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THE GENERAL PRACTITIONER FACES TAXES

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This discussion is offered for consideration principally by those lawyers who practice in communities where their clients expect them to act as their legal counsellors in all matters affecting their lives and property—communities where specialization in one branch of law is not practical. It does not purport to be helpful to the tax technician. It is hoped that it may be of interest and of some benefit to the general practitioner.

Many competent lawyers who conduct a general practice have evinced a tendency to decline retainers in matters involving taxation, the most common of which are today, of course, matters involving Federal income taxes. Many lawyers feel that they can competently represent a client in a case involving the law of torts, contracts, probate or criminal procedure, and yet feel that they cannot conscientiously hold themselves out as qualified to handle adequately matters involving taxes.

This is unfortunate, both from the standpoint of the lawyer and of the clients. Taxes have become such a large component part of most transactions involving property that the acquisition, retention, transfer and devolution of such property cannot be intelligently undertaken without knowing to what extent any such dealings will impose a tax of one kind or another and upon whom the tax will be imposed. When, therefore, an individual or a business firm proposes to take any of these actions with regard to his or its property, counsel must be obtained prior to taking such action, lest a burdensome liability be unknowingly incurred.

Two Phases of Tax Practice

There are two phases of tax practice: tax counsel and tax litigation. The former requires a more comprehensive understanding of the tax structure in general than does the latter. When a tax matter has reached the litigation stage, the issues are limited to those incident to that particular litigation. When a lawyer holds himself out as a competent tax counsellor, he must have some comprehension of all of the tax

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law, for there may be numerous phases thereof involved in the problems that are brought to him. Futhermore, where he has the opportunity of advising the client *before* the transaction is effected, he has a hand in casting the die. And it is particularly true of tax matters that an ounce of prevention is worth a pound of cure. If the client seeks advice on a tax matter *after* the transaction is completed, the incidence of tax is already fixed, and relief, if any, is largely confined to obtaining a favorable interpretation of what has happened. It is much better to be able to guide the transaction. One of the best things a lawyer can do for his clients is to educate them to go over their business matters with him *before* they act.

An article of the scope contemplated here can go no further in making suggestions relative to tax counsel than to comment that competency as such can be achieved only by long and intensive study of the statutory provisions, the regulations promulgated thereunder, and the myriad cases of judicial construction of these, coupled with a wide practical experience in handling tax matters.

Handicaps From Lack of Knowledge of Tax Law

When problems involving taxation arise, the individual or company involved will almost certainly call on its lawyer for advice. If he has not equipped himself to deal with the tax features of business tranactions, he cannot competently draft a will or trust instrument involving an estate of substantial size, he cannot advise as to how a business should be bought or sold, he cannot safely draft a divorce and alimony decree. These are but a few commonplace illustrations of the many limitations that a lack of knowledge of taxes will place upon him. One of the most insidious features of the situation lies in the fact that many lawyers, so unequipped, would scoff at the statements in this paragraph if they were to read them.

It may be well at this point, therefore, to demonstrate the three situations we have just called "commonplace":

The first statement is that a lawyer cannot competently draft a will or trust instrument involving an estate of substantial size without recognizing the tax implications. Let us suppose the client, John Doe, possesses an estate of value approximately $250,000. He is married, may reasonably be expected to remain married, and has a son and daughter, both minors. He offers only the suggestion that he is getting along in years and wishes to provide disposition of his estate in such a manner as "to take care of Mary and the children in the

best way possible." This places considerable responsibility on the lawyer, because John Doe will probably do what he tells him to do, and will probably sign the will substantially as his lawyer first submits it to him. If the lawyer is familiar with Federal estate taxes, he will see immediately that there is an estate with a potential Federal estate tax liability of approximately $45,000, which liability may be reduced to approximately $10,000 if proper provisions are incorporated in the will. He will realize also, however, that he cannot determine whether to take advantage of this $35,000 reduction in John's estate tax until he knows how large an estate Mary has in her own name. He will realize that he must analyze the present and prospective estates of every member of the family group and make an integral plan for them *before* he puts a will in front of John Doe for execution. After he has done all of this, he may effect the $35,000 tax savings in John's estate, may save additional amounts for the estates of other members of the family, and incidentally, will have *justified* a much more substantial fee for his own services to his client than he would have done otherwise.

