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NOTES AND COMMENTS

Accountants—Unauthorized Practice of Law in Federal Tax Matters

A recent California lower court decision, *Agran v. Shapiro*,¹ has rekindled the dispute between lawyers and accountants as to what constitutes the unauthorized practice of law² in the federal taxation field, and the issues involved have not yet been settled.³ These issues are relatively new because of the increasing complexity of federal tax problems in recent years.⁴ Although efforts have been made by the lawyers and accountants to settle their disputes,⁵ these efforts have been nullified to some extent by such cases as *Agran*, in which the two professions have filed *amicus curiae* briefs.

In order to understand the issues in the *Agran* case, it is necessary to refer to some of the related cases for background purposes. Many cases, concerning laymen, including accountants, in the unauthorized practice controversy, have involved advertising in one form or another,⁶ and the courts, especially where the layman has designated himself as a "tax expert" or the like,⁷ have prohibited such advertising. This seems to be a fair result since the general practitioner of law cannot advertise or hold himself out to the public as a specialist.⁸ Moreover,

¹ *Agran v. Shapiro*, 273 P. 2d 619 (Cal. App. Dep't 1954). According to 40 A.B.A.J. 775n. (1954), judgment was stayed pending application to the U. S. Supreme Court.

² The practice of law embraces conveyancing, the preparation of pleadings and other papers incident to actions and special proceedings, the management of such action and proceeding on behalf of clients before judges and courts, the preparation of legal instruments of all kinds, and in general all advice to clients and all action taken for them in matters connected with the law. *People ex rel. Courtney v. Ass'n of Real Estate Taxpayers of Illinois*, 354 Ill. 102, 109, 187 N. E. 823, 826 (1933).

³ The judge, writing the *Agran* opinion, said that the avenue is open for review by the Supreme Court because of the federal constitutional question. Apparently, this question arises because of the conflict between state law and certain federal regulations: 26 U. S. C. A. § 1111, Rule 2 (Supp. 1953), which applies to practice before the Tax Court; and 31 CODE FED. REGS. § 10.2 (f) (1949), which applies to practice before the Treasury Department.

⁴ 1 MERTENS, LAW OF FEDERAL INCOME TAXATION iii (1942).

⁵ *Statement of Principles Relating to Practice in the Field of Federal Taxation*, 37 A. B. A. J. 517 (1951).

⁶ *Lowell Bar Ass'n v. Loeb*, 315 Mass. 176, 52 N. E. 2d 27 (1943); *Gardner v. Conway*, 234 Minn. 468, 48 N. W. 2d 788 (1951); *Rhode Island Bar Ass'n v. Libutti*, 100 A. 2d 406 (R. I. 1953); *Chicago Bar Ass'n v. United Taxpayers of America*, 312 Ill. App. 243, 38 N. E. 2d 349 (1941).

⁷ *Lowell Bar Ass'n v. Loeb*, *supra* note 6; *Chicago Bar Ass'n v. United Taxpayers of America*, *supra* note 6; *Gardner v. Conway*, *supra* note 6.

⁸ *Mandelbaum v. Gilbert & Barker Mfg. Co.*, 169 Misc. 656, 290 N. Y. Supp. 462 (N. Y. City Ct. 1936); *Gardner v. Conway*, *supra* note 6; THE CANONS OF PROFESSIONAL ETHICS OF THE AMERICAN BAR ASSOCIATION, §§ 27, 45 (1954).

the members of the American Institute of Accountants do not contest these rulings.⁹

Also closely allied to the main issues in the principal dispute are those cases where laymen, not necessarily within the three classes of accountants,¹⁰ and corporations have participated in the adjustment of state or municipal tax assessments. Thus, where a layman or a corporation attempted to reduce property tax assessments,¹¹ to reduce sales taxes,¹² to recover illegally collected occupation taxes,¹³ or to advise in a tax foreclosure suit,¹⁴ the courts have held that these laymen and corporations were practicing law and as a result have declared their contracts void for illegality,¹⁵ have held these laymen in contempt of court,¹⁶ have enjoined such practices,¹⁷ and have found them guilty of a misdemeanor.¹⁸

Where laymen are permitted to represent their clients under the rules of certain state administrative boards,¹⁹ some courts have held that it does not matter whether the unauthorized practice was done in the office, before a court, or before an administrative tribunal. The real test, according to these courts, is "the character of the act done, and not the place where it is committed."²⁰ The fact that the administrative tribunals permit laymen to practice before them is of no avail according to these courts, because it is the inherent power of the judiciary to define and regulate the practice of law; and the legislature

⁹ *Statement of Principles Relating to Practice in the Field of Federal Taxation*, 37 A. B. A. J. 517 (1951); BY-LAWS, NORTH CAROLINA ASS'N OF CERTIFIED PUBLIC ACCOUNTANTS, INC., Art. XVII, § 2 (1952).

