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COMMENT OF THE SECTION ON COURTS, LAWYERS AND THE ADMINISTRATION OF JUSTICE OF THE D.C. BAR ON THE PROPOSED SALES TAX OF LEGAL SERVICES

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David Reiser
Arthur B. Spitzer
Richard B. Hoffman**

* Principal author
** Did not participate in this comment

THE FOLLOWING SECTIONS OF THE DISTRICT OF COLUMBIA BAR JOIN IN THIS COMMENT:

The District of Columbia Affairs Section; The Estates, Trust and Probate Law Section; The Family Law Section; The Injury to Persons and Property Section; The Labor Relations Section; The Patent, Trademark and Copyright Law Section

THE FOLLOWING VOLUNTARY BAR ASSOCIATIONS IN THE DISTRICT OF COLUMBIA JOIN IN THIS COMMENT:

The Bar Association of the District of Columbia; The American Immigration Lawyers Association - D.C. Chapter

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"The views expressed herein represent only those of the Section on Courts, Lawyers and the Administration of Justice of the District of Columbia Bar and not those of the D.C. Bar or its Board of Governors."

1707 L Street, NW, Sixth Floor, Washington DC 20036-4202 202/331-4364 Sections Infoline 202 223-7729 FAX 202/828-8572

SUMMARY OF THE COMMENT OF THE SECTION OF COURTS, LAWYERS AND ADMINISTRATION OF JUSTICE ON THE PROPOSED SALES TAX ON PROFESSIONALS

The Section of Courts, Lawyers and Administration of Justice opposes the enactment of the Bill currently before the City Counsel proposing a five percent sales tax on legal fees for the following reasons:

1. The burden of this tax is on clients, not attorneys.

2. The greater portion of the burden of this tax will be on the citizens and businesses of the District as opposed to clients outside the District. A large number of these clients are small businesses and individuals not easily able to bear the additional cost.

3. The tax does not tax discretionary expenditures, but, rather, taxes necessary expenses. It is a "misery tax" on those already suffering financial problems. For example, it would tax the cost of enforcing child support, civil rights, worker's compensation benefits, recovery for personal injuries, and other rights, as well as costs of defending against invalid claims.

4. The tax would discourage and limit access to justice by the citizens of the District.

5. The tax would have to be paid by churches, schools, hospitals and other charitable organizations who are already financially strapped.

6. The tax would put those attorneys who practice in the District at a economic disadvantage to those whose practice is

elsewhere, because it would encourage clients to utilize suburban attorneys.

7. A member of the D.C. Bar is not required to maintain an office in the District, and the tax would encourage attorneys to move their offices to the suburbs or elsewhere, resulting in a net economic loss to the District and a loss of legal services to District citizens.

8. Those smaller firms and practitioners without multi-jurisdictional offices or bar memberships, and thereby unable to move their practices, will be at a competitive disadvantage to the larger firms who have such mobility.

9. The national and federal emphasis of much of the practice of law in the District will mean that much of such practice will either not be subjected to taxation or will be performed by offices or firms outside of the District.

10. The Bill is unclear as to what services would be taxable as services "in the District of Columbia" and is therefore difficult to effectively and fairly administer and enforce.

11. The placement of the burden of collecting the tax on attorneys improperly interferes with the attorney-client relationship.

12. Enforcement of the tax may run afoul of the attorney-client privilege.

13. The tax would provide yet another disincentive to businesses locating or doing business in the District.

COMMENT OF THE SECTION ON COURTS, LAWYERS
AND ADMINISTRATION OF JUSTICE ON THE
PROPOSED SALES TAX ON LEGAL SERVICES

Bill 8-520, now being considered by the City Council, proposes to enact a five percent sales tax on legal services. The Section recognizes that there are serious financial needs by the District that need to be addressed. However, an attempt to solve these problems by taxing those citizens of the District who must pay for legal services is unfair and impractical. Although the Bill on its face proposes to tax attorneys, it is in reality a tax on clients and would affect almost every citizen of the District who seeks the assistance of the legal system. It would impose an additional financial burden on those least able to bear it. It would be a "misery tax," taxing the misfortunes of the city's citizens and it would discourage citizens of the District from seeking legal assistance. Moreover, the proposed tax would be an administrative nightmare, both for those who must pay it and those who must enforce it. The enactment of such a tax in the District of Columbia, with its unique geography and special status as National Capital, would penalize the residents of the District and the attorneys who practice in the District by imposing upon them a substantial economic disadvantage in favor of their suburban counterparts. The most onerous impact of this tax will not be on large law firms and large corporate clients, but on those smaller practitioners and clients much less able to bear the cost.

