfer was to be by a stock redemption agreement.[157] The court adopted the arbitrator's award and ordered Georgia to sign the stock redemption agreement, which she did in January 2015.[158] For 2014, Georgia filed an income tax return in which she took the position that the transfer was not a taxable event.[159]

Georgia filed this lawsuit against Shulman in 2016 asserting a number of claims in addition to legal malpractice.[160] The causes of action were based on allegations that defendant Shulman provided negligent tax planning advice[161] and acted against Georgia's interest by advising her husband.[162] Georgia's suit sought recovery for approximately $1.6 million of additional federal taxes she thought she was exposed to plus other costs and expenses.[163] When the suit was instituted, and even at the date of the court's opinion, the IRS had not assessed any tax or even sent a deficiency notice concerning the property transfer.[164]

Shulman filed a motion for summary judgment seeking to dismiss the action on several different grounds.[165] Two days later, Georgia moved to abate her lawsuit until either the IRS assessed taxes on the property transfer or until the statute of limitations barred it from doing so, which would occur on August 15, 2021.[166]

The reason for the abatement was to prevent Georgia from having to take inconsistent positions in different venues.[167] To be successful

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156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.* at 866.

160. *Id.*

161. The court's opinion in its discussion of whether the case was ripe for litigation noted the questionable nature of the bad tax advice claim, since Georgia had already signed the marital settlement agreement before retaining Shulman and did not take Shulman's advice after hiring him. *Id.* at 872.

162. *Id.* at 866.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.* at 868. It should be noted that when a plaintiff in a tax malpractice situation commences the tax malpractice litigation before final resolution of the tax claim, the plaintiff faces a very difficult dilemma. In the malpractice forum, the plaintiff needs to argue that additional taxes are owed. *See id.* In the tax forum (whether judicial or administrative) the plaintiff needs to argue that no additional taxes are owed. *Id.* Plaintiff is in the untenable position of simultaneously arguing inconsistently in different forums. *See id.* (citing Murphy v. Campbell, 964 S.W.2d 265, 272 (Tex. 1997)).

in her malpractice suit against Shulman, she would need to prove she owed additional taxes, while in a proceeding with the IRS, she would argue she did not owe any additional taxes.[168] The trial court granted the abatement.[169] Shulman then moved for mandamus to reverse the abatement order.[170]

The Texas Court of Appeals reversed the abatement for several reasons. The court held that a four-year abatement was too long.[171] Four years was "an extraordinary length of time to require a party to await resolution of claims and defenses that have been substantially discovered and presented to the court by summary judgment motion."[172] Such a long delay was unfair to the defendant.[173] It was especially so since certain grounds asserted by him for summary judgment did not depend on whether the plaintiff incurred any additional taxes.[174] Moreover, it was foreseeable that the abatement could continue beyond the four years.[175] If the IRS claimed additional taxes were due, the abatement could be extended until final resolution with the IRS or even until subsequent litigation ended.[176]

In ruling for the defendant, the court distinguished an earlier case, *Murphy v. Campbell*,[177] which held that a court could, and should, abate a malpractice case pending final resolution of the related tax case.[178] However, in *Murphy* there was already a Tax Court case pending.[179] In *Shulman*, not only was there no case pending, the IRS had not yet even asserted a deficiency.[180] Also, the abatement in *Murphy* would be much shorter than the four-year abatement granted here, because there the Tax Court litigation was already pending.[181]

After ruling on the abatement issue, the Texas Court of Appeals sua sponte raised a ripeness issue.[182] The Court held ripeness is a

168. *Id.*
169. *Id.* at 866.
170. *Id.* at 864.
171. *Id.* at 870.
172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.*
176. *Id.*
177. 964 S.W.2d 265 (Tex. 1999).
178. *In re Shulman*, 544 S.W.3d at 869.
179. *Murphy*, 964 S.W.2d at 272.
180. *In re Shulman*, 544 S.W.3d at 866.
181. *Id.* at 869.
182. *See id.* at 871.

threshold issue that implicates subject matter jurisdiction and must be addressed.[183] The court focused on whether any damages were already incurred by the plaintiff. If not, her cause of action did not yet accrue.[184] Here, the IRS had not yet asserted any additional taxes were due.[185] Also, the court noted that the claim that the defendant's tax advice caused damages was yet an open question.[186] The defendant was hired after the marital settlement agreement was already signed and the plaintiff did not take his tax advice after hiring him.[187] Although the court held an argument on the ripeness issue, it held the record was not developed sufficiently to permit a resolution and remanded the issue to the trial court.[188]

It should be noted that the court in *Shulman* reversed the trial court's abatement because of its length and deleterious effect on the defendant.[189] The court explicitly left open the possibility that on remand the trial court, in its discretion, could order a temporary abatement or other appropriate relief.[190] Also, it seems that abatement might be available in Texas in appropriate circumstances, as suggested by *Murphy v. Campbell*.[191]

Similar to Texas in which an abatement procedure is possibly available even when a malpractice case is commenced before the amount of tax has been established, New Jersey handles this situation by means of a stay and seems to be much more plaintiff friendly. In *YA Global Investments, L.P. v. RSM McGladrey, Inc.*,[192] the plaintiffs filed a professional malpractice action against the defendant accountants alleging that, as a result of the defendants' negligent tax and accounting advice, the IRS determined plaintiffs owed taxes and penalties in excess of $100 million.[193] Soon after filing the complaint, plaintiffs quickly moved for a stay, pending resolution of a case to be commenced in Tax Court in which they planned on contesting the

183. *Id.*
184. *Id.* at 872.
185. *Id.* at 871.
186. *Id.* at 872.
187. *Id.*
188. *Id.* at 873.
189. *Id.* at 869.
190. *Id.* at 871.
191. *Id.* at 869.
192. No. A-2152-15T3, 2016 WL 5724900 (N.J. Sup. Ct. App. Div. 2016).
193. *Id.* at *1.

