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Accountancy and the Law

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ACCOUNTANCY AND THE LAW [1]

In recent years there has been much discussion between accountants and lawyers regarding the overlap between accounting and law in such fields as taxation and corporate law. There has been some litigation brought by various legal associations against the accountant charging the unlawful practice of law in connection with the preparation of tax returns and the organization of business enterprises. The refusal by large segments of both the legal and accounting professions to recognize the import of new and complex problems created by government regulation of business and the consequent dovetailing of the professions is leading to a head-on collision about their respective jurisdictions in the income tax field. Poised thinking and broad vision exercised by both parties may soften considerably the impact and damage which is certain to result. From the lawyer's standpoint we must first understand the accountant's profession, his responsibilities and liabilities, and then, with an insight into the problems involved in the situation, try to arrive at a solution which will be equitable to both professions.

Responsibilities of Accountants - Litigation involving accountants has not been overwhelming, but from the cases reported almost binding precedents can be stated which will guide us in the principles of law applicable to various instances.

An accountant holds himself out as skilled in a profession and is charged with a higher degree of responsibility than one who is inexperienced and does not seek professional work. If it is apparent or can reasonably be deduced that the books do not represent a fair presentation of the financial position of the business then the accountant is under a legal obligation to discover and disclose the true state of affairs. However, this does not mean that the accountant is an insurer unless he assumes such a position. "He undertakes for good faith and integrity, but not infallibility; and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon mere errors of judgment." [2] If he uses the care required and expected of ordinarily skillful accountants in con-

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1. Before any discussion can be entered concerning the duties and liabilities of a public accountant, it is first necessary to define what a public accountant is and what he does. According to the Illinois Accountancy Law of 1927, a public accountant is an expert in the keeping of books or accounts. He is one who serves or offers to serve the public generally in performing audits and preparing financial statements of any business, knowing that such statements are to be used for the information of stockholders or silent partners in such business, or as an inducement to any person to invest in or extend credit to such business. Regulations, and related cases, concerning public accountants are found in 27 A.L.R. 1530, 42 A.L.R. 777, 43 A. L.R. 1086.
2. Smith v. London Assur. Corp., 109 App. Div. 882, 96 N.Y. S. 820 (1905).

formity with accepted standards of auditing procedure, no legal responsibility is incurred by him. The accountant is expected to show a higher degree of care where there is ground for suspicion of fraud. Where the client has imposed limitations on the scope of the examination, the accountant can not be liable for fraud or defalcation of a trusted employee, which was not within the discovery of the accountant because of the limitations. Where the scope of the examination is unrestricted, the accountant must satisfy himself that the assets and income are accounted for and that the liabilities and expenses are properly supported. He need not substantiate every item; [1] but again, he must not omit any item which the custom of the profession decrees should be covered.

Liabilities of Accountant - In any event, where the accountant's negligence is the proximate cause of loss, the client may recover damages from him in a breach of contract suit; [2] or if the injury was sustained by a third party, damages may be recovered in a tort action. [3] The measure of damages is the amount which has been lost as a consequence of the accountant's failure to perform his duty properly. The liability to third perties will not be recognized unless the negligence is so great as to amount to fraud. There must be a false representation of a material fact, which is known to be false by the party making it, or else to be recklessly made; the misrepresentation must be made with intent to deceive and for the purpose of inducing the other party to act upon it to his injury or damage. [4]

Overlapping of Professions - The Committee on the Unauthorized Practice of Law of the American Bar Association asserts that the practice of law includes giving advice as to the validity of a tax or the effect of a tax statute with respect to matters outside the accounting field, or determining legal questions preliminary to making out a lawful tax return. [5] It is common knowledge that the accountant must be thoroughly familiar with tax matters and one of his primary functions is the preparation of income tax returns. When an accountant sets up the books of an organization he must do so with the idea of saving his client money when the time comes for filing tax returns. The accountant must know the law to do this: and his knowledge is acquired by examining the statutes, by knowing the regulations promulgated by the tax commissioners and by studying prior decisions of the tax courts. He should be allowed to use the information thus obtained in determining problems which arise in the ordinary preperation of a return, and the courts are apparently adopting this view. [6]

The American Bar Association has also recommended that both an

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1. Craig v. Anyon, 208 N.Y.S. 259, 152 N.E. 431 (1925).
2. City of E. Grand Forks v. Steel, 141 N.W. 181 (1913).
3. State Street Trust Co. v. Ernst, 278 N.Y. 104, 15 N.E. 2d 416, 120 A.L.R. 1250 (1938); but see: Ultramares Corp. v. Touchee, 255 N.Y. 170, 174 N.E. 441, 74 A. L.R. 1139 (1931); O'Connor v. Ludlam, 92 F. 2d 50 (1937); Landell v. Lybrand, 107 A. 783 (1919).
4. Farrar v. Churchill, 135 U.S. 609 (1890).
5. 63 A.B.A. Rep. 322, 325, 326 (1938).
6. In re Bercu, 78 N.Y. S. 2d 209 (1948); Mandelbaum v. Gilbert & Barker Mfg. Co., 290 N.Y. S. 462 (1936).