Recognition of tax consequences is important in advising a client as to the sale or purchase of a business. Mr. X owns all of the stock of X Corporation. Mr. Y desires to purchase this business. They have agreed on $75,000 as the sale price. They may come together to the lawyer's office and ask him to advise them how to effect the transaction.

The easy thing to do is to have X endorse his stock to Y for the $75,000. If, however, the lawyer is at all tax-conscious, he will ask for a balance sheet of the business to determine whether it would be to the advantage of the parties to transfer assets instead of stock.

In many instances this can be done to the advantage of both the seller and the purchaser. The sale price may be considerably in excess of the cost of the stock to the present stockholder. If he sells the stock, he will, therefore, incur a capital gain tax liability, which may be substantial in amount. If the corporation sells the assets it will incur whatever tax liability attaches. If the assets sold are capital assets, the gain thereon will be taxed to the corporation at capital gain rates. Mr. X's position may be such that it is to his advantage to have the corporation, rather than him personally, incur the tax liability on the gain. Furthermore, Mr. X will still own his corporation intact and, if he so desires, he can continue corporate business operations. Mr. Y, the purchaser, may at the same time acquire certain advantages in purchasing the assets instead of the stock. In the first place, if he does this, he will not have to concern himself with possible undisclosed

liabilities of the corporation, such as additional tax liabilities of the corporation which may develop from an audit of tax returns for prior years. Another advantage may accrue to him in acquiring some of the assets at a higher cost basis.

Of course, not every instance will make it advantageous to both parties for the transactions to be effected by a sale of assets rather than stock. The illustration is given simply to demonstrate that the tax features are of serious importance in consummating a sale or purchase and that the lawyer who is consulted must be conversant with the implications of these features in order to render competent advice.

Matters involving domestic relations would ordinarily be regarded as far afield from taxes. And yet, if the decree involves alimony and a provision for the support of children, failure to consider the tax liabilities of the parties incident to the alimony and support may have dire effects on the client. Until enactment of the Revenue Act of 1942, the husband could not deduct alimony payments in computing his income tax, with the result that he paid all the tax and the wife got the alimony free of any tax obligations. Under the present law, "periodic payments" made by a husband to a wife are includible in her gross income where the payments are made pursuant to a decree of divorce or of separate maintenance or pursuant to a "written instrument incident to such divorce or separation." The husband is allowed to deduct such alimony payments from his income. It is important to know that only such installment payments are considered "periodic payments" as do not in any one year exceed ten per cent of any principal sum which is specified in the decree or instrument as discharging the husband's obligation, and that such principal sum must be required by the terms of the decree or instrument to be paid over a period extending more than ten years from the date of the decree or instrument. Accordingly, before agreeing to a divorce decree, a lawyer had better ascertain whether or not his client is getting the advantage or burden incident to the alimony payments.

Many more examples could be cited, if space would permit, demonstrating how the knowledge of tax incidence affects most phases of modern American life. And one does not need to have clairvoyant perception to realize that the situation will not be different during our lifetime.

Obviously, the lawyer who is relied on for general counsel in his community cannot continue to avoid these responsibilities and at the same time retain the confidence of his fellow-citizens and earn a competent livelihood from his profession. His only alternative is to

learn at least enough about taxes to be able to recognize when a tax problem is involved in a transaction. It will be far better for him and his client if he will also equip himself to resolve such problems in a manner that will inure most to the benefit of the client.

Many of those lawyers whom we are considering are men or women who attended law schools a generation ago when a number of even the approved law schools did not offer any course in taxation. At that time, taxes played a far less important role in our economy than they do today. These lawyers began their practice and continued it for a number of years without feeling too much the impingement of taxes. Since, in recent years, it has become more marked, they have tried not to recognize the inevitable. With the situation as it is, and as it obviously will continue, they cannot so conduct themselves and expect to survive professionally. In larger communities, lawyers may confine their practice to tort and criminal practice and proceed without much difficulty, so far as their client's interests are concerned, but as stated above, we are dealing with the situation of the lawyer who is called on in his community for general legal counsel.

Objections to Tax Practice

The objection most commonly expressed by lawyers against handling tax matters is an aversion to matters of accounting, which often constitute an important fact feature in tax controversies. Lawyers often do not like dealing with the exactitude of mathematical computations.

This attitude is superficial. While mathematical exactitude plays one important role in tax matters, that feature is still not primary. If it were, tax controversies would best be resolved by a board of accountants or statisticians. Instead, they are resolved by *courts of law,* administered by men trained in law.