IRS's assessment.[194] The plaintiffs very forthrightly conceded they brought this malpractice action without yet knowing the accuracy or adequacy of the defendants' advice out of concern the statute of limitations might expire before the IRS reached a final determination.[195] The need for a stay was because of their desire to avoid asserting simultaneously inconsistent positions in different venues.[196] They would be supporting the defendant's tax advice in the tax litigation while attacking it in the malpractice action.[197]

Although a bit circuitously,[198] the New Jersey appellate court reversed the trial court's denial of a stay. The court held it would be unfair to the plaintiffs to compel them to litigate inconsistent theories in different courts and it would also waste judicial resources.[199]

A self-help and rather obvious way to navigate this ripeness versus the statute of limitations problem is illustrated in *Broz v. Plante & Moran, PLLC*.[200] In *Broz*, the issue involved alleged erroneous tax preparation by the defendant accountants for tax years 1996 and 1998 to 2001.[201] The plaintiffs instituted a Tax Court litigation to contest the IRS's asserted tax deficiency.[202] In 2008, the plaintiffs sued the defendants for malpractice.[203] The parties entered into a series of tolling agreements pending the resolution of the Tax Court case.[204] While a tolling agreement between a plaintiff and defendant will certainly avoid any possibility of having the statute of limitations run before the amount of tax is determined, it does require the agreement of both parties, which may not always be possible.

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194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.*

198. The appellate court initially denied the plaintiffs' leave to appeal the trial court's denial of the stay. The New Jersey Supreme Court granted the plaintiffs' motion for leave to appeal and summarily remanded the case to the appellate court with directions to consider the merits of plaintiffs' arguments. *Id.*

199. *Id.*

200. 951 N.W.2d 64 (Mich. Ct. App. 2020).

201. *Id.* at 68.

202. *Id.*

203. *Id.*

204. *Id.* It is not clear if the 2008 malpractice action is the present action. The court indicates later that the present action was commenced in January 2012. *Id.*

B. Contractual Statute of Limitations

The relationship between a client and a tax professional and their duties to one another are governed by their agreement, which is subject to basic contract law principles. This applies to all facets of the relationship, not just the scope of engagement that this Article focuses on next. When there is a breach of the agreement and a statute of limitations is sought to be invoked, it is governed by applicable local law.[205] Typically, in many states the limitations period may be extended by principles of continuous representation.[206] *Aaron* is a poignant reminder that a contractually agreed upon limitations period is governed by contract law and is binding as written. There is no extension due to continuous representation.[207]

Aaron involved estate planning for William Davidson, a wealthy philanthropist who owned several sports teams including the Detroit Pistons basketball team.[208] Davidson signed an engagement letter on May 28, 2008, retaining the defendant, Deloitte Tax, to prepare and effectuate an estate plan that was to be tax efficient.[209] Deloitte estimated that under its plan, the estate would owe $158 million in taxes.[210] Davidson died in March 2009.[211] In May 2013, the IRS demanded over $2.7 billion in taxes from Davidson's estate.[212] Eventually, in July 2015, the estate negotiated a settlement with the IRS to pay over $457 million in taxes.[213] From the time of Davidson's death in 2009 until the settlement of the tax amount in 2015, Deloitte Tax rendered services to Davidson's estate and was involved in discussions with the IRS concerning the estate's tax liability.[214] In September 2015, several months after finalization of the settlement with the IRS, Davidson's estate sued Deloitte Tax for malpractice and several other claims.[215]

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205. *See* GALLER & LANG, *supra* note 8, at 310–11.
206. *See id.* at 310.
207. Aaron v. Deloitte Tax LLP, 50 N.Y.S.3d 279, 280 (App. Div. 2017).
208. Aaron v. Deloitte Tax LLP, No. 653203/2015, 2016 WL 4430495, at *1 (N.Y. Sup. Ct. 2016).
209. *Id.* at *3.
210. *Id.* at *4.
211. *Id.* at *5.
212. *Id.* at *2.
213. *Id.*
214. *Id.*
215. *Id.*

The suit against Deloitte was dismissed by the trial court and affirmed on appeal by New York's Appellate Division, First Department.[216] The key reason for the dismissal was because the May 28, 2008 engagement letter provided: "[n]o action, regardless of form, relating to this engagement, may be brought by either party more than one year after the cause of action has accrued."[217]

The cause of action was held to accrue on January 21, 2009, when Davidson executed the last estate plan transaction.[218] Although the plaintiff argued the suit was timely under the continuous representation doctrine, both the trial and appellate courts disagreed.[219] On appeal the First Department held:

> Plaintiffs may not avail themselves of the continuous representation tolling doctrine because the limitations period was contractual, not statutory, and was reasonable. The engagement letter indicated that decedent, a sophisticated and experienced businessman, and defendant, did not necessarily expect the representation to continue after the plan was in place . . . .[220]

Continuous representation seemingly can never extend a valid contractual limitations period, at least not in New York.

III. SCOPE OF ENGAGEMENT

Whenever a layman retains any professional, a clear and unambiguous agreement specifying the precise scope of the services to be rendered, in addition to identifying the contracting parties,[221] is most desirable. It benefits both the layman and the professional. Each is

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216. *Id.* at *6; Aaron v. Deloitte Tax LLP, 50 N.Y.S.3d 279 (App. Div. 2017).

217. *Aaron,* 2016 WL 4430495, at *3.

218. *Id.*; *see Aaron*, 50 N.Y.S.3d at 280.

219. *Aaron,* 2016 WL 4430495, at *3; *see Aaron*, 50 N.Y.S.3d at 280.

220. *Aaron*, 50 N.Y.S.3d at 280. The plaintiffs also argued the statute of limitations should be tolled under the equitable estoppel doctrine. However, the courts held there was no factual basis to trigger equitable estoppel, since the defendant informed the decedent that the estate tax plan was subject to scrutiny and challenge by the tax authorities. *Id.* Presumably, this doctrine might be available to extend a contractual limitations period if the requisite fraud were present.

