Defending Liberty Pursuing Justice
Vol. 28 No. 3
SPRING 2009

Section of Taxation
NEWSQUARTERLY

Dealing with an Uncooperative Client

By Michael B. Lang*

In a perfect world, a client would consult a lawyer before engaging in any transaction that might have significant tax consequences and would then attempt to implement the transaction in accordance with the lawyer's advice; a client filing returns and other documents would seek advice where appropriate in advance and would file in accordance with the advice received, on a timely basis and without perjuring himself; a client advised by counsel not to enter a dubious tax shelter transaction would not do so; and a client advised of a material error in a prior communication to, or filing with, the Service or in testimony before a tribunal would agree to correct the error or at least consult with independent counsel about whether to do so. But this is not a perfect world. Clients ignore the advice of their lawyers. They engage in transactions without following their lawyers' advice or without getting advice at all. They file forms that contain inaccuracies, both unintentional and intentional. Sometimes they tell their lawyers of their intention to do so in advance of filing. Clients often refuse, or are at least reluctant, to correct misstatements in communications or filings with the Service or tribunals, even in situations where the errors are material.

This article briefly reviews the principal obligations of a tax lawyer to the client and others when a client refuses to follow the lawyer's advice. It will serve as background material for **"Dealing with an Uncooperative Client,"** the subject of this year's **Tax Link Live** member benefit teleconference, which will be presented by the ABA Tax Section on **Wednesday, June 3, at 1:00 p.m. ET**. For details on this special, 90-minute CLE ethics program, please see the program announcement on page 9.

Return Preparers

Many lawyers are "tax return preparers" within the meaning of section 7701(a)(36) when they prepare a return (or a substantial portion of a return) for a client. Under Regulations sections 301.7701-15(b)(2) & (3), a person who provides "advice on a position that is directly relevant to the determination of the existence, characterization, or amount of an entry on a return" that is a substantial portion of the return is generally a return preparer if the advice is provided with respect to events that have already occurred when the advice is given.

continued on page 18

* Chapman University School of Law, Orange, CA.

CONTENTS

TAXATION
A Section of the American Bar Association

In the context of return filing, both taxpayers and tax return preparers, including lawyers, can avoid a penalty with respect to a return position for which there is a reasonable basis if the return position is adequately disclosed on the return. *See* I.R.C. §§ 6662(d)(2)(B)(ii) and 6694(a)(2)(B). Otherwise, the return position must be supported by substantial authority to avoid imposition of a penalty, except in the case of a position that is with respect to a tax shelter or a reportable transaction. In such a case, the return preparer can avoid a penalty only if it is reasonable to believe that the position is more likely than not to be sustained on its merits. I.R.C. § 6694(a)(2)(C).

A signing return preparer can satisfy the disclosure requirement for a reasonable basis position by providing the taxpayer with a prepared tax return that includes the required disclosure. Treas. Reg. § 1.6694-2(d)(3)(i)(B). A nonsigning preparer can satisfy the disclosure requirement by advising the taxpayer of any opportunity to avoid possible penalties under section 6662 and of any applicable disclosure standards, provided the preparer contemporaneously documents the advice in his files. Treas. Reg. § 1.6694-2(d)(3)(ii)(A). A parallel rule applies when a nonsigning preparer is advising another return preparer. Treas. Reg. § 1.6694-2(d)(3)(ii)(B). In none of these cases is there any requirement that the taxpayer actually file the return with an adequate disclosure of the position.

Suppose the taxpayer refuses to disclose the position on the return. Note that the preparer may not even know whether the return, as filed, includes the disclosure, in which case the issues discussed below will not arise until the taxpayer calls the preparer for assistance during an audit. Suppose, however, the taxpayer tells the preparer that the return is being filed without the disclosure. Must the preparer, assumed to be a lawyer, withdraw from representing the taxpayer? Presumably the preparer could not represent the taxpayer if the return is audited, but what about representing the taxpayer in planning a real estate purchase or putting together and implementing an estate plan? These questions, and others involving uncooperative clients, require exploration of the ethical standards that apply to a lawyer seeking to withdraw from representing a client.

Mandatory Withdrawal

Model Rule of Professional Conduct ("MRPC") 1.16(a)(1) requires a lawyer to withdraw from representing a client if "the representation will result in violation of the rules of professional conduct or other law." *Accord*, Restatement Third, The Law Governing Lawyers ["Restatement"] § 32(2)(a). Some jurisdictions have somewhat different rules. *See, e.g.*, Cal. Rule of Professional Conduct 3-700(B) (no mention of "other law," but mandating withdrawal if lawyer knows or should know the client is bringing the action "without probable cause and for the purpose of harassing or maliciously injuring any person"). Thus, withdrawal would be required if continued representation would involve a non-consentable conflict of interest, such as when a lawyer is asked to represent a client being audited with respect to a tax return as to which the client refused to make an appropriate disclosure of a reasonable basis position as advised to do by the lawyer. In addition, if the revenue agent handling the audit becomes aware that the lawyer provided the client advice in connection with the return preparation or with regard to any transaction with significant tax consequences reflected on the return, there is a good chance the agent will ask to see a conflict waiver, thus triggering potential application of Circular 230, section 10.20. If the conflict is non-consentable, as it would appear to be, the lawyer would be well-advised not to agree to handle the audit rather than face responding to such a request.