I. <u>The bill would impede the access to justice</u>.

The Bill does not take into account the effect a tax on legal services would have on the access to justice by the citizens of this District, a public policy issue that cannot be ignored in the city's search for new sources of revenue. It is an unfortunate fact of life in the legal professsion that a person usually hires an attorney not because he or she actively desires to do so, but because an attorney is necessary to enforce or defend that person's rights: the parent who must seek the aid of the court to enforce child support; the tenant who is being wrongfully evicted; the debtor facing bankruptcy or his or her creditor who is seeking to be paid for goods or services provided; the spouse who is seeking or defending a divorce action; the injured worker who seeks workers' compensation benefits; the citizen who seeks to enforce his or her civil rights; the immigrant who faces deportation; the injured person who seeks recovery from a tortfeasor; the defendant who is sued unjustly; the small business involved in a commercial dispute with a supplier; and the driver who faces revocation of his license. Every citizen of the District may need legal representation some day. These are not people who are paying for such assistance with their disposable income, as they might for new clothes or theatre tickets. Rather, these are people who are forced by circumstances to incur necessary expenses.

Such a "misery" tax on the citizens of the District of Columbia is inconsistent with the policy goals behind previous

District of Columbia sales taxes. By exempting from sales tax such items as groceries, medicine and medical appliances (D.C. Code §§47-2001(n.)(2)(E); 47-2005(14) and (15) the legislature recognized that it is inappropriate to tax the purchase of such necessaries. It is no less inappropriate to tax the necessary costs by which citizens secure access to the system of justice to enforce or defend their legal rights and interests.

It is true that the Bill would exempt from taxation legal services that are based on the right to counsel guaranteed by the Sixth Amendment to the United States Constitution and by D.C. Code §11-2601 (relating to provision of counsel to indigents). Section 102(K)(2)(A). But this right to counsel only attaches "at or after the initiation of adversary judicial proceedings against the defendant." United States v. Gouveia, 467 U.S. 180, 187 (1984). Thus, while attorney's fees for representing a criminal defendant after arrest or indictment would be exempt under the proposed act, attorneys fees incurred in successfully preventing an indictment would not. There is no sound policy reason for such a distinction. Moreover, there is no rational public policy basis for exempting attorneys fees for defending a criminal defendant while taxing the fees necessary to protect an abused spouse or to collect child support or to enforce any of the myriad rights for which citizens must turn to the judicial system for protection. Whatever the needs of this city are for additional revenue, it is simply bad policy to raise such revenue off of the misfortune of our citizens. Moreover, if, as a result

of the increased financial burden, citizens fail to seek legal counsel and thereby are not afforded their rights, this proposed tax will have done a disservice to this District that all the revenue it raises cannot outweigh.

The proposed tax is also regressive, taxing the very people, low and moderate income citizens and small business, for whom a five percent increase will be the hardest to bear. Even though the proposed tax is to be paid by attorneys, the Bill makes its clear that the client will ultimately have to pay the tax. (Sections 105(a), 109). For a business client in the District, this will mean a corresponding increase in the cost of doing business and, hence, prices to its customers. For an individual it will mean that the cost of justice will increase by five percent. Further, for individuals, unlike businesses, there will be no deduction on their income taxes for payment of this sales tax -- the client will have to absorb the tax in full.

Nor will charitable or religious organizations, hospitals or schools be exempt from this tax. Unlike the existing sales tax on goods (D.C. Code §§47-2001(r), 47-2005(3), (18), and (19)), the Bill offers no exemptions for these institutions. Whenever a church or school or hospital or youth organization or any of the myriad benevolent institutions in this city retains an attorney, it would be subject to the tax. Imposing such an additional cost of operation on those very groups who, with their limited funds, provide such substantial benefits to the city seems a perversion of tax policy.

II. <u>The Bill would unfairly discriminate against District of Columbia citizens and professionals in favor of those outside the District</u>.

The Bill and its accompanying letter set forth no realistic estimate of the revenue expected to be raised by a sales tax on legal services. However, whatever the revenue that is hoped for, it is plain that the economic consequences of the Bill would have a serious detrimental effect both on clients and attorneys in the delivery of legal services in the city. Unlike most jurisdictions, the District of Columbia is geographically small with a sizeable percentage of the goods and services utilized by its citizens -- including legal services -- provided by persons who live or work in the surrounding jurisdictions. In addition, the District's status as National Capital means that attorneys -- both members of the District of Columbia Bar and otherwise -- represent clients before federal courts, agencies, Congress and the executive branch pursuant to the right to petition the government under the First Amendment. These circumstances will make fair interpretation, administration and enforcement of the Bill extremely difficult and will impose an unfair and discriminatory burden on those clients and members of the Bar who seek or provide legal services in the District.

