

31st Annual Tax Symposium

ACCOUNTING MALPRACTICE LITIGATION: WHAT YOU (HOPEFULLY NEVER) NEED TO KNOW

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I. ANATOMY OF PROFESSIONAL LIABILITY LITIGATION

- A. Liability of CPAs is limited to statutory actions under MCL 600.1962.
 - 1. CPAs can be sued for intentional misrepresentation or fraud.
 - 2. CPAs can be sued by clients or by intended beneficiaries for negligent acts or omissions.
 - a. Claims of negligence against accountants are governed by the common law elements of professional malpractice.
 - b. A plaintiff must prove (1) that the plaintiff was either a professional client or intended beneficiary; (2) negligence in the performance of professional duties; (3) causation; and (4) the fact and extent of injury.

II. RETENTION AGREEMENTS AND STATUTE OF LIMITATIONS

- A. The statute of limitations for an action of accounting malpractice against a CPA is two years EXCEPT a plaintiff may file a malpractice complaint within six months after the plaintiff discovers or should have discovered the existence of the claim.
 - 1. The two-year period begins at the time that the accountant discontinues serving the plaintiff in a professional capacity as to the matters out of which the claim for malpractice arose.
 - 2. Six-month discovery period often begins with the Notice of Deficiency.

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B. Michigan cases discussing the statute of limitations in the context of claims of accountant malpractice.

1. *Levy v Martin*, 463 Mich 478 (2001)
 - a. “A client who entrusts preparation of annual tax returns to an accountant is provided with an assurance of professional preparation of the tax returns that induces the client to take no further action regarding those matters until it is time to prepare the next year's tax returns.”
 - b. Complaint filed in 1997 was timely even though it concerned tax returns in 1991 and 1992 because accountant-client relationship continued into 1996.
2. *JGM Transportation, Inc v Lewis & Knopf CPAs*, 2015 WL 773707 (Mich App, 2015) (unpublished)
 - a. Accountants “structured the tax preparation services as discrete transactions that ended with its written notice that the engagement had been concluded.
 - b. Complaint filed in 2012 concerning 2008 tax return was not timely because invoice stated that engagement was concluded.

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III. COMMON LIABILITY ISSUES: STANDARD OF CARE AND COMPARATIVE FAULT

A. Standard of care

1. To prove negligence, plaintiff must show that accountant did not exercise “the skill and care ordinarily possessed and exercised by practitioners of the profession in the same or similar localities.”
2. Expert testimony is necessary unless the lack of professional care is so obvious as to be within the common knowledge and experience of an ordinary layperson.

B. Comparative fault

1. “One’s duty to pay taxes cannot be circumvented merely by alleging that another party is contractually obligated to fulfill those responsibilities. [A taxpayer’s] lack of ordinary business care and prudence cannot be salvaged by claiming that he relied on the advice of his attorneys and accountants.” *United States v Red Stripe, Inc*, 792 F Supp 1338, 1345 (EDNY, 1992)
2. A tax preparer generally may rely in good faith without verification upon information furnished by the client. However, the practitioner may not ignore implications of the information, and must make reasonable inquiry if the information appears incorrect, inconsistent, or incomplete. 31 C.F.R. § 10.34(d).

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IV. COMMON DAMAGE ISSUES: TAX LIABILITY AND INTEREST

- A. Can a client recover back taxes in an accounting malpractice suit?
 - 1. Some jurisdictions do not allow recovery of back taxes.
 - a. The amount of a tax deficiency is not the measure of damages imputable to a negligent tax preparer. *Miller v Volk*, 63 Mass App 303 (2005).
 - b. Back taxes are not recoverable because they are payments rightfully due to the IRS. *Olenicoff v UBS AG*, 2012 WL 1192911 (CD Cal, 2012).
 - c. Recovery of back taxes would place investors in better position than before tax opinion. *Alpert v Shea Gould Climenko & Casey*, 160 AD2d 67 (NY App, 1990).
 - 2. Some jurisdictions allow recovery of back taxes if they would have been avoided with proper planning.
 - a. Tax liability can be recovered to the extent that taxes would have been avoided through required advice. *Eckert Cold Storage, Inc v Behl*, 943 F Supp 1230 (ED Cal, 1996).
 - b. Measure of damages is difference between what taxpayer would have owed absent negligent advice and what they actually paid. *DDRA Capital, Inc v KPMG*, 2018 WL 924204 (D VI, 2018).
 - 3. Michigan is undecided.

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4. Court said in *CJ Enterprises, Ltd v Rattenbury & Assocs, Inc*, 1996 WL 33324081 (Mich App, 1996) (unpublished) – “plaintiffs, as taxpayers, were at all times liable for any lawfully due tax.”
 - a. Plaintiffs representing taxpayers will argue that *CJ Enterprises* is not binding, and was deciding a statute of limitations issue.
- B. Can a taxpayer recover interest assessed by the IRS in an accounting malpractice suit?
 1. Some jurisdictions do not allow recovery of interest.
 - a. Plaintiffs had value of the use of money and would be unjustly enriched to recover that interest from another source. *Leendertsen v Price Waterhouse*, 81 Wash App 762 (1996).
 2. Some jurisdictions allow recovery of interest (to a limited extent).
 - a. Interest not recoverable only if the IRS charged a market rate of interest. *Stone v Kirk*, 8 F3d 1079 (CA 6, 1993); see also *O'Bryan v Ashland*, 717 NW2d 632 (SD, 2006).