MRPC 1.2(d) prohibits a lawyer from counseling or assisting a client in conduct the lawyer knows is criminal or fraudulent. Such conduct might in some circumstances include assisting a client in implementing a tax shelter investment. MRPC 4.1 prohibits a lawyer in the course of representing a client from knowingly making a false statement of material fact or law to a third person (which would include the Service) or failing to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client unless disclosure is prohibited under MRPC 1.6. MRPC 3.3, dealing with candor toward a tribunal, prohibits a lawyer from knowingly making a "false statement of fact or law to a tribunal" or failing "to correct a false statement of material fact or law previously made" by the lawyer. MRPC 3.3(a)(1). It also prohibits the lawyer from offering evidence "the lawyer knows to be false." MRPC 3.3(a)(3), also requiring reasonable remedial measures if the lawyer comes to know that previously offered material evidence is false. This may include, if necessary, disclosure to the tribunal, even if such disclosure includes information otherwise protected by MRPC 1.6. *See* MRPC 3.3(b). Other aspects of MRPC 3.3 provide additional standards of candor toward a tribunal, standards that vary considerably from one state to another. If a client seeks to have the lawyer perform any of the acts prohibited by the applicable version of MRPC 1.2(d), 3.3, or 4.1, the lawyer should first seek to dissuade the client from the client's desired course of action. If the attempt at persuasion fails, the lawyer is required to withdraw from the representation.

Circular 230 includes provisions covering ground that overlaps with that covered by the Model Rules discussed above. Thus, Circular 230, section 10.51(a)(7) prohibits any practitioner from willfully assisting, counseling, encouraging a client in violating, or suggesting that the client violate, any

When terminating representation, MRPC 1.16(c) requires the lawyer to comply with any applicable law requiring notice or permission of a tribunal and indicates that, if ordered to do so by a tribunal, the lawyer must continue the representation.

Federal tax law, or knowingly counseling or suggesting to a client an illegal plan to evade Federal taxes. It also covers the same activities with respect to prospective clients. Practitioners are also prohibited from knowingly giving false or misleading information, or participating in giving false or misleading information to the Treasury Department (including the Service), its employees or officers or any tribunal dealing with Federal tax matters. Circular 230, § 10.51(a)(4), which defines "information" to include "facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral." Thus, if the client seeks to use the lawyer's assistance in any of these prohibited acts, the lawyer is again generally required to withdraw from the representation.

Permissive Withdrawal

Of course, not every situation in which a client refuses to follow his lawyer's advice requires the lawyer to "fire" the client. Sometimes the client is not seeking to use the lawyer's assistance to do anything that might be considered fraudulent or criminal, or whatever the client chooses to do, however wrong, may not ultimately involve or have involved using the lawyer's assistance at all. In fact, the lawyer may not know what the client has done, only that the client rejected the lawyer's advice. When withdrawal is not required by MRPC 1.16(a), it is permitted if: (1) it can be done without material adverse effect on the client's interests, (2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent, (3) the client has used the lawyer's services to perpetrate a crime or fraud, (4) the client insists on taking action the lawyer either considers repugnant or with which the lawyer fundamentally disagrees, (5) the client, after a reasonable warning, fails substantially to fulfill an obligation to the lawyer (such as paying fees or court costs or honoring limitations on the objectives of the representation), (6) the representation will result in an unreasonable financial burden to the lawyer or has been rendered unreasonably difficult by the client, or (7) for other good cause. MRPC 1.16(b) and Comments [7] & [8]. If the problem is a disagreement between the client and the lawyer, Comment [2] to MRPC 1.2 suggests that the lawyer should "consult with the client and seek a mutually acceptable resolution of the disagreement" before considering withdrawal.

How to Withdraw

When terminating representation, MRPC 1.16(c) requires the lawyer to comply with any applicable law requiring notice or permission of a tribunal and indicates that, if ordered to do so by a tribunal, the lawyer must continue the representation. Furthermore, upon termination of a representation, the lawyer must take steps "to the extent reasonably" practicable to mitigate the consequences to the client, such as providing reasonable notice to the client, allowing the client time to employ other counsel, returning papers and property to which the client is entitled, and refunding unearned fees paid in advance. MRPC 1.16(d) and Comment [9], indicating that retention of papers as security for a fee may be permitted under state law. *See also* Restatement § 33. Massachusetts Rule 1.16(e) provides a detailed list of documents, papers, and other items that must be made available to a former client within a reasonable time following the client's request. Other jurisdictions are likely to require the lawyer to respond as this rule requires in Massachusetts, so the list is worth consulting when a lawyer decides to withdraw from representing a client.