The Bill itself is far from clear on what services it proposes to tax. Rule 102(K)(1)(A) defines "taxable services" as including:

> The sale of or charges for legal services. For the purposes of this title, the term "legal services" means the services performed by a member of the bar or the member's agent,

> including providing legal advice, drafting, modifying, or reviewing documents, and representing others in legal, quasilegal, or other proceedings or in negotiations, conferences, or other deliberations.

Rule 104 provides, in pertinent part:

> A tax is imposed upon all vendors for the privilege of selling taxable services performed <u>within the District</u>.

(Emphasis supplied). Rule 105(a) provides, in part:

> Each purchaser <u>in the District</u> shall reimburse the vendor for the tax imposed by this title.

(Emphasis supplied).

Under the language of the bill, the tax appears to be imposed only upon a member of the Bar for legal services performed within the District. Although the bill's language does not appear to exempt services provided to out-of-District clients, Section 105, by its terms, appears to limit the attorneys right of reimbursement to a client("purchaser") <u>in the District</u>. This language is, therefore, susceptible to the interpretation that the attorney must pay the tax for all work he or she performs in the District, but can collect reimbursement only from clients located in the District.

Aside from the lack of clarity in the Bill's language itself, the special and unique characteristics of the practice of law make it virtually impossible to clearly define what services are to be taxed under the Bill. Abraham Lincoln's observation that a lawyer's time and advice are his only stock in trade particularly underscores the difficulty in determining what legal

services may be or are intended to be taxed under the Bill. Most professionals passionately espouse the uniqueness of their profession when compared with others, and attorneys do the same. However, the difficulties of determining whether legal services are performed "in the District" demonstrates that, with respect to taxing professional services, the practice of law is indeed different. A plumber or an architect or an engineer will generally provide services at or with respect to a piece of property, within or without the District. A copying service or a reporting service will make the copies or take a deposition at a determinable location in or out of the District. A retailer will make a sale in its store which is either in or out of the District. But the question of where an attorney performs his or her services is a much more difficult one.

The District of Columbia Court of Appeals, applying the Act of Congress creating the current District of Columbia court system, has made it clear that any member of the District of Columbia Bar may practice before the District of Columbia courts, whether or not that attorney has an office in the District. Haynes v. District of Columbia, 503 A.2d 1219 (D.C. 1986). According to D.C. Bar records, 12,626 out of 27,315 non-government members of the D.C. Bar have principal offices outside the District, and 4,639 have their only offices in nearby Maryland and Virginia. It is also clear that a substantial percentage, if not a majority, of D.C. Bar members also are admitted to the bars of another jurisdiction. Indeed, the

relative ease with which members of other bars may waive into the D.C. Bar has made it common for even those law school graduates who plan to practice in the District of Columbia to take another state's bar examination and waive into the District.[1/]

Under the Haynes ruling, an attorney with, for example, both District of Columbia and Virginia bar membership could prosecute and defend cases in District of Columbia courts and handle District of Columbia legal matters without even having an office in the District. Under the language of the Bill, such an attorney, if he performed work only in his Virginia office, would not be subject to taxation because his services were not performed in the District. Attorneys who kept their offices in the District, on the other hand, would be taxed in full for their services to their clients, simply because they performed the same services within the District.

Given the easy mobility of the residents of this region and the lack of a requirement of a District of Columbia office, the Bill imposes a burden on lawyers who remain in the District that is both unfair and unwise. D.C. lawyers are already at a disadvantage in relation to their suburban competitors, paying higher rates for office space and support staff. If a client can get the same service from a suburban attorney as from a D.C. attorney but must pay five percent more for using the D.C.

[1/] According to the District of Columbia Court of Appeals, in 1989, 4,284 new members of the bar were admitted on motion from other jurisdictions as opposed to 320 by examination.

attorney, the client will be more inclined to consult an attorney from Maryland or Virginia. Facing such a competitive disadvantage, the attorney now in D.C. -- particularly the solo or small firm practitioner whose profit margin is not large enough to withstand such a loss of clients --will be inclined to move his or her practice to the nearby suburbs.