The lawyer generally has no hesitancy in accepting a case which will necessitate his retaining a handwriting expert, an engineer, an architect or a detective to assemble for him information best understood by a person trained in one of those professions. They bring their reports to him, he evaluates the information therein, determines how best it can be presented as evidence and what part is relevant and material.

The basic idea is the same with matters involving computations. We would not attempt to say that a lawyer can be successful in tax practice without having some personal understanding of accounting. We frankly feel that there is a minimum prerequisite that he have at least enough understanding of accounting to be able to read and under-

stand a balance sheet and statement of operations. Our conviction is that every law student should be required to have satisfactorily completed a course in elementary accounting before entering upon the study of law. If the lawyer has the basic understanding of accounting, he can refer the accounting matters to a competent accountant for working the details of this phase of the case and submitting the results to him. When this is done, however, he should familiarize himself with these details in order to be able to present his case competently and to cross-examine witnesses adequately.

Care should be exercised in the selection of the accountant. As is true in every profession, there are accountants who are skilled in their work, and there are others far less competent. A careless job in preparing the accounting facts can be fatal in the trial of the case. A lack of understanding on the part of the lawyer of the facts contained in the accounting evidence can be just as fatal.

Tax Procedures

It may not be amiss to discuss briefly the chief features involved in tax procedure, because here again the average general practitioner frequently envisions the procedure as enshrouded in legerdemain, and so is often inclined to shy away from an encounter with it. As a matter of fact, it is far more simple than that of many other forums.

Tax litigation usually originates from an audit of a tax return made by an Internal Revenue Agent. These men are trained in accounting and in tax procedures. It is their duty to examine returns and records supporting these returns to determine whether correct returns and payments have been made. Our experience has led us to feel that these men are, as a group, highly capable and conscientious. We feel that they are entitled to respect and cooperation from the taxpayer and from his representatives.

A few lawyers, unfortunately, are inclined to minimize the importance of their dealings with these government representatives. This is definitely a mistake. The agent is human. If he meets discourtesy or evasion, his reaction will be as unfavorable as that of any other human being who encounters these faults. Many tax controversies that have resulted in costly litigation could have been avoided if the taxpayer or his lawyer had shown a spirit of cooperation with the agent, instead of being insincere or supercilious. The client is not—or should not be—interested in having the agent snubbed so that the lawyer can later put on his frock-tailed coat and win the case in the Supreme Court when he could have won the argument with the agent if he

had gone about it in the right way. Every effort should be made to discuss any issue of law or fact with the revenue agent in sincerity and truth.

If, after reviewing and discussing the features at issue, there is still disagreement as to liability, there is no more need to harbor personal resentment against the agent than there is to do so with respect to a member of the bar who has been cast in the role of your adversary. The agent is probably performing his duty, as he sees it, to the best of his ability. You are doing the same thing. This should cause each of you to respect the other.

At the conclusion of his examination, the agent will discuss his findings with the taxpayer, or with you, if you have been properly designated as the taxpayer's representative. At this point it may be well to mention the importance of qualifying yourself as the duly appointed representative of the taxpayer. Many of us are inclined to feel that, if we are respected members of the bar, and if we tell someone that we represent a client, no further questions in that regard should be raised. The Treasury Department feels differently about it. A lawyer may be a member of the bar of the Supreme Court of the United States and of every inferior court below it, but he cannot represent a taxpayer before the Treasury Department unless he has been admitted to practice in that forum. Enrollment may be accomplished by application to The Director of Practice. It should perhaps also be mentioned that in any matter where you propose to represent a client before the Treasury Department, you should obtain and file a duly executed power of attorney from the client and a statement relative to fees, as specified by the Department.

Conference Procedure

If the taxpayer agrees with the findings of the agent, he may execute a form so signifying, and the tax, if any, will be assessed. If the taxpayer does not agree with the agent's findings, the agent will send him a preliminary notice, setting out the items on which there is disagreement, and advising the taxpayer that he may present his objections at an informal conference with the Group Chief. This employee is also a revenue agent, who, possibly because of longer experience and demonstrated ability, has been designated to review informally such disagreements with the object of determining whether the issues can be resolved at this point. Unless the taxpayer is going to present further clarification of the facts or of the law beyond that which he presented to the first agent, there will be little point in hav-

ing this conference. The Group Chief will not be inclined to reverse the revenue agent without a factual or legal basis for doing so. It is suggested, therefore, that if you are going to go to the trouble of having this conference, you should submit a written statement of the facts and legal authorities as you understand them. If they are convincing, you may be able to conclude your client's difficulty without going higher.