¹⁰ These classes are: (a) certified public accountants (authorized by law to use their title to certify financial statements); (b) public accountants; and (c) bookkeepers and others. 17 UNAUTHORIZED PRACTICE NEWS 3 (Dec. 1951).

¹¹ *Bump v. District Court of Polk County*, 232 Iowa 623, 5 N. W. 2d 914 (1942); *Stack v. P. G. Garage, Inc.*, 7 N. J. 118, 80 A. 2d 545 (1951); *Kountz v. Rowlands*, 46 Pa. D. & C. 461 (1943); *People ex rel. Courtney v. Ass'n of Real Estate Taxpayers of Illinois*, 354 Ill. 102, 187 N. E. 823 (1933).

¹² *Mandelbaum v. Gilbert & Barker Mfg. Co.*, 160 Misc. 656, 290 N. Y. Supp. 462 (N. Y. City Ct. 1936).

¹³ *Chicago Bar Ass'n v. United Taxpayers of America*, 312 Ill. App. 243, 38 N. E. 2d 349 (1941).

¹⁴ *State ex rel. Hunter v. Daugherty*, 136 Neb. 490, 286 N. W. 783 (1939).

¹⁵ *Mandelbaum v. Gilbert & Barker Mfg. Co.*, 160 Misc. 656, 290 N. Y. Supp. 462 (N. Y. City Ct. 1936); *Stack v. P. G. Garage, Inc.*, 7 N. J. 118, 80 A. 2d 545 (1951).

¹⁶ *Bump v. District Court of Polk County*, 232 Iowa 623, 5 N. W. 2d 914 (1942); *State ex rel. Hunter v. Daugherty*, 136 Neb. 490, 286 N. W. 783 (1939); *People ex rel. Courtney v. Ass'n of Real Estate Taxpayers of Illinois*, 354 Ill. 102, 187 N. E. 823 (1933).

¹⁷ *Kountz v. Rowlands*, 46 Pa. D. & C. 461 (1943); *Chicago Bar Ass'n v. United Taxpayers of America*, 312 Ill. App. 243, 38 N. E. 2d 349 (1941).

¹⁸ *Stack v. P. G. Garage, Inc.*, 7 N. J. 118, 80 A. 2d 545 (1951).

¹⁹ *People ex rel. Chicago Bar Ass'n v. Goodman*, 366 Ill. 346, 8 N. E. 2d 941 (1937) (industrial commission); *Chicago Bar Ass'n v. United Taxpayers of America*, 312 Ill. App. 243, 38 N. E. 2d 349 (1941) (department of finance).

²⁰ *People ex rel. Chicago Bar Ass'n v. Goodman*, 366 Ill. 346, 357, 8 N. E. 2d 941, 947 (1937).

can only make provisions to punish those acts which the judiciary has found to constitute the unauthorized practice of law.²¹ However, other cases hold that since the legislature cannot tell the judiciary who shall be attorneys, the courts cannot tell the administrative boards whom they shall receive before them when these boards have the power to formulate their own rules.²²

In the field of federal taxation the problem of what constitutes the unauthorized practice of law becomes more complicated. "The ascertainment of probable tax effects of transactions frequently is within the function of either a certified public accountant or a lawyer."²³ Apparently the two professions were in accord that when these ascertainment raise uncertainties over the interpretation of tax or general law, the accountant should advise his client to enlist the aid of a lawyer.²⁴ However, a sharp line cannot be drawn here because the accountant, in order to work effectively with figures, must have an adequate acquaintance with departmental rulings and judicial decisions which federal taxation has produced.²⁵

The state courts have gone so far as to permit the accountant or layman to fill out simple income tax returns.²⁶ However, where the layman, incidental to the preparation of the return, solved "knotty questions of law," such as deciding whether a man could file a joint return with his common-law wife and whether she could be a partner in his trucking business when he had control but shared the profits,²⁷ advised as to the tax advantages and disadvantages of corporations and partnerships, merger and dissolution of corporations, and the increase and decrease of capital stock,²⁸ advised modification of contracts, interpreted laws, and gave opinions to effect compliance with the tax laws,²⁹ the state courts have held this to be the unauthorized practice of law.