221. In *Marks v. Schafer and Weiner, PLLC*, the plaintiff incurred liability for federal trust fund taxes not paid by his corporations which were in chapter 11 bankruptcy proceedings. No. 20-11059, 2021 WL 1056774, at *2–3 (E.D. Mich. Mar. 19, 2021). His suit against the defendant attorneys for erroneous advice concerning the trust fund taxes was dismissed because the retainer agreement clearly indicated the defendants were retained to represent the plaintiff's corporations and not the plaintiff individually. *Id.* at *5.

aware of exactly what is expected. This truism also applies to the retention of a tax professional, whether attorney or accountant. The existence of a clear delineation of the services to be performed should eliminate disputes arising from different, and perhaps faulty, recollections of the parties as to whether something was bargained for and agreed upon. The existence of such an engagement letter should prevent many disagreements as to the scope of the expected services from ever reaching litigation. And, if a disagreement does end up in litigation, it should also facilitate a rapid determination by means of motion practice rather than by requiring a full-blown trial. The situation that may arise in the absence of a clear engagement agreement is illustrated by several recent cases.

Perhaps the most surprising of these cases is *Nomura Asset Capital Corp. v. Cadwalader, Wickersham & Taft LLP*.[222] Both parties are well known, large, and sophisticated. The plaintiff, Nomura, is a large international financial institution.[223] The defendant, Cadwalader, is a large Wall Street–type law firm.[224] One might be surprised that such sophisticated parties would not have a clearly defined agreement spelling out the services to be rendered. Perhaps this can be explained by the satisfactory, and very profitable, multi-year relationship enjoyed by the parties.[225] Nevertheless, as the court noted early in its opinion, in the absence of such an agreement, the resulting litigation was pending for almost ten years and was finally resolved almost two decades after the underlying events occurred.[226]

The transaction at issue in *Nomura* involved mortgage securitizations.[227] In this field, an investment bank (Nomura) makes mortgage loans with the goal of combining a number of such loans into securitization pools.[228] The loan pools then are sold to a trust that issues trust certificates to investors.[229] Each certificate represents ownership of a portion of the revenue stream generated by the mortgage loans.[230]

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222. 41 N.E.3d 353 (N.Y. 2015).
223. *Id.* at 355.
224. *Id.*
225. *Id.*
226. *Id.* at 356.
227. *Id.* at 355.
228. *Id.*
229. *Id.*
230. *Id.*

To make this arrangement tax efficient and viable, the trust must qualify as a real estate mortgage investment conduit (REMIC) trust.[231] The primary requirement for tax compliance is that substantially all of the REMIC's asset must be "qualified mortgages and permitted investments."[232] In turn, a qualified mortgage is principally a loan secured by an interest in real property, the fair market value of which is equal to at least 80 percent of the amount of the loan as of the loan origination date or when the REMIC sponsor contributes the loan to the trust.[233] Only "land or improvements such as buildings or other inherently permanent structures qualify as real property."[234] Personal property does not qualify.[235] "This is known as the '80 percent test.'"[236]

Although Nomura and Cadwalader had apparently worked together successfully in this area for many years,[237] a problem arose with a loan included in a 1997 REMIC securitization known as series 1997-D5.[238] The $50 million loan was made to a hospital in Chicago.[239] To meet the 80 percent test, the real property value of the hospital had to be worth at least $40 million.[240] Nomura's appraiser valued the property at $68 million, more than enough to meet the 80 percent test.[241] However, in arriving at the final valuation, the appraiser used three valuation approaches—income capitalization, sales comparison, and cost—that resulted in values of $68 million, $64 million and $40.6 million respectively.[242] A closer look at the underlying approaches disclosed that some non-real property may have been included in the property appraised.[243] Also, under the cost approach, equipment of $9.64 million was included in the valuation.[244] However, there was no breakdown of what the equipment consisted of.[245] It was therefore

231. *Id.*; *see* I.R.C. § 860A.

232. *Nomura*, 41 N.E.3d at 356.

233. *Id.*; *see* I.R.C. § 860G(A)(3)(A); 26 C.F.R. § 1.860-2(a)(1)(i) (2022).

234. *Nomura*, 41 N.E.3d at 356.

235. *Id.*; 26 C.F.R. § 1.856-3(d) (2023).

236. Nomura, 41 N.E.3d at 356.

237. *Id.* at 361. One of Cadwalader's partners gave deposition testimony that she worked with Nomura on mortgage securitizations "over the course of ten years." *Id.*

238. *Id.* at 355.

239. *Id.* at 356.

240. *Id.* at 356–57.

241. *Id.* at 357.

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.*

unclear if the hospital's real property was worth the minimum of $40 million required to qualify under the 80 percent test.[246] Nevertheless, Nomura relied on the appraisal and included this loan among the D5 properties.[247]

As part of the requirements for REMIC qualification, Nomura warranted in both the pooling service agreement (PSA) and in the mortgage loan purchase and sale agreement (MLPSA) that each loan in the D5 trust was REMIC qualified.[248] Also, as part of the closing, Cadwalader provided an opinion letter to Nomura that the D5 series was REMIC qualified.[249] In the letter, Cadwalader stated that it based its legal conclusion on information contained in the PSA, MLPSA, prospectus, and other materials.[250] The opinion letter also stated, "as to any facts material to such opinions . . . not known to" Cadwalader, it relied on "statements, certificates and representations" of Nomura.[251] As part of the closing, Cadwalader did not review or even see the actual appraisal for the Chicago hospital or for any other loan in the D5 pool.[252] Approximately twenty-four days before the D5 closing, a Cadwalader associate received "a freestanding asset description report prepared by Nomura's bankers for credit purposes titled . . . [Chicago hospital] Deal Highlights."[253] This document summarized the appraisal for the Chicago hospital and indicated its valuation of $68 million.[254] A careful reading of the highlights document might have disclosed the issue about the qualification of this loan under the 80 percent test, since certain appraisal approaches included "operations of the property" and "property management (operations)" in addition to the land and building.[255] The parties disagreed as to whether the highlights document disclosed the valuation issue concerning the hospital or whether Cadwalader even needed to review the document.[256]

246. *Id.*
247. *Id.*
248. *Id.* at 357–58.
249. *Id.* at 357.
250. *Id.*
251. *Id.*
252. *Id.*
253. *Id.*
254. *Id.*
255. *Id.*
256. *Id.* at 359.