When withdrawal is not required, it seems likely that the lawyer will face a heavier burden of assuring that the withdrawal does not harm or inconvenience the client than when withdrawal is required. Comment [3] to MRPC 1.16 cautions that in pending litigation if a court asks for an explanation for the withdrawal, client confidentiality concerns may require the lawyer to make a vague statement, such as "professional considerations require the termination of the representation." However, Comment [15] to the 2001 version of MRPC 1.6 provided that the lawyer could give notice of the fact of withdrawal and withdraw or disaffirm any opinion, document, affirmation, or the like (sometimes referred to as a "noisy withdrawal"). This Comment now appears in the Arkansas Rules as Rule 1.6(c). *See also* ABA Formal Op. 92-366. The current version of the Model Rules does not include the Comment, although the broader permissive disclosure authority under current MRPC 1.6 discussed below probably obviates the need for a comment specifically authorizing a noisy withdrawal in many circumstances.

Client Confidential Information

Withdrawal is one thing. However, the lawyer is also permitted under the current version of the Model Rules (although not required) to reveal otherwise confidential information "to the extent the lawyer reasonably believes necessary

… to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another [such as the Service] and in furtherance of which the client has used or is using the lawyer's services" or "to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services." MRPC 1.6(b)(2) & (3). This provision was not in the 2001 version of the Model Rules.

These exceptions to the rule protecting client confidential information are among the most controversial of all legal ethics rules and vary considerably from state to state, with disclosure actually required in some instances. New Jersey Rule 1.6(b)(1), for example, *requires* disclosure of information to the "proper authorities" to prevent the client from committing a "criminal, illegal or fraudulent" act that the lawyer reasonably believes likely to result in substantial injury to the financial interest or property of another. At the other extreme, California Rule 3-100 has no permissive disclosure in the circumstances mentioned in the text although it is believed that the more protective confidentiality rules of jurisdictions like California are limited under the Supremacy Clause by disclosure provisions of federal law, such as the permissive disclosure provisions of the regulations promulgated by the Securities and Exchange Commission under the Sarbanes-Oxley Act. *See* 17 C.F.R. § 205.3(d)(2). Some jurisdictions also require the lawyer to attempt, depending on the context, either to dissuade the client from committing the crime or fraud or to take corrective action. *See* Okla. Rule 1.6(b)(3); Tex. Rule 1.02(d) & (e).

Withdrawal with Respect to a Particular Matter

Withdrawal from a representation does not necessarily mean withdrawing from representing the client altogether. The Model Rules seem to view a representation as being with respect to a particular matter. *See* MRPC 1.16, Comment [1] ("representation in a matter"); 1.1, Comments [1] & [5] ("a particular matter"); 1.2 & Comments, Scope of Representation and Allocation of Authority Between Client and Lawyer. For example, if a lawyer finds a material error in the client's Year One federal income tax return that will directly affect the current (Year Three) return, the client's unwillingness to file an amended return for Year One would make it necessary for the lawyer to withdraw from preparing the current year return. But does that mean the lawyer cannot plan and implement a section 1031 like-kind exchange for the client and provide advice about how the 1031 exchange should be reflected on the current year's federal income tax return? Perhaps not, as this planning and advice seems totally unrelated to the earlier return issue. But, if the lawyer views the client's attitude about amending the Year One return as sufficiently morally repugnant, he may want to terminate the representation anyway. In addition, if the lawyer was the preparer of the Year One return, the lawyer's interest in correcting the error creates a conflict with the client's interest in not correcting it. In this circumstance, withdrawing from representing the client with respect to any matters may seem like the more pragmatic course, whether mandated or not.

Duties to Former Clients

Even after withdrawing from representing a client, the lawyer's duty to protect the former client's confidential information continues, subject to the exceptions discussed above. MRPC 1.9(c)(2). Furthermore, the lawyer may not use information relating to the former representation to the disadvantage of the former client except as permitted for a client or when the information has become generally known. MRPC 1.9(c)(1). These rules also apply if the lawyer's present or former firm, as opposed to the lawyer himself, formerly represented the client.

MRPC 1.9(a) prohibits a lawyer who has represented a client in a matter from later representing another person "in the same matter or a substantially related matter in which that person's interests are materially adverse" to the former client's interests without the informed consent of the former client, confirmed in writing. The new client's informed consent, confirmed in writing, will generally also be required. *See* MRPC 1.7; Circular 230, § 10.29; *see also* Va. Rule 1.9(a), expressly requiring consent of both present and former clients. This protection extends to cases where the former representation was by the firm with which the lawyer was formerly associated, rather than by the lawyer, if the lawyer had acquired protected information about the former client that is material to the matter. MRPC 1.9(b). ■