The *Agran* case followed the "knotty question of law" test. The plaintiff, who was the auditor and accountant for a corporation owned

²¹ *In re* Opinion of the Justices, 289 Mass. 607, 194 N. E. 313 (1935); *See* *People ex rel. Chicago Bar Ass'n v. Goodman*, 366 Ill. 346, 352, 8 N. E. 2d 941, 947 (1937).

²² *Eagle Indemnity Co. v. Industrial Accident Commission of California*, 217 Cal. 244, 18 P. 2d 341 (1933); *Comment*, 35 MICH. L. REV. 442 (1937); *accord*, *Rhode Island Bar Ass'n v. Libutti*, 100 A. 2d 406 (R. I. 1953).

²³ *Statement of Principles Relating to Practice in the Field of Federal Taxation*, 37 A. B. A. J. 517, 537 (1951).

²⁴ *Ibid.*

²⁵ *See* *Lowell Bar Ass'n v. Loeb*, 315 Mass. 176, 183, 52 N. E. 2d 27, 32 (1943).

²⁶ *Lowell Bar Ass'n v. Loeb*, 315 Mass. 176, 52 N. E. 2d 27 (1943); *Blair v. Motor Carriers Service Bureau, Inc.*, 40 Pa. D. & C. 413 (1939).

²⁷ *Gardner v. Conway*, 234 Minn. 468, 48 N. W. 2d 788 (1951).

²⁸ *Blair v. Motor Carriers Service Bureau, Inc.*, 40 Pa. D. & C. 413 (1939).

²⁹ *Application of New York County Lawyers Ass'n In re Standard Tax & Management Corp.*, 43 N. Y. S. 2d 479 (Sup. Ct. 1943).

by the defendant, prepared the defendant's individual tax returns. He sued the defendant for the services rendered to him as an individual,³⁰ which services consisted of advising the defendant on certain carry-back losses and subsequent conferences with revenue agents which ultimately led to a reduction of the amount due the government by the defendant. The court held the contract void for illegality on the ground that the advice involved the question whether the loss could be carried back, and this in turn depended on whether it was a loss attributable to the operation of a trade or business regularly carried on by the taxpayer within the meaning of that phrase as used in the Internal Revenue Code.

The *Agran* decision and the *Gardner v. Conway*³¹ decision, by their holdings and dicta, rejected the "incidental" test which was used by an intermediate New York court. The New York court held Bercu, a certified public accountant, guilty of contempt of court when he advised a corporation that it could take certain unpaid 1935-1937 city taxes as deductions if paid in 1943 even though the company was on the accrual basis.³² The court, basing its decision on the necessity of protecting the public against incompetent legal service, held that since Bercu was not the company's regular auditor, he could not be called in for a fee to interpret the law. However, the court implied that if Bercu had been the company's regular auditor, he could have solved this question as an incident of that regular job without being in contempt of court.

The *Agran*, *Bercu*, and *Gardner* cases by necessity deal directly or indirectly with federal administrative rules in the federal tax field. The Federal Administrative Procedure Act does not "grant or deny to any person who is not a lawyer the right to appear for or represent others before any agency or in any agency proceeding,"³³ but specific statutes³⁴ give the Tax Court and the Treasury Department the right to make their own rules of procedure. The Tax Court permits laymen to argue before it on the conditions that they be of good moral character and pass a written and sometimes oral examination, while a lawyer is automatically admitted if he is a member in good standing of the bar of the highest court in his state or the Supreme Court of the United

³⁰ *Agran v. Shapiro*, 273 P. 2d 619 (Cal. App. Dep't 1954). Plaintiff sued for \$2,000.00. The court reversed and remanded, saying that the plaintiff could not recover for services which were illegal but that he could recover the value of the services which were legal.