Moreover, amending the Bill to tax all services in litigation before the District of Columbia Courts will not solve the problem. Not only could such an amendment not properly apply to litigation before the federal courts of this jurisdiction (see page 11-12 below), it could also not encompass the vast amounts of non-litigation services which make up the bulk of the practice of law in this area. Commercial advice, federal taxation, and estate planning are just a few of the areas on which a client could consult a Virginia or Maryland lawyer rather than a D.C. lawyer, thereby avoiding payment of the tax and taking prospective clients from lawyers who remain in D.C. This is particularly true of suburban clients who now consult D.C. lawyers, but the tax would also encourage District of Columbia residents to seek legal advice elsewhere.

The presence in the District of many large multi-office firms creates additional difficulties in administering any sales tax on legal services. First, the ability of such firms to charge many of their services to an office outside of the District would make enforcement difficult and would unfairly place the tax burden on those D.C. firms without such multiple

offices. Moreover, many D.C. firms are in reality "national" law firms whose work involves clients, issues, and litigation outside the District and has no connection with the District other than the fact that a party is represented by the D.C. firm. For example, if a D.C. firm represented an Oklahoma client in the courts of Oklahoma in a case involving Oklahoma law, would the tax apply because the work or a majority of it was done in the firm's D.C. office? Enforcement of the tax might be prohibited under the due process clause of the Constitution as a "tax upon the exercise or enjoyment of a right or privilege in another state derived from the laws of that state and therein exercised and enjoyed." Great A&P Tea Co. v. Grosjean, 301 U.S. 402, 424 (1937); accord; American Oil Company v. Neill, 380 U.S. 451 (1965). Even if the tax were determined not to violate the Constitution, it would certainly discourage the out-of-state client from retaining the District of Columbia law firm and discourage the firm from conducting any of its out-of-state practice in its District of Columbia office. Indeed, there would be substantial economic pressure on such "national" firms to move the bulk of their work and staff out of the District altogether.

Not only will the large "national" law firms be better able to avoid the tax, but large business clients will have a similar advantage over their smaller competitors. Large corporate clients will be best able to avoid the tax by hiring out-of-District counsel or by simply employing in-house counsel to perform their legal services and thereby take advantage of the

exemption for "[s]ervices rendered by an employee for an employer" in Section 102(K)(2)(B). Smaller District of Columbia businesses needing the assistance of D.C. attorneys will not be able to easily take advantage of these options and will have to pay the tax, thereby incurring an additional economic disadvantage in favor of their larger competitors.

The District's status as seat of government provides another compelling argument against the tax. There are thousands of D.C. attorneys whose entire practice is before the Supreme Court and other federal courts or federal agencies, or involves pleading their client's position before Congress or the executive branch. There are undoubtedly many attorneys from outside the District who perform the same function. There is no requirement of D.C. Bar membership or of a D.C. office on an attorney who appears before the Supreme Court (Sup. Ct. R. 5.1), the District of Columbia Circuit Court of Appeals (Fed R. App. Proc. 46(a)), the Federal Circuit (Local Rule 46(a)), or the United States Claims Court (Rule USCC 81(b)). There is likewise no such requirement in order to appear before any federal agencies or commissions. Rule 49(c) of the District of Columbia Court of Appeals, regulating the unauthorized practice of law, has a "federal exception" to the requirement that only members of the D.C. Bar practice law in the District of Columbia, specifically permitting attorneys who are not members of our bar to appear before any federal court, department or commission. Rule

49(c)(3) and (4).[2/] Such an exemption implements the right of all citizens of the United States to petition their government, incorporated in the First Amendment. This right has been recognized for years by the District of Columbia courts under the "government contacts doctrine" which precludes our Courts from exercising personal jurisdiction over a person or corporation whose only contact with the District is an appearance before or petition to an agency of the federal government. Environmental Research International Inc. v. Lockwood Greene Engineers, Inc., 355 A.2d 808 (D.C. 1976).

The District's jurisdiction to tax D.C. attorneys for an exclusively federal practice is subject to question. However, even if the District were deemed to have such jurisdiction, there is nothing to prevent clients seeking an advocate before the federal courts or federal government from hiring an out-of-District lawyer who could provide the identical service without the impediment of the tax. Faced with such a competitive disadvantage, there is likewise no reason why most District of Columbia attorneys whose practice is strictly federal could not just as easily practice over the District line and similarly avoid the tax, taking employment and office rental revenue with them.

[2/] Rule 49(c)(1) even allows non-admitted attorneys to practice in the local courts of the District of Columbia on a pro hoc vice basis so long as they do not handle more than five actions per year before those courts and provided they do not maintain an office in the District.

