

1707 L Street, N.W.
Sixth Floor
Washington, D.C.
20036-4202
(202) 331-4364
FAX (202) 828-8572
Sections Infoline
(202) 223-7729



SECTIONS
THE DISTRICT OF COLUMBIA BAR

Robert N. Weiner
Chair, Council on Sections
Jonathan N. Eisenberg
Vice Chair,
Council on Sections

Charles F.C. Ruff
D.C. Bar President
Sara-Ann Determan
D.C. Bar President-Elect
Katherine A. Mazzaferri
D.C. Bar Executive Director

Lynne M. Lester
Sections Manager

Memorandum

BY FAX

TO: Section Chairpersons
FROM: Lynne M. Lester *LM*
DATE: March 7, 1990
SUBJECT: Emergency Consideration of Proposed
Comments on the D.C. Professional Services
Sales and Use Tax Legislation

The D.C. Bar Taxation Section has requested to conduct an emergency mailing to the Bar's 23,000 active metro members concerning the above-mentioned issue. So that the mailing will be received before the filing deadline set for Wednesday, March 14, your comments on the enclosure are needed by the close of business today, Wednesday, March 7.

Please call me at 331-4364 if there are any questions.

Enclosure
cc: Katherine A. Mazzaferri, Esq. (w/o enclosure)

TAXATION SECTION



The District of Columbia Bar

Committees:

Business Related Taxes
Employee Benefits
Estate Planning/Death Related Taxes
Exempt Organizations
Tax Audits and Litigation
Tax Policy

Steering Committee:

Jane C. Bergner, Chair
Collette Goodman
Ellen A. Hennessy
Gerald A. Kafka
Stephen A. Naubelm
Cella L. Roady
Bradley Seltzer
Charles B. Temkin

Robert N. Weiner
Chair, Council on Sections

Jonathan N. Eisenberg
Vice Chair, Council on Sections

Charles F.C. Ruff
D.C. Bar President

Sara-Ann Determan
D.C. Bar President-Elect

Andrew H. Marks
Board of Governors Liaison

Katherine A. Mazzaferri
D.C. Bar Executive Director

Lynne M. Lester
Sections Manager

March 6, 1990

MEMORANDUM TO MEMBERS OF THE DISTRICT OF COLUMBIA BAR

RE: *DISTRICT OF COLUMBIA PROFESSIONAL SERVICES SALES AND USE TAX OF 1990, BILL 8-520*

THE SECTION OF TAXATION OF THE DISTRICT OF COLUMBIA BAR URGES YOU AND YOUR FIRMS TO OPPOSE THIS BILL BY WRITING TO AND CONTACTING MEMBERS OF THE CITY COUNCIL, AS WELL AS TESTIFYING AT THE HEARING ON THE BILL.

• The bill would impose a 5-percent sales tax on certain professional services performed in the District of Columbia, including "legal services" which are broadly defined to include services performed by members of the Bar or their agents (most likely including nonlawyer participants in law firms, as permitted by the revised Rules of Professional Conduct effective January 1, 1991).

• The tax must be separately stated to clients on bills, and upon payment of the fee, the attorney is responsible for payment of the tax.

• In our Section's view, if this bill is passed by the D.C. City Council, it will: (1) put D.C. attorneys at a competitive disadvantage when compared with their counterparts practicing in Maryland, Virginia and other jurisdictions; (2) present significant problems in determining whether certain services are performed in D.C. and, in that context, create attorney-client privilege problems; (3) impose additional financial burdens on clients who have a limited ability to pay for legal services, including non-profit corporations and individuals involved in actions such as divorce, child custody, personal injury and contract enforcement; (4) impact small and minority businesses who retain attorneys; (5) tax services, such as lobbying, performed by a lawyer which, if performed by a non-lawyer, would not be taxed; and (6) in the end, impact adversely on the District of Columbia's finances by diminishing the revenues of D.C. law firms and causing both a flight of law firms to the suburbs and a reallocation of legal work to suburban offices of D.C. firms, thereby decreasing the demand for goods and services and the tax base in the District of Columbia.

• Only Councilman John A. Wilson has indicated opposition to the bill. Other members of his Finance Committee are Charlene Drew Jarvis, H.R. Crawford, Betty Ann Kane and Hilda Mason. They have not yet declared their position.

• The names and addresses of the members of the City Council are enclosed.

• The hearing is set for Friday, March 16, 1990. The details are also set out on the enclosed sheet.

TIME IS OF THE ESSENCE. WE URGE YOU TO TAKE IMMEDIATE ACTION.

1. The views expressed herein represent only those of the Section of Taxation of the District of Columbia Bar and not those of the District of Columbia Bar or its Board of Governors. The Section of Taxation is comprised of approximately 1,400 members.

TAXATION SECTION



The District of Columbia Bar

Committees:

- Business Related Taxes
- Employee Benefits
- Estate Planning/Death Related Taxes
- Exempt Organizations
- Tax Audits and Litigation
- Tax Policy

Steering Committee:

- Jane C. Bergner, Chair
- Collette Goodman
- Ellen A. Hennessy
- Gerald A. Kafka
- Stephen A. Nauheim
- Cella L. Roady
- Bradley Seltzer
- Charles B. Temkin

**STATEMENT OF THE