

# What If Uncle Jim Is Under Audit or Your Client Wants to Give You a Porsche? Ethical Issues When There Is a Personal Connection with a Client<sup>1</sup>

By Lance E. Rothenberg\*

On Wednesday, June 1, at 1:00pm ET, the Tax Section will sponsor its annual **Tax Link Live** member benefit teleconference. This special, 90-minute CLE ethics program, “**What If Uncle Jim Is Under Audit or Your Client Wants to Give You a Porsche?**” will feature the following speakers: Peter L. Faber, McDermott Will & Emery; Scott D. Michel, Caplin & Drysdale; Megan L. Brackney, Kostelanetz & Fink, LLP; and Lance E. Rothenberg, Hodgson Russ LLP. This article is background material for the program. For more information and to register, please visit the teleconference website: <http://meetings.abanet.org/meeting/tax/TX0611S/>.



When a client, or prospective client, seeks legal advice, a lawyer is expected to provide candid, objective, and competent assistance. In providing that assistance, a lawyer wears several hats, which can include: advocate, counselor, problem solver, officer of the court, spokesperson, negotiator, defender, and, perhaps, even hired gun. While each engagement is unique and raises its own issues, a practitioner must always be mindful of, and guided by, ethical and professional considerations.

This article will highlight a selection of the ethical issues that might arise when representing those clients with whom a lawyer has a personal connection; in short, representing friends and family members. In addition, as an offshoot, it will discuss issues that may arise when an appreciative client wishes to give a gift to his or her attorney. Both sets of circumstances—complicated by that personal connection between attorney and client—can raise thorny ethical issues that are illustrated here in three egregious, but hopefully thought-provoking, hypothetical scenarios.

## Behaving Ethically Is Simple: Just Do the Right Thing, Right?

As a preliminary matter, an overview of the applicable rules is in order. There are various sources of ethics rules that govern the practice of law. For tax practitioners, first and foremost is Circular 230, which regulates practice before the Service. 31 C.F.R.,

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<sup>1</sup> This material was initially presented as a panel discussion at the ABA Section of Taxation's Midyear Meeting held in Boca Raton, Florida, on January 21, 2011. In addition to the author, the original panelists were Megan L. Brackney (Kostelanetz & Fink, LLP), Robert Davis (K&L Gates, LLP), and Michael Lampert (Michael A. Lampert, P.A.).

Subtitle A, Part 10. In addition, the American Bar Association has promulgated Model Rules of Professional Conduct (“Model Rules”), and each state imposes its own set of ethics rules upon attorneys admitted to practice within its borders (e.g., New York’s Rules of Professional Conduct). There remain many additional sources of ethical guidance, including ethics opinions, both formal and informal; court opinions; disciplinary decisions; and the Restatement (Third) of The Law Governing Lawyers. That’s a lot of rules!

Among this thicket of ethical guidance are four rules, in particular, that an attorney must heed when considering whether to represent friends and family: (1) a lawyer’s duty as a fiduciary; (2) the duty of independent judgment; (3) the duty to avoid conflicts of interest; and (4) the duty of confidentiality. In addition, there are specific rules addressing the receipt of gifts from a client. Each of these rules is introduced below.

### Duty as a Fiduciary

Lawyers are fiduciaries, meaning an attorney is under a “duty to exercise and maintain the utmost good faith, honesty, integrity, fairness and fidelity” in dealings with clients. *Hafter v. Farkas*, 498 F.2d 587, 589 (2d Cir. 1974). Even if a lawyer is representing his uncle, sister, or a close friend, that individual is a client, and he or she must be treated accordingly.

### Duty of Independent Judgment

Each client is owed a duty of independent judgment. The Model Rules explain that “[i]n representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client’s situation.” ABA Model Rule 2.1. For example, when advising a parent or sibling it may be more difficult to remain objective, and yet as a client,

that individual is owed just that—unbiased advice.

### Duty to Avoid Conflicts of Interest

A lawyer must strive to avoid conflicts of interest. The typical conflict of interest scenario involves potential conflicts between multiple clients; the clients may be adverse to each other in some way. However, a lawyer must also ascertain whether there might be a conflict of interest between herself and her client. The Model Rules instruct that “a lawyer shall not represent a client if the representation involves a concurrent conflict of interest.” ABA Model Rule 1.7(a); *see also* Circular 230, § 10.29. Significantly, a “concurrent conflict of interest” is defined to include situations where “there is a significant risk that the representation of one or more clients will be materially limited ... by a personal interest of the lawyer.” ABA Model Rule 1.7(a)(2).

In other words, if a lawyer has a “personal interest” in the client’s case, she should consider whether she can adequately represent that client. For example, it would be important to consider whether the attorney can effectively communicate advice to that client. Or, perhaps, a friend or family member may seize upon a personal connection to push a lawyer to dabble in an area that is outside of the lawyer’s area of expertise (e.g., a tax attorney opining on patent law issues) or to take a position that is contrary to the attorney’s instincts (e.g., there’s no authority for that deduction, but he’s my uncle).

### Duty of Confidentiality

It is a bedrock principle of the legal profession that client confidences are protected by means of the attorney-client privilege. The Model Rules provide that “[a] lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or

the disclosure is [otherwise] permitted.” ABA Model Rule 1.6(a). Where there is a personal connection between an attorney and her client, the context in which the advice is sought is highly relevant. Is Dad asking for family advice from his son or legal advice from his lawyer?

### Duty to Avoid Conflicts of Interest; Specific “Gift” Rule

Generally, the relationship between attorney and client is a business relationship, whereby the lawyer provides legal services to the client in exchange for a fee. It is not so uncommon, though, for clients to express their gratitude and offer a gift to their attorney. The Model Rules state that “[a] lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client.” ABA Model Rule 1.8(c).