³¹ *Gardner v. Conway*, 234 Minn. 468, 48 N. W. 2d 788 (1951).

³² Application of New York County Lawyers Ass'n *In re Bercu*, 273 App. Div. 524, 78 N. Y. S. 2d (1st Dep't 1948), *aff'd without opinion*, 299 N. Y. 728, 87 N. E. 2d 451 (1949).

³³ 60 STAT. 237 (1946), 5 U. S. C. § 1005a (1952).

³⁴ 53 STAT. 159 (1939), 26 U. S. C. § 1111 (1952) (Tax Court); 23 STAT. 258 (1884), 5 U. S. C. § 261 (1952) (Treasury Department).

States.³⁵ The latter Court has upheld the power of the Tax Court to make such a rule.³⁶ The rule of the Treasury Department gives any properly enrolled agent, including accountants, the same rights, powers and privileges that enrolled lawyers have before the Department. However, enrolled agents cannot prepare any instrument which transfers title to personal or real property for the purpose of affecting federal taxes, "nor shall such enrolled agent advise a client as to the legal sufficiency of such an instrument or its legal effect upon the federal taxes of such client: and provided further, that nothing in the regulation in this part shall be construed as authorizing persons not members of the bar to practice law."³⁷ Relying on the last phrase, the court in the *Agran* case held the contract void for illegality.

The most important issue between the lawyers and the accountants is whether the federal administrative rules are binding on the state courts. The Florida court has held that a person who was admitted to practice before the Tax Court, the Treasury Department, and the Supreme Court of the United States could not practice as a federal tax counsel in Florida unless he was a member of the Florida bar, even though the federal agencies before which he intended to practice permitted him to do so.³⁸ The Missouri court, on the other hand, held that a layman, who was permitted to practice before the Interstate Commerce Commission under the rules of that agency, could collect for services rendered to his client even though such a contract was void under the state's public policy protecting the public against incompetent legal service. The court said that the contract was made legal by federal law, and if the court declared the contract void for illegality, it would be interfering with a federal function.³⁹

The Supreme Court of the United States, if and when it decides the issues presented in such cases as *Agran*, will be faced with the problem of whether states, by court action, can interpret federal administrative regulations so as to deprive the accountants of their federal right to advise their clients in federal tax matters. Sooner or later, the Supreme Court will be faced with a case where the accountant is admitted to practice before the Tax Court, but who has been barred from that practice by a state court, even though the rules of the Tax Court do not contain a clause saying that nothing shall be construed

³⁵ 26 U. S. C. A. § 1111, Rule 2 (Supp. 1953).

³⁶ *Goldsmith v. United States Board of Tax Appeals*, 270 U. S. 117 (1926), where the plaintiff sought a writ of mandamus to compel defendant to admit him to practice before the defendant, whose rules, at that time gave the Board discretion to refuse any certified public accountant the right to practice before it.

³⁷ 31 CODE FED. REGS. § 10.2 (f) (1949).

³⁸ *Petition of Kearney*, 63 So. 2d 630 (Fla. 1953).

³⁹ *De Pass v. Harris Wool Co.*, 346 Mo. 1038, 144 S. W. 2d 146 (1940); *In re Lyon*, 301 Mass. 30, 16 N. E. 2d 74 (1938); *accord*, *Brooks v. Mandel-White Co.*, 54 F. 2d 992 (2nd Cir. 1932).

to permit a person not a member of the bar to practice law. Then the Court will have to decide whether the federal regulations are superior to state public policy.

If the Supreme Court hears the *Agran* case, it could follow the *Bercu* test and hold that since *Agran* was the defendant's regular accountant, he could solve legal problems incidental to the preparing of the defendant's return. If the Court rejects the *Bercu* test it could hold with *Agran's* "knotty question of law" test, but would have to interpret the regulations involved. The difficult question, as related to the *Agran* case, is whether the Treasury Department rule which says "that nothing in the regulation . . . shall be construed as authorizing persons not members of the bar to practice law" forbids *Agran* to give the type of advice he gave. The state courts by their interpretation of this clause, have practically limited the accountant to filling out simple income tax returns. The Court could find that by such an interpretation the rights and privileges granted to laymen under the regulation are practically nullified because it is rare that a taxpayer, who files a simple income tax return, would need representation of any kind before the Treasury Department.