Approximately three years after the closing of the D5 securitization, the hospital defaulted on the loan and went bankrupt.[257] Thereafter, the trustee of the D5 securitization trust notified Nomura that it breached its warranties that the hospital loan was REMIC qualified.[258] After litigation and facing trial, Nomura settled the claim by paying $67.5 million.[259] It then commenced the present action seeking to recoup its settlement costs from Cadwalader.[260] The primary malpractice claims asserted against Cadwalader were: (1) Cadwalader failed to advise Nomura about the required qualifications for REMIC eligibility, including that the appraisals had to separately value real property; and (2) failed to perform the necessary due diligence to assure that each D5 property was REMIC qualified before issuing its preclosing opinion letter.[261]

Cadwalader moved for summary judgment, but the trial court denied the motion for both the advice and the due diligence claims.[262] On appeal, the First Department dismissed the advice claim and limited the due diligence claim to focus only on factual issues related to the highlights document.[263] Both parties were granted leave to appeal to the New York Court of Appeals.[264]

The Court of Appeals ruled in favor of the defendant, Cadwalader, and granted its summary judgment motion to dismiss both asserted malpractice claims.[265] In deciding the case, the court noted that there was ample evidence from both Cadwalader and Nomura personnel that Cadwalader properly and adequately advised Nomura as to the requirements for REMIC qualification with respect to the D5 securitization as well as the other securitizations Cadwalader was involved with.[266] Similarly, there was ample evidence that Cadwalader advised Nomura, and Nomura understood, that Nomura was responsible for the accuracy of its warranties that all properties in D5 were REMIC qualified.[267] It was Nomura's responsibility to review all the property

257. *Id.* at 358.
258. *Id.*
259. *Id.*
260. *Id.*
261. *Id.* at 358.
262. *Id.* at 358–59.
263. *Id.* at 359.
264. *Id.*
265. *Id.* at 355.
266. *Id.* at 361–62.
267. *Id.* at 360–61.

appraisals for securitized loans.[268] It was also understood that Cadwalader would not independently review the accuracy of any representations unless specifically requested by Nomura.[269] To further buttress its position, Cadwalader introduced expert testimony that the norm in the industry was for the attorney not to review appraisals.[270]

The moral of this case is obvious. A clear and explicit retainer agreement setting forth Cadwalader's role would have obviated the need for an almost decade-long litigation that undoubtedly cost hundreds of thousands of dollars in aggregate counsel fees and wasted much attorney and client time.

A similar situation, though much more mundane, arose in *Head*. Here, the plaintiff hired the defendant CPA to prepare her 2005 federal and state income tax returns.[271] When the returns were completed, she reviewed and signed them in the defendant's office, tendered a check for the taxes owed, then had the defendant file her returns.[272] She then engaged the defendant to prepare her 2006 through 2009 tax returns.[273] However, these returns were not filed timely since neither the plaintiff nor the defendant filed them.[274] The plaintiff assumed the defendant would file them just as he did with the 2005 returns; the defendant thought he filed the 2005 returns for the plaintiff as a courtesy, but that subsequently she was responsible for filing her returns.[275]

On August 11 and 12 of 2011, the plaintiff received two notices from the IRS that her 2006 and 2007 tax returns were not filed.[276] She forwarded these notices to defendant Towson, the CPA who prepared her taxes, who later stated he believed the IRS made an error since he provided the completed returns to the plaintiff together with filing instructions.[277] From this point until the unfiled returns were filed with the IRS in September and October of 2012, Towson engaged in a

268. *Id.*

269. *Id.* at 362–63.

270. *Id.* at 363.

271. Head v. Gould Killian CPA Grp., P.A., 812 S.E.2d 831, 833 (N.C. 2018).

272. Head v. Gould Killian CPA Grp., P.A., 795 S.E.2d 142, 144 (N.C. Ct. App. 2016), *aff'd in part, rev'd in part*, 812 S.E.2d 831 (N.C. 2018). Although tax returns for several states were also involved, only the federal returns are focused upon in the North Carolina Court of Appeals and Supreme Court opinions. *Id.*

273. *Head*, 812 S.E.2d at 833.

274. *Id.*

275. These facts are presented more clearly in the Court of Appeals opinion. *See Head*, 795 S.E.2d at 144.

276. *Head*, 812 S.E.2d at 833.

277. *Id.*

pattern of deceit trying to conceal that the returns were never filed.[278] At various points he claimed to have been in contact with the IRS when he was not.[279] When he subsequently was in contact with the IRS, he consistently misrepresented the nature of the communications. In short, he appeared to be trying to cover something up.[280]

As if to highlight the issues that may arise from the absence of a clearly defined relationship between a client and a retained professional (here a CPA), the precise relationship between the plaintiff and defendant during the August 2011 to October 2012 period was completely obscure. On September 27, 2011, the plaintiff informed Towson that she "was leaving [Towson's] accounting firm." She then said, "[s]hortly you will be receiving information from . . . [plaintiff's new CPA] to begin the transfer of information."[281] Nevertheless, Towson continued working on plaintiff's matters.[282] He completed the plaintiff's 2010 tax returns and filed them electronically.[283] He claimed to be working on amendments to the 2008 and 2009 returns, and he communicated with the IRS about the 2006 and 2007 tax returns, which he eventually completed and filed.[284] Despite having seemingly fired Towson, in July 2012 she gave Towson a power of attorney, and in September 2012 she signed the signature pages for the 2006 and 2007 tax returns without seeing the whole returns.[285] Despite all this, Towson later gave deposition testimony that he understood he was fired and was not the plaintiff's CPA at this point anymore.[286]