In the event you do not reach an agreement here, the report of the revenue agent will be made and a copy furnished the taxpayer, together with what is commonly referred to as a "30-day letter," which is a notice to the taxpayer that he may, within thirty days, file a formal protest, under oath, with the District Director of Internal Revenue. These protests have some technical requirements, which are easily met, and they amount to no more than a statement of the facts and law upon which the taxpayer relies. They require no great talent to prepare. They are a simple, logical statement of facts and supporting authority. The important thing is to be sure to get the protest filed within the period specified. The case is thereupon transmitted to the "Appellate Division."

Hearings on protests are held in the Appellate Division of the District Commissioner's office. If you have duly filed your power of attorney with the protest, you will be notified well in advance of the date set for the hearing. If you have not filed the power of attorney, the client will be so notified. The Treasury Department is not going to *assume* that you are authorized to act as attorney. This hearing before the Appellate Division is again informal. You call at the proper office at the time appointed, you are introduced to the conferee, and you and he go into a conference room where you discuss the facts and applicable law. Here again it is important to act in sincerity and to try with all earnestness to convince the conferee of the justness of your cause. Perhaps it is even more important, because, if you fail here, you are headed either for the Tax Court, the District Court, or the Court of Claims, involving further pleadings and presentation of evidence with all court formality.

The Tax Court

In the event settlement is not effected with the Appellate Division, a "90-day letter" will be sent the taxpayer. This advises him that he is allowed ninety days from the date thereof within which to file a petition with the Tax Court for its review of the controversy. The preparation of this petition is not difficult, but it must be done with exactitude.

It is a statement of the taxpayer's case and is similar to the complaint filed in code pleading states. The Commissioner of Internal Revenue is the respondent, and is required to file an answer to the petition. The case is tried usually upon the issues thus joined.

The Tax Court is presently composed of sixteen judges. Except in a relatively few instances cases are tried before one judge. Cases are assigned for trial in cities throughout the country to meet the convenience of the taxpayers. The judges of the Tax Court are skilled in tax matters and constitute a very competent tribunal.

The proceedings of the Tax Court are conducted in accordance with the rules of evidence applicable in the courts of the District of Columbia in the type of proceedings which prior to September 16, 1938 (date of adoption of the Federal Rules of Civil Procedure) were within the jurisdiction of the courts of equity of that district. The Tax Court may prescribe its own rules of practice and procedure (other than evidence) and where these rules do not include matters of procedure the rules of evidence in the Federal Rules of Civil Procedure are applicable to the Tax Court.

As a general rule, the burden of proof is on the taxpayer. The rule is to the contrary in fraud cases, transferee proceedings and new matters pleaded by the Commissioner.

The Tax Court takes itself very seriously with respect to matters of procedure. While complete informality has been observed up to this point, the lawyer now finds himself in a position where he is expected to follow the established routines of the Court as to presentation of witnesses, exhibits and other evidence. The writer recalls an incident which now evokes some amusement, although at the time it was slightly embarrassing, where he was reprimanded by no less a personage than the itinerant clerk who travels with the judge assigned for trial of the cases. The Court had requested the writer to hand him a document being introduced in evidence, and when he handed it to the judge he inadvertently rested his hand on the edges of the judge's desk. The clerk promptly took him to task for such a breach of court etiquette.

Do not underestimate the importance of complying strictly with every rule of the Tax Court. Never file a pleading, motion or document as much as one day late. Be sure that every matter is presented in the name of the right party. Many of our state courts have been lenient as to amendments, supplemental orders and other devices to help the lawyer correct his earlier errors. The Tax Court is not so

inclined. It is a very busy court, and upon a slight technical violation you may find your client's case thrown out of court.

It is suggested that if you have not been present at a hearing of the Tax Court, it may be well to spend one or two days listening to the trial of other cases before you present your own. The Court will insist on strict compliance with its methods and rules of procedure. You may save yourself some embarrassment by hearing a veteran tax practitioner try his case before you try yours.