The Comments to the Model Rules provide additional guidance and provide that “[a] lawyer may accept a gift from a client, if the transaction meets general standards of fairness. For example, a simple gift such as a present given at a holiday or as a token of appreciation is permitted.” ABA Model Rule 1.8(c), cmt (6). The standard employed, “general standards of fairness,” leaves some room for interpretation.

### Hypothetical Scenarios

How might these various ethics rules come to bear in the real world? Below are three situations that are designed to highlight the practical application of these rules. The situations are colorfully presented in the hopes of generating discussion. The issues raised will be only briefly touched upon, but the lessons should, hopefully, be fairly clear.

## Hypothetical #1— “The In-Law Out-Law”

Larry Lawyer works for a tax controversy firm in New York. Larry's father-in-law, Philandering Phil, receives an audit notice from New York State. Phil comes to Larry for help. After looking over the notice, Larry sees that New York is claiming that Phil should be filing and paying tax as a resident of New York. Larry thinks this should be an easy case, because his mother- and father-in-law live and work in New Jersey, not New York.

In the course of their discussions, Phil confides in Larry that for the year in question he had secretly rented an apartment in New York City for his mistress. Under New York law, if an individual maintains a permanent place of abode and spends more than 183 days in the state, then he can be treated as a resident for tax purposes even if he lives elsewhere. N.Y. Tax Law § 605(b)(1)(B).

Phil maintained the apartment, but he spent less than 183 days in the state. Phil claims the relationship has ended, but he would like to fight the audit, because the state (along with New York City) is seeking to assess a hefty tax liability. Larry, who now knows a dirty family secret and who is upset and worried about his wife and mother-in-law, thinks Phil should consider quietly paying the tax, and, if he hasn't already, giving up the apartment.

This situation raises a host of issues for poor Larry. To begin with, as ugly as the facts may be, does he owe his father-in-law a duty to fight the audit rather than to allow his own personal interests to interfere by suggesting that Phil just pay the tax? Must Larry keep his father-in-law's indiscretions a secret from his own wife? From his mother-in-law? Among the many issues presented, Larry must consider whether this is a jointly filed tax return. If it is, does the mother-in-law bear liability for the additional taxes? Can Larry even represent his father-in-law or should he refer him to another firm? If Larry doesn't represent Phil, is he bound to protect

Phil's secrets then? This has the trappings for an uncomfortable Thanksgiving dinner no matter what the outcome of the audit.

## Hypothetical #2— “With Friends Like These”

Counselor Chris has served as outside tax counsel to Widgets Corp. for the better part of ten years, in large part because his former college roommate, Dishonest Dan, is the company's CFO. The Service has initiated an income tax audit of the company, and Dan calls Chris for help.

In the course of their discussions, Dan confides in Chris that he had secretly cooked the books for three quarters in 2008, because he needed to improve earnings to obtain financing. The Service will be visiting the company tomorrow morning to audit the 2007 and 2008 tax years.

Dan is not the only one with a problem in this scenario. Chris's close friend and long time colleague has committed malfeasance and has confided in him. But who is Chris's client? Can Chris advise both Dan and the company under these circumstances? Can Chris disclose Dan's wrongdoing to the company's CEO? Must he? What if Chris doesn't get along very well with the CEO, and if Dan were to depart from the company, Chris might lose a significant client? Should Chris recommend that Dan obtain independent counsel, and ask that the new lawyer give him a call? In addition to the ethics rules, are there applicable securities laws that might affect the outcome? Chris has some fast thinking to do; remember, the revenue agents are coming tomorrow.

## Hypothetical #3— “Don't Look a Gift Horse in the Mouth”

Alyssa Attorney is a partner in a white-collar criminal defense firm. Against the odds, she mounted a brilliant defense and successfully represented a taxpayer, No-Records Ned, in a criminal tax evasion trial. The

trial team beat back all charges and won an acquittal for Ned.

At the conclusion of the engagement, Ned paid all the fees and costs that the firm billed him. He then meets Alyssa for a thank you lunch where he appreciatively hands her an envelope stuffed with lots and lots of cash. Ned tells Alyssa that this is a gift just to her and not to the firm, because he truly appreciates her hard work and effort.

Perhaps unlike the other scenarios above, this is a problem every lawyer would like to have. But can Alyssa accept the gift? It seems that she has not solicited it. Does it matter whether Ned is giving her \$200, which is comparable to an expensive dinner? What if Ned handed Alyssa \$2,000? Or \$20,000? Instead of cash, what if Ned handed Alyssa the keys to a brand new Porsche? Or delivered to her home a fine, hand-woven Oriental rug? Under her partnership agreement with her firm, what duties does Alyssa owe to her partners? Should she disclose the gift? Would it matter if Alyssa was an associate rather than a partner of the firm? Should she report the value of the gift as income on her tax return, or is it really a gift? Ask around your office or among your colleagues; these gift situations are not as uncommon as you might think.

## Conclusion

The three scenarios above have been intentionally painted with a colorful brush. But very often these same issues will arise within the more common, plain vanilla cases that lawyers deal with day in and day out. Developing a personal connection with a client is an enjoyable part of the practice of law, and helping friends and family when they need legal assistance is commendable. And who doesn't enjoy being offered a gift? Spotting the issues and addressing them head-on, though, is important. Careful attention to these rules, among others, along with a healthy reliance upon the “smell test,” should keep practitioners within the bounds, out of trouble, and on the right side. ■