The plaintiff commenced this action on November 4, 2013, asserting claims for professional negligence and fraudulent concealment, seeking compensatory and punitive damages.[287] The professional malpractice claim was for defendant's failure to properly prepare and file her 2006 to 2009 tax returns.[288] The fraudulent concealment claim was for defendant's intentionally deceiving her about

278. *Id.* at 834.
279. *Id.*
280. *Id.* at 834–35.
281. *Id.* at 833.
282. *Id.*
283. *Id.* at 834.
284. *Id.*
285. *Id.*
286. *Id.* at 833–34.
287. *Id.* at 834.
288. *Id.*

the status of her tax returns.[289] In 2014, the defendant unsuccessfully moved to dismiss all claims.[290] In December 2015, the defendant successfully received partial summary judgment dismissing the fraudulent concealment claim for the 2006–2009 tax years and also the professional negligence claims for 2006 and 2007 on statute of repose grounds.[291] On appeal, the North Carolina Court of Appeals affirmed the trial court's dismissal of the fraudulent concealment claim because it held the concealment occurred after the plaintiff had already terminated her relationship with the defendant and defendant therefore had no duty to the plaintiff.[292] The court reversed the dismissal of the negligence claim because there existed a fact question as to whether defendant was obligated to file plaintiff's tax returns, the answer to which would determine when the statute of repose started to run.[293]

In *Head*, the North Carolina Supreme Court reversed the Court of Appeals' affirmation of the dismissal of the fraudulent concealment claim.[294] The court held that the plaintiff's allegations of fraudulent concealment raised material questions of fact about the continuing relationship between her and the defendant between September 2011 and October 2012.[295] Despite the seeming termination of the relationship, the defendant seemingly still had an ongoing professional relationship with the plaintiff.[296] The court affirmed the Court of Appeals' reinstatement of the professional negligence claim since there existed material factual issues concerning the scope of defendant's duties relating to whether he undertook to file the plaintiff's tax returns.[297] Correlatively, the statute of repose issue could not be resolved until the parties' contractual arrangement was ascertained because this would determine when the last act of the engagement occurred, which is when the statute of repose commenced to run.[298]

Because of the absence of an initial clear scope of engagement agreement and the later ambiguity concerning whether the defendant was fired, the parties litigated from November 2013 until May 2018,

289. *Id.*
290. *Id.* at 834–35.
291. *Id.* at 835.
292. *Id.*
293. *Id.* at 835–36.
294. *Id.* at 838.
295. *Id.*
296. *Id.* at 837–38.
297. *Id.* at 839.
298. *Id.*

when the North Carolina Supreme Court remanded the case for trial.[299] It took over a decade to finally resolve a case about tax returns dating back to 2006.[300]

McAllister v. Watkins[301] presents a counterpoint to *Nomura* and *Head*, neither of which had a scope of engagement agreement between the client and the tax professional. Intrinsically, *McAllister* is not especially noteworthy. It involved a suit by a client against his tax attorney because the client was dissatisfied with the quality of the attorney's representation before the IRS.[302] The client asserted causes of action for professional negligence and breach of contract.[303] In *McAllister*, the court granted the attorney summary judgment dismissing both claims.[304] In its discussion of the breach of contract claim, the court wrote, "[p]laintiff alleges that Defendants breached the Engagement Agreement . . . by failing to adequately represent Plaintiff and failing to do 'anything and everything necessary to resolve your tax problems. No limits. No exclusions.'"[305]

The quoted language indicates an incredibly broad engagement agreement, with no expressed limitations. The attorney agreed to do "anything and everything necessary" to resolve the tax issue—no limitations or exclusions. While this is an explicit scope of engagement agreement, its potential breadth is unclear and quite troublesome. Would the attorney be required to litigate if no administrative resolution was reached? What about appeals? Must the attorney seek certiorari to the United States Supreme Court if the appeal is unsuccessful? I suggest the moral is very clear. A scope of engagement agreement is most desirable, but it needs to be carefully crafted to set forth precisely the services to be rendered.

Stevenson v. Stanyer[306] is a good illustration of the benefit of a clear scope of engagement agreement, even if not in writing. In *Stevenson*, the defendant attorney, Stanyer, was engaged to review the will of an elderly client.[307] After reviewing the client's assets and

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299. *Id.* I have not found any citation to a trial of this matter. I assume the case was settled or not reported.
300. *Id.*
301. No. CIV-15-371-C, 2016 WL 6127529 (W.D. Okla. Oct. 20, 2016).
302. *Id.* at *1.
303. *Id.*
304. *Id.* at *3.
305. *Id.* at *2.
306. No. 35970-1-III, 2019 WL 2895378 (Wash. Ct. App. July 3, 2019).
307. *Id.* at *1.

ascertaining her wishes, he drafted a new will that left her estate in equal shares to her two children.[308] One of the assets of the client was a trust of which she was the trustee.[309] The primary asset of the trust was a lake home the client and her late husband transferred to the trust decades earlier.[310] At her death, the home would pass to her two children in equal shares.[311] The client died six months after executing the will.[312] The plaintiff, who was the decedent's child and personal representative of her estate, instituted this malpractice action on the grounds that the defendant could have advised his mother to enter into an agreement with the trust beneficiaries to dissolve the trust, thereby making the lake house an asset of the decedent that would get a stepped-up basis at her death.[313] By not doing so, the beneficiaries would incur capital gains taxes estimated to be approximately $159,000.[314]

However, the court held there was no evidence that the defendant was retained to give tax advice to his client's children, either directly or as beneficiaries of the trust, or to the trust.[315] He was retained only to advise the decedent on the transfer of her property to her children at her death.[316] Although there did not seem to be a formal retainer agreement, the scope of the representation was determined from emails, testimony, and affidavits.[317]