It is not customary to conclude the trial with oral argument. The Court will designate a period of time for the submission of briefs. It goes without saying that these should be carefully prepared, covering all the evidence and the pertinent legal authority. Eventually you will receive a written opinion from the Tax Court. At the present time the Court has several thousand cases ahead of it. It may be from one to two years after you have filed the petition before the case is tried and equally as long after the case is tried until you will obtain a decision.

A decision of the Tax Court may be reviewed by a United States Court of Appeals if a petition for such review is filed with the Clerk of the Tax Court by either the Commissioner or the taxpayer within three months after the decision is rendered. The appeal from the Tax Court is to the Court of Appeals for the circuit in which is located the director's office to which was made the return of the tax in respect of which the liability arose, or if no return was made, appeal may be taken to the Court of Appeals for the District of Columbia.

Other Forums and Their Advantages

It should be noted that, throughout all the foregoing procedure, the taxpayer has not paid the additional tax called for by the Commissioner. These proceedings may involve a period of anywhere from two to five years, and during that time, interest accrues at a six per cent rate. When the taxpayer eventually has to pay the tax, if he does, he will find a substantial accrual of interest added to his liability. We have felt in a number of cases that where the taxpayer can afford to do so it is wiser for him to pay the tax and file a claim for refund and bring suit to recover. If eventually he wins his argument, he gets back his payment with interest at six per cent.

The lawyer should not overlook the fact that after payment of the tax is made it is necessary to file a claim for refund with the Treasury Department and have it rejected before bringing suit in the District Court or in the Court of Claims.

There are other advantages as we see it to using this latter method. Experience has pretty well shown that on many matters taxpayers are more successful in these latter forums than they are before the Tax Court. Suit for refund may be instituted in the District Court against the collector (now the District Director of Internal Revenue) to whom the tax was paid, or against his personal representative if he is dead. Or action may be maintained against the United States (rather than the collector) in the Court of Claims or in the District Court if the amount is $10,000 or less, or even if it exceeds $10,000, when the collector to whom the tax was paid is dead or out of office. If the suit is against the collector, it may be tried before a jury. In any instance, the lawyer should be able to look at all the facts and the adjudications of the available forums and determine which is the best court in which to proceed.

Responsibility of the Lawyer

It is particularly true in tax matters that the lawyer should always proceed with full consciousness of his duty to present and establish the true facts as they exist. If facts exist which are unfavorable to his client, he can pretty well be assured that they will be exposed sooner or later. If unfavorable facts predominate, he should be conscious of that situation before he begins his litigation and govern himself accordingly. It is in this connection that he can perhaps get his greatest help from the accountant who should be thoroughly familiar with the facts that are going to be most pertinent in the eventual trial of the controversy. In addition, these men are usually conversant with tax procedures and tax law, and their suggestions may be of invaluable assistance to the lawyer.

During the past generation, great inroads have been made into the fields of practice which were once regarded as within the domain of the lawyer. The investigation of titles has gone to title guaranty companies, collections have gone to lay agencies, trust and estate matters have been solicited by trust companies, and pretrial investigations have gone to adjustment companies. The aggregate effect has been to limit more and more the field of professional activity left open to the lawyer. Government agencies have not helped the situation. As government has become more and more paternalistic, bureaucrats have affirmatively tried to discourage the citizenry from retaining legal counsel. This is a vital threat to liberty. Paternalistic governments have never liked the idea of a skilled lawyer standing in their path to protect the rights of the individual. If they can, they will promulgate a regulation to circumvent him or to cut his fee.

We who are lawyers are partly to blame for this situation. Our profession furnishes the majority of the members of the legislative bodies of the Federal and state governments, and yet we have permitted this antagonistic attitude to be fostered in government. The fields of practice we have lost have gone to others because they have rendered better and more efficient service in those fields than the average lawyer. Too often, after obtaining our license to practice law, we have taken the attitude that we have already learned all there is to know and that the world should automatically come to us for gems of wisdom, instead of recognizing that we have just been invested with a sacred trust and a talent which we are then supposed to put to work for the benefit of ourselves as well as for our fellowmen.

The field of taxation is rightfully ours, but, like the hare, we have fallen asleep while the tortoise in another profession has wearily but steadfastly plodded down the road to the goal of tax comprehension. If you doubt this, pick at random any group of twenty lawyers and like group of accountants and test both of them as to their knowledge of tax law and procedure. The result would be embarrassing to our profession. This situation should, and can be, remedied. Any competent lawyer has the ammunition for accomplishment in this field. More of them need to load their guns and bang away.

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