Furthermore, if the issues presented in the *Agran* case are ever argued before the Court, it will undoubtedly uphold the right of the Tax Court and the Treasury Department to make their own rules, and it would seem that the Court would also say that the federal law in this field is superior to state public policy because the representation of federal taxpayers must be free from state interference.

Public policy prohibition of incompetent legal service is the basis upon which the state courts have refused to allow the accountants to interpret "questions of law" in the federal income tax field; but as a practical matter taxable business income is, to a large extent, determined by such accounting factors as inventory pricing, capital transactions, prepaid income and expenses, depreciation and bad debt write-offs. The protection of the public is, indeed, a very important consideration in these cases; consequently, the courts should consider the dual cost to the taxpayer of paying an accountant and a lawyer for advice that is not exclusively of a legal nature.⁴⁰ A bill⁴¹ has been submitted to Congress, which if passed, would alleviate this problem by allowing properly enrolled accountants to engage in the settlement of

⁴⁰ According to the American Institute of Accountants, 55,960,236 income tax returns were filed during the fiscal year of 1952. Out of this number, 9,400 cases required discussion for settlement at upper levels of the Revenue Service, 1,200 cases were decided in the Tax Court, and only 636 were decided in courts of law.

⁴¹ H. R. 9922, 83rd Cong., 2nd Sess. (1954).

their clients' tax liability with the Internal Revenue Service on a more extensive basis than the state courts now permit.

HERBERT S. FALK, JR.

Constitutional Law—Due Process—State Jurisdiction over Foreign Corporations for Collection of Use Taxes

Defendant, a Delaware corporation, occasionally sold furniture to Maryland residents who came to defendant's Delaware store to make purchases. Some of the purchases were consigned to Maryland addresses and shipped by common carrier, while others were delivered directly to Maryland customers by defendant's truck. Defendant was not qualified or registered to do business in Maryland, maintained no branch office or agencies there, and solicited no orders from Maryland residents through traveling salesmen, mail or telephone. The Maryland Court of Appeals ruled that the Delaware corporation was engaged in business in the state within the meaning of the Maryland use tax statute,¹ and consequently liable for the collection of the use tax² from its Maryland customers.³ In reversing the Maryland court, the United States Supreme Court (four justices dissenting) held that Maryland had no jurisdiction over defendant corporation, and, therefore, to require it to collect a use tax was a violation of due process.⁴

In previous cases, the Supreme Court has ruled that a state may

¹ MD. ANN. CODE, art. 81 § 371 (1951) provides: "Every vendor engaged in business in this state and making sales of tangible personal property for use, storage or consumption in this state which are taxable under the provisions of this subtitle, at the time of making such sales, or if the use, storage or consumption becomes taxable hereunder, shall collect the tax imposed by this sub-title from the purchaser." 368(k) of the same act defines the term "engaged in business in this state" as selling or delivering in the state, or any activity in connection therewith, tangible personal property for use, storage or consumption within the state.

² The purpose of the use tax is to complement and support the sales tax, usually in two respects. First, it protects state merchants from competition with out-of-state merchants whose sales are not taxed, and second, it prevents the loss of state revenue by removing from its residents the advantage of non-taxed out-of-state purchases.

³ *Miller Brothers v. State of Maryland*, 201 Md. 535, 95 A 2d 286 (1953). Maryland entered suit against defendant to recover use taxes assessed by the state comptroller and attached a station wagon belonging to defendant. Defendant filed a petition to quash the writ of attachment on the grounds that the assessment was unconstitutional. In holding that the defendant was subject to the use tax statute the court relied on the fact that it delivered merchandise to purchasers in Maryland. Other factors advanced on argument for holding defendant liable were as follows: (a) Defendant delivered some purchases to common carriers consigned to Maryland addresses. (b) It occasionally mailed sales circulars to all former customers, including Maryland customers. (c) It advertised with Delaware papers and radio stations knowing that such advertisements would reach Maryland inhabitants.

⁴ *Miller Brothers v. State of Maryland*, 347 U. S. 340, 342 (1954): "Seizure of property by the state under pretext of taxation when there is no jurisdiction or power to tax is simple confiscation and a denial of due process of law."