In connection with scope of engagement agreements, an important caveat is contained in *Carle v. Wyrick Robbins, Yates & Ponton, LLP*.[318] Despite the terms of an engagement agreement, if the

308. *Id.*
309. *Id.*
310. *Id.*
311. *Id.* at *1–2.
312. *Id.* at *2.
313. *Id.* at *2.
314. *Id.* at *2–3. The court does not clearly spell out the tax problem. When property is obtained by gift, even via a trust, the donees obtain the donor's basis in the property. I.R.C § 1015(a). Here, the basis was presumably low when the lake house was transferred to the trust decades earlier. If the trust had been dissolved and the decedent obtained ownership of the lake house before her death, the basis in the house would then be stepped-up to its fair market value at her death—likely a much higher amount. *See* I.R.C § 1014(a). The difference between these two amounts is gain that could have been sheltered from eventual capital gains taxation. The opinion indicates the inclusion of the value of the lake house in the decedents' estate would not have resulted in increased federal estate tax. *Stevenson*, 2019 WL 2895378, at *3.
315. *Stevenson*, 2019 WL 2895378, at *2–3.
316. *Id.* at *3.
317. *Id.*
318. 738 S.E.2d 766 (N.C. Ct. App. 2013).

attorney renders advice that goes beyond the scope of the engagement agreement, the attorney may be held responsible for that advice.[319] For the engagement agreement to protect the professional, the terms of the agreement must be followed.[320]

Without getting into the details of the underlying transaction in *Carle*, it involved a transaction like the one in *Bloostein*.[321] The plaintiffs owned a corporation and decided to create an ESOP and monetize their stock in the corporation.[322] As in *Bloostein,* they were going to utilize an IRC section 1042 transaction in which they sold some of their corporate stock to the ESOP, invested in qualified replacement property, obtained a loan, and accomplished this without incurring any current capital gains taxes on the sale of their stock to the ESOP.[323] The IRS eventually disallowed the benefits because the qualified replacement securities had been fraudulently sold rather than retained.[324]

The defendant attorneys were retained to represent the plaintiffs' personal interest in the transaction. Other attorneys were retained to represent other parties to the transaction.[325] A large, national law firm was later retained to provide an opinion letter on the tax implications of the transaction.[326] The engagement letter signed by the plaintiffs and defendants specifically excluded the rendition of any tax advice by the defendant.[327] Nevertheless, the plaintiffs alleged that defendants did render tax advice, and that this raised a factual issue about the defendants' scope of engagement.[328] Although the court affirmed the trial court's grant of summary judgment on statute of repose grounds, the court stated "there is a genuine issue of fact regarding the actual scope of the defendant's legal services."[329] The court seemingly acknowledged that the actual services rendered were determinative, not necessarily what was specified in the engagement agreement.

319. *Id.* at 771.
320. *Id.*
321. *See supra* text accompanying notes 67–69.
322. *Carle*, 738 S.E.2d at 768.
323. *Id.*
324. *Id.*
325. *Id.*
326. *Id.*
327. *Id.* at 769.
328. *Id.* at 771.
329. *Id.*

IV. OTHER ISSUES

A. Changes in the Law

The issue of whether a tax practitioner has a duty to anticipate changes in the tax law seems most intriguing. The issue was addressed in *Schreier v. Drealan Kvilhaug Hoefker & Co. P.A.*[330] and answered in the negative. However, the answer was simply conclusory and shed no light on the issues or reasoning involved.

In *Schreier*, the plaintiff's parents owned a seven hundred acre farm.[331] Since 1992, the farm was owned by two revocable inter vivos trusts, one in each of their names.[332] The father died in 2012 and the mother died in 2014.[333] The defendant accountant prepared the father's and mother's estate tax returns.[334] The father's return was filed on January 30, 2013.[335] On this return, the accountant did not claim a deduction for the value of the decedent's homestead, which the court and the district court below referred to as the "Q" deduction.[336] On the mother's estate tax return filed in 2015, the accountant did claim the Q deduction.[337] When the father's estate tax return was filed, the Minnesota statute provided the deduction was available where "the decedent continuously owned the property for the three-year period ending on the date of death of the decedent."[338] The defendant believed the deduction was not available, since the farmland was owned by the decedent's trust, not by the decedent.[339] On May 23, 2013, the Minnesota statute was amended to expand the definition of qualified farm property to include farmland "owned by a person or entity,"[340] thereby making the deduction available on the mother's estate tax return. The

330. 992 F.3d 674 (8th Cir. 2021).
331. *Id.* at 676.
332. *Id.* at 678.
333. *Id.* at 676.
334. *Id.* at 676–79.
335. *Id.* at 676.
336. Schreier v. Drealan Kvilhaug Hoefker & Co. P.A., 611 F. Supp. 3d 746, 761 n.1 (D.N.C. 2020), *aff'd*, 992 F.3d 674 (8th Cir. 2021) ("[U]nder certain circumstances, a Q deduction allows the estate of a deceased farmer to deduct the value of homestead farmland from the total value of the estate, which reduces the total tax liability for the estate. *See* MINN. STAT. § 291.03.").
337. *Schreier*, 922 F.3d at 677.
338. *Id.* at 678; *see* MINN. STAT. § 291.03 (2019).
339. *Schreier*, 992 F.3d at 679.
340. *Id.* at 678; *see* MINN. STAT. § 291.03 subdiv. 10(2) (2022), *amended by* 2013 Minn. Sess. Law Serv., ch. 143, art. 7 § 9 (West).

amendment was retroactive[341] and was applicable also to the father's previously filed estate tax return.[342]

The plaintiff sued the accountant[343] for malpractice, arguing the accountant should have claimed the Q deduction on the father's return anyway or waited to file the return until the deduction applied to the father's return. The Eighth Circuit affirmed the district court's grant of summary judgment to the accountant.[344] The Eighth Circuit agreed with the district court that the Q deduction was not available under the old law.[345] With respect to the plaintiff's allegation that the defendant was negligent in not waiting to file the tax return until the new legislation was enacted, the Eighth Circuit's language best summarizes its holding:

> The [district] court also did not err in ruling that "Penning [the accountant] was not negligent in failing to wait to file the return until the amendment was enacted" because the "portion of the amendment that affected John's [the father] estate return was not added to the proposed amendment until May 19, 2013, months after Penning filed the return." As the court said, "Even if Penning had been generally aware of proposed amendments to the law when she filed the return, the court will not subject her to liability for not anticipating changes that were months away from being considered."[346]

The above quote is the court's entire discussion of this issue. If, in fact, the particular change involved appeared abruptly without any advance indication that it was under consideration, the Eighth Circuit's decision is clearly correct. Something that materializes without warning months after a tax return is filed (or tax advice rendered),

341. *Schreier*, 992 F.2d at 678. The changes made by article 7, section 9 were retroactive for estates of decedents dying after June 30, 2011. *Id.*; *see* MINN. STAT. § 291.03 subdiv. 10(2) (2022), *amended by* 2013 Minn. Sess. Law Serv., ch. 143, art. 7 § 9 (West).

342. *Schreier*, 992 F.3d at 676. The Eighth Circuit stated the Q deduction later became applicable to the father's estate tax return. *Id.*

343. *Id.* at 679–80. The plaintiff also sued the attorney who drafted his parents' trusts and gave them continuing advice. However, there was no evidence the attorney was involved in the preparation of the tax returns, so this aspect of the case is ignored. *Id.*

344. *Id.* at 678.

345. *Id.* at 679.

346. *Id.*

should not retroactively make the advice negligent.[347] However, more discussion of the court's reasoning would have been very helpful in addressing less clear-cut situations.

If a certain change in the law is known to be under consideration and is significant enough that knowledgeable practitioners in the field are aware of it and considering it in rendering tax advice, then ignoring the possible change may constitute negligence. After all, the definition of negligence is when a professional does not "exercise the level of skill, care and diligence that is commonly possessed and exercised by other members of the profession under similar circumstances."[348]

Similarly, if a possible retroactive change to a statute is under consideration, in the context of return filing, why should a practitioner not be required to seek an extension of time to file the return if an extension is available? Isn't this what a diligent practitioner would and should do?

B. Punitive Damages

Generally, punitive or exemplary damages are available sometimes in tort actions and are designed to punish wrongful conduct by a defendant and to deter others from engaging in similar conduct.[349] These amounts are awarded in addition to any compensatory damages.[350] Such amounts are awarded when a defendant's conduct contains some quantum of culpability, such as engaging in fraudulent or malicious conduct.[351] Merely being negligent will not result in the award of punitive or exemplary damages.[352] These same principles also apply to tax malpractice causes of action, where punitive damages have been awarded in appropriate situations.[353]

347. *See id.* at 679 ("As the court said, 'Even if Penning had been generally aware of proposed amendments to the law when she filed the return, the court will not subject her to liability for not anticipating changes that were months away from being considered.'").

348. *See* WOLFMAN ET AL., *supra* note 8, § 601.1, 601.2 (attorneys); *id.* § 601.2.2 (accountants).

349. DAN DOBBS ET AL., THE LAW OF TORTS § 483 (2d ed. 2011).

350. *Id.*

351. *Id.*

352. *See generally id.* (explaining the concept of punitive damages in tort actions).

353. *See, e.g.*, WOLFMAN ET AL., *supra* note 8, § 605.1.3; Todres, *supra* note 12, at 748–50.

Yung v. Grant Thornton, LLP[354] is an example of a situation in which the conduct of the defendant accounting firm was particularly egregious. In *Yung*, the Kentucky trial court awarded the plaintiffs compensatory damages of approximately $20 million and punitive damages of $80 million.[355] The Kentucky Court of Appeals affirmed the compensatory damages but reduced the punitive damages to $20 million, equal to the compensatory damages.[356] The court held that punitive damages equal to the compensatory damages—i.e., a 1:1 ratio—were sufficient punishment for the defendant, and that a ratio of 4:1 was excessive.[357] On appeal in 2018, the Kentucky Supreme Court affirmed the compensatory damages award and reinstated the trial court's $80 million punitive damages award because of the defendant's highly reprehensible conduct.[358] The court held the award was valid under Kentucky law and "passed constitutional muster under federal due process guidelines."[359]

Rather than attempt to summarize the defendant's many fraudulent and inappropriate actions, which of necessity would be quite lengthy,[360] I believe the following summary by the Kentucky Supreme Court adequately conveys the depth of the deceit perpetrated by the defendants:

> Knowing the Yungs' aversion to tax risks personally and professionally, [the defendant] GT made false representations and omitted material facts imperative to the Yungs' fully-informed decsionmaking as to Lev301 [the defective tax shelter]. This includes not only at the initial implementation of the Lev301 transaction but also at subsequent points when no consideration was given to unwinding the transaction, and later when GT addressed the I.R.S.'s scrutiny of the

354. No. 07-CI-2647, 2013 WL 9930973 (Ky. Cir. Ct. 2013), *aff'd in part, vacated in part*, No. 2014-CA-001957, 2016 WL 4934672 (Ky. Ct. App. 2016), *aff'd in part*, *rev'd in part*, 563 S.W.3d 22 (Ky. 2018).

355. *Id.* at *20.

356. Grant Thornton LLP v. Yung, No. 2014-CA-001957, 2016 WL 4934672, at *2 (Ky. Ct. App. 2016), *aff'd in part, rev'd in part*, 563 S.W.3d 22 (Ky. 2018).

357. *Id.*

358. Yung v. Grant Thornton, LLP, 563 S.W.3d 22, 73 (Ky. 2018).

359. *Id.*

360. I previously attempted to summarize the facts in *Yung* and give necessary background information and it took over twelve printed pages. *See* Jacob L. Todres, *Bad Tax Shelters—Accountability or the Lack Thereof: Ten Years of Tax Malpractice*, 66 BAYLOR L. REV. 602, 639–51 (2014).

transaction and the Yungs' tax returns. Knowing from the outset that the Yungs did not want to be GT's "guinea pigs," GT falsely represented that other corporations had successfully relied on the strategy. While communicating to the Yungs that GT would reach and did reach a "more likely than not" opinion that the Lev301 as structured for the Yungs would withstand I.R.S. scrutiny, internal Firm communications disclosed otherwise.

Over the course of the time, despite multiple I.R.S. notices and regulations, professional articles, opinions of outside legal counsel and internal confusion alerting GT that the Lev301 was likely an abusive tax shelter and I.R.S regulations likely would apply retroactively to the Yungs' detriment, GT never once disclosed to the Yungs the problems with the Lev301 concept in general nor specifically, e.g., the use of a recourse bank loan and the need for a stated business purpose for the transaction. When the Yungs discovered on their own that the I.R.S. could possibly disallow the Lev301 tax benefits and communicated that concern to GT, GT misrepresented its confidence in the product. Although GT stopped selling Lev301 multiple times in response to I.R.S. notices and new regulations, the Yungs were not told even once about the cessation of sales of an increasingly dubious product. Furthermore, although the Yungs were never informed of the problems associated with their particular transaction, the knowledge of those problems (e.g., recourse loan, business purpose) was reflected in numerous internal communications within GT and personnel sought to avoid like circumstances with other sales. When GT was subject to an I.R.S. examination because of the Lev301, GT did not inform the Yungs; instead, these "trusting" clients learned of the scrutiny from a tax publication.

These various misrepresentations and nondisclosures were made to save the $900,000 deal and to cover GT's negligent and fraudulent acts that accumulated over time. This summary of GT's grossly negligent and fraudulent behavior does not fully reflect GT's reprehensible behavior in the marketing and sale of the Lev301 to the Yungs. In our view, these individual and cumulative acts place GT's behavior

toward their clients at the high end of professional reprehensibility.[361]

While *Yung* is notable for its approval of a ratio of 4:1 punitive damages to compensatory damages and for the magnitude of the punitive damages awarded, its importance is much more than just historical. It remains a warning to practitioners that egregious, inappropriate conduct risks incurring significant financial penalties in addition to other relevant civil and criminal sanctions.[362]

CONCLUSION

Although the words "tax malpractice" may conjure up visions of errors made in difficult, labyrinthine, or esoteric tax provisions, the reality is that most errors are much more mundane. Most involve basic missteps that could, and do, occur in almost any area of legal or accounting practice. By and large, the recent developments examined here follow this pattern. The notable exception, and the one most interesting from a conceptual vantage point, is the apparent, though implicit, expansion of the definition of tax malpractice to include errors in other non-tax-related areas where the damages include increased taxes of the injured party. Whether this extension of "tax malpractice" by *Serino* and *Bloostein*[363] will gain traction and what its possible consequences are remain to be seen.

Apart from this conceptual issue, the remaining developments, though interesting, involve rather mundane areas or issues such as statutes of limitations and repose[364] and the need for a clear scope of engagement agreement.[365] While statutes of limitations and repose are common, careful attention by plaintiff's counsel is necessary in those states in which the statute of limitations or repose may commence running before all the elements of the underlying tax cause of action exist. Plaintiffs' attempts to navigate this issue will typically involve

361. *Yung*, 563 S.W.3d at 66–67.

362. For a current example, see Press Release, U.S. Dep't of Just., Five Tax Shelter Promoters and Two Appraisers Indicted in Syndicated Conservation Easement Tax Scheme (Mar. 1, 2022), https://www.justice.gov/opa/pr/five-tax-shelter-promoters-and-two-appraisers-indicted-syndicated-conservation-easement-tax [https://perma.Cc/3eh3-uapy] (news release by the Department of Justice announcing that five tax shelter promoters and two appraisers were indicted in connection with syndicated conservation easement tax schemes).

363. *See supra* Section I.C.

364. *See supra* Part II.

365. *See supra* Part III.

commencing the underlying (typically tort) cause of action to satisfy the statute of limitations and/or repose and then attempting to pause this action until the actual tax results are determined administratively or judicially. Some plaintiffs did so successfully in New Jersey in *YA Global Investments, L.P.*;[366] but others were unsuccessful in Texas in *In re Shulman*.[367] However, the Texas court left the door open to obtaining such relief in other, appropriate circumstances. A simple solution for this problem would be a tolling agreement between the parties extending the statute of limitations. However, this would require obtaining the defendant's consent.[368] Finally, *Aaron* is a reminder that a contractually agreed upon limitations period differs from a statute of limitations. Judicial doctrines such as continuous representation, which may toll a statute of limitations, may not apply to a contractual limitations provision.[369]

The need to have a clear scope of engagement agreement between the client and tax professional is so basic that it almost seems strange to focus upon it. Yet, there were a number of cases in this area, at least one of which involved very large, sophisticated parties as both client and attorney.[370] Although obvious upon reflection, a close reading of *Carle* warns that the tax professional must adhere to the terms of the engagement agreement for it to govern the relationship. If services actually rendered go beyond the agreed scope of the engagement, the tax practitioner's responsibility may be deemed to have increased similarly.[371]

A blanket assertion that a tax practitioner needs to be able to predict future changes in the law seems a bit far-fetched, as the Eighth Circuit concluded.[372] However, there may be instances when this might be required.[373] Finally, *Yung* is a reminder that an egregious breach of the tax practitioner–client relationship may result in the imposition of significant punitive damages in addition to any compensatory damages.[374]

366. *See supra* text accompanying notes 192–199.
367. *See supra* text accompanying notes 144–92.
368. *See supra* text accompanying notes 200–05.
369. *See supra* Section II.B.
370. *See supra* Part III.
371. *See supra* text accompanying notes 318–30.
372. *See supra* Section IV.A.
373. *See supra* Section IV.A.
374. *See supra* Section IV.B.