In addition, the Bill would, at a minimum, create the serious practical problem of apportioning fees for those services performed in the District with those performed outside. James v. Dravo Contracting Co., 302 U.S. 134 (1937). Given the multi-jurisdictional nature of the practice of even the smaller practitioners in this region, this burden will fall most heavily on such small practitioners who do not have the extensive bookkeeping and accounting capability of the larger firms. It is worth pointing out that very few states have enacted a tax on such professional services. The most recent to do so, Florida, repealed the tax within six months after its enactment. (Chapters 87-6; 87-99, 87-402; 87-548, Laws of Florida (West's Session Law Service)). Plainly, in neither Florida nor any other jurisdiction does there exist the type of geographical and political factors that exist here and that make a tax on legal services here particularly inappropriate.

III. The Bill will adversely affect the attorney-client relationship.

In addition to the unfair burden on both the citizens and attorneys in the District of Columbia, all attorneys will face serious professional problems as a result of having to act as tax collectors from their clients. The Bill provides that the vendor (the attorney) must pay the tax (Section 104) and seek reimbursement from the client (Section 105). If the attorney pays the tax and the client refuses to pay the tax, because of disagreement with apportionment between in-and-out-of-District

services or otherwise, the Bill leaves to the attorney the resolution of such a dispute and the enforcement of such reimbursement by the client. This is completely different from the ordinary situation in which a sales tax is collected and places an unfair burden on an attorney which other vendors do not bear. While a retailer will collect the tax at the time of the sale and, indeed, not turn over the item purchased until the tax is paid, an attorney is obligated to pay the tax whether or not the client pays the tax. In addition, the attorney is not in a position to withhold his or her legal services until the tax is paid. If the client does not pay, the Bill gives the attorney no more than an ordinary unsecured debt. If the attorney wishes to enforce the debt, he or she must sue the client. Indeed, the fact that the language of Section 105(a) imposes a legal obligation to reimburse the attorney only on residents of the District of Columbia leaves open the possibility that the attorney will not be able to secure reimbursement from an out-of-District client. Not only is it unfair to treat attorneys differently from other vendors by requiring them to pay tax without the present ability to obtain reimbursement, the Bill's requirement that the attorney pay the tax and then attempt to collect it from the client raises serious ethical concerns.

Rule 1.7(b)(4) of the Rules of Professional Conduct recently adopted by the District of Columbia Court of Appeals provides that an attorney "shall not represent a client with respect to a matter if . . . the lawyer's professional judgment

on behalf of the client will be or reasonably may be adversely affected by . . . the lawyer's own financial, business, property or personal interests." Rule 1.8(a) provides: "A lawyer shall not . . . knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client . . ." except under certain limited circumstances. That the attorney must bill for services already and unavoidably contains seeds of discord. By placing the attorney in the position of having to enforce a tax obligation against his or her client, the Bill makes the situation much worse. It is one thing for a merchant to be in an adversary position with a supplier or customer and quite another for an attorney to be forced to maintain a hostile position while at the same time attempting to retain an ongoing fiduciary relationship with a client.

The enforcement of this tax obligation also impedes the attorney-client relationship because in many cases an attorney will be unable to rebut the presumption of taxability under Section 108 without violating the attorney-client privilege, something the attorney is ethically forbidden to do. Rules of Professional Responsibility Rule 1.6. The privilege is the client's not the attorney's, and, because the attorney, not the client, is the person liable to the District for the tax, the client has no reason to waive the privilege in such a case. The necessity for apportionment between in and out-of-District services performed for a client made necessary by the multi-jurisdictional nature of the practice in the District will be a

particular source of problems in this regard. In the event the District chooses to audit the allegation, how is the attorney to show it was appropriate? While it is perfectly proper for a commercial vendor to open its books and records to the District and permit an audit of them, it would be entirely improper for an attorney to open his or her files to such an audit to show what work actually occurred out of the District.

IV. Conclusion:

The proposed sales tax on legal services cannot be viewed only in the context of a scheme to raise revenue for the city. If adopted, it will have ramifications affecting the economic wellbeing of both clients and attorneys in the District and, more importantly, affecting the access of our citizens to justice. The tax will place District of Columbia lawyers at a real competitive disadvantage, encouraging clients to seek legal assistance elsewhere and ultimately forcing many attorneys to move to the nearby suburbs to avoid the tax and the loss of clients. The tax will force attorneys to become tax collectors from their clients. It will create an interest on the part of attorneys adverse to their clients, placing an unwarranted strain on the attorney-client relationship. Most importantly, however, it will place the burden of this tax on the backs of those citizens of the District who must avail themselves of the legal system, the very persons whose access to justice should be encouraged, not impaired.