attorney and an accountant be engaged to solve income tax problems. [1] Their argument is that the client is paying an accountant for answering incidental legal questions whereas the fee should be paid to the lawyers. The accountants' position is that these legal questions are not incidental to the problem, but collateral, with regard to the preparation of the return. At any rate, the hiring of an accountant and a tax lawyer would involve a higher financial burden on the taxpayer, who is already dismayed at the amount of tax he has to pay.

Accountants claim a prior right in the income tax field, insisting that they should not be cast out by the practice of lawyers who generally are incapable of handling the work efficiently. [2] Reliance is based on the public accountants' thorough training in accounting methods, and tax matters which most lawyers do not have. Accountants are almost unanimously versed in tax matters, whereas, in law the tax field is limited to specialists. This is evident even at the start of the careers of certified public accountants and lawyers. The examination passed by accountants included questions on income tax matters, while few bar examination even touch on the subject, nor is it a required course in most law schools. As a result of this, accountants have always handled the bulk of the community taxation problems.

The lawyer's latest argument is that the tremendous volume and complexity of federal taxation has substantially enlarged the scope of the lawyer's jurisdiction. They feel that in case of dispute the lawyer's technical judgment is required in statutory interpretations and in obtaining the best procedural devices available. Accountants are allowed to practice before the tax courts, so, naturally feel justified in rejecting the lawyer's viewpoint and relying on their own knowledge and judgment, at least until the case reaches the appeals stage in a court which reviews decisions of the tax courts in "the same manner and to the same extent as decisions of the district courts." [3] Accountants blame the conflict in this field on a mere handful of lawyers. The lawyers preach restraint of laymen whom they conceive to be invading their field and claim that protection of the public interest is their motive. [4] However, there is evidence that some of these lawyers are not animated by altruistic purposes but that the foremost motivation seems to stem from the desire to dominate a lucrative practice. [5]

The most recent entanglements between the professions have favored the

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1. 63 A.B.A. Rep. 322, 325 (1938).
2. 52 N.Y. State Bar Assn. Rep. 307 (1929).
3. 26 U.S.C.A. sec. 1141.
4. In the first session of the 81st Congress, there were two bills introduced: the Gillette Bill, S. 1944, supported by the Federal Bar Assn. of N.Y., which would restrict appearance before all government agencies, commissions and tax courts to attorneys; and the Walter Bill, H.R. 4446, supported by the A.B.A., which would restrict appearance before all government agencies, except tax courts, to attorneys. As of March 7, 1950, there had been no action on the Gillette Bill and the only action on the Walter Bill was the reporting of it in the House on June 24, 1949. Whether these bills pass or not, the mere introduction of them illustrates the lawyers' concern regarding the presenting of legal arguments before government agencies by laymen.
5. 85 Journ. Accoun. 182, 184 (1948).

lawyer's viewpoint. Perhaps the reason for this is that the bench is dominated by lawyers and not accountants. This is not to advocate the placing of accountants on the bench, but to observe that it will probably have to be the accountants who yield and perhaps desist in offering advice to prospective clients.

The foremost case to illustrate this point is In re Bercu. [1] Here, Croft Steel Products, Inc. had a lawyer, who was also an accountant, who had told the president of the company that a certain tax liability was not deductible for the year 1943, but must be charged back to the years in which the tax accrued. There had been no ruling by the tax commissioners in those years that Croft Company's products were taxable, so the Croft Co. had not charged a tax on the products. The president of the company consulted Bercu, a certified public accountant, and Bercu made a study of a score or more of the hundreds of cases on the question and found a decision to support the Company's position that since the Commissioner had not ruled in 1936 and 1937 that their products were taxable, it was proper to deduct the liability on their 1943 return, the year in which the liability was determined. Bercu wrote the company to this effect stating that the disputed tax liability was properly due and accruable in the year in which the dispute was settled. The New York County Lawyers' Association brought action against Bercu for the unlawful practice of law. The court held that Bercu was actually engaged in the unlawful practice of law because he was doing no accounting work for the taxpayer in the ordinary acceptation of an accountant's work. He had nothing to do with the taxpayer's books or its tax return. Inasmuch as Bercu was not doing accounting work he could not be permitted to give legal advice, despite his knowledge or use of the law. Justice Peck said that accountants may prepare income tax returns and assume legal jurisdiction of incidental legal problems that may arise in connection thereto, but may not, without engaging in an unauthorized practice of law, as an independent consultant, pass upon specific questions of law.

The court overruled the considerations of convenience and economy in favor of letting the accountant handle the matter, and based its decision on public protection for which the bar and bar standards are maintained and refused to let the accountant act as a public consultant on the law of his specialty.

Conclusion - The clear objective of both professions is to render the best service to client and community. How is this service to be rendered? The solution, if ever one is to be reached, must necessarily consider the interests of the public, the Government, lawyers and accountants. It has been suggested that the taxpayer should be permitted to buy his services where he wishes, but this is of no help because it is against the canons of the American Bar Association for lawyers to solicit business. [2]

The lawyers have been prone to say that wherever there is a question on law involved, they have exclusive jurisdiction. In days gone by, this was the proper solution and still might present the answer, but with the

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1. 78 N.Y. Supp. 2d 209 (1948); Aff. N.Y. Ct. of App., 87 N.E. 2d 451 (July, 1949).
2. Cannons of Professional Ethics of the A.B.A., Canon 27.

far reaching growth of government over our economy, [1] almost every activity of a purely commercial or management character is in some way covered by the law. For many of these fields covered by law the essential matter requires technical knowledge removed from the scope and training of the general practicing lawyer. If the lawyers desire exclusive jurisdiction in these fields, they must first qualify themselves in these fields. Obviously, an attempt to teach merely the details of technical bookkeeping lies outside the law school field. However, the well-equipped lawyer is obliged to know underlying accounting principles and perhaps a course in these principles as they relate to legal problems should be offered. On the other hand, it is necessary for accountants to recognize that they have no right to dabble in fields where their knowledge in superficial, viz., the technical or procedural phases of law. The accountants should take a definite course of legal studies, the most helpful of which would be partnerships, corporations, contracts, property, sales, taxation, and security transactions.

However, we must have some idea of where the line is between the respective duties of both professions. It is definite that the attorney would not want to make monthly reports of the accounts of the business entity even if he were qualified to prepare them. In the world of today the preperation of tax returns is the main reason for the keeping of accounts; therefore, the returns for the average accountant are merely the transfer of items from the books to the required return. This is definitely an accountant's job. The average lawyer would not feel this is in the field of law.

Where, then, do the two fields overlap? The accountant would have to know the law to a certain extent to be able to do a conscientious job for his client. Necessarily, in order to know the law, the accountant must also interpret the laws. This knowledge and interpretation of the law is only incidental to the accounting profession, when he is handling the accounts of the client. He would not be "practicing law" under this set-up.

However, it is submitted that when the accountant acts as a "tax consultant" and therefore is asked solely to interpret the law, this would be encroaching upon the field of the lawyer. When incidental to the keeping and auditing of accounts, his being consulted by the client is to be distinguished from the situation in which the advice is not collateral but direct legal advice.

This distinction would allow the accountant all necessary latitude in the practice of accountancy without stepping into the legal profession. As brought out in the Bercu case, supra,

> "The difference is that in one case the accountant is dealing with a question of law incidental to preparing a tax return, and in the other case he is addressing himself to a question of law alone."

Under this rational and practical adjustment of the conflict between the two fields, we shall find complete accord with the majority of members in both fields besides the benefit to the general public.

The next step to be taken is the representation of the client in the tax courts. Accountants have been and still are allowed to present the case in

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1. According to the Lawyer and Law Notes, Winter Issue, 1949, p. 2, a peak of 253 Federal agencies has been reached.

tax courts. It is argued that tax courts are conducted very informally and therefore legal procedure is not necessary, ergo the attorney is not needed. But today, when taxes are an important item in almost every business, it is necessary that the client be afforded every protection provided him under the law. The accountant is not qualified to give this protection. The client may feel that the cost of engaging an attorney will only mean more expense, but in the majority of cases he will be definitely protected and probably save money.

A good example of the protection is when "fraud" may be involved. Does the accountant know the legal implications of fraud? Would not the lawyer be more qualified? In almost every case evidences of fraud are always sought by the tax investigators. Would not this be important to the client when we consider that the penalty for fraud can be up to fifty percent of the tax due in addition to a jail sentence.

It is also necessary to look into the benefit to the courts which would be brought about by the saving of time through legal procedure known to the lawyer and not the accountant.

It is therefore submitted that practice before the tax courts is definitely the field of the attorney—never the accountant. As to the services rendered out of the courts, the problem should be solved in the following manner.

With an understanding of the functions of an accountant, the attorney will recognize an accounting problem when he sees it, and should advise the client to retain an accountant to handle that phase of the problem in cooperation with the legal phase. The accountant, by understanding the functions of a lawyer, will likewise recognize a legal problem and should recommend that the client call in an attorney. This procedure, if followed, will give the client maximum service; and though the fees will be a little higher, in the long run the client will save by being able to utilize the specialists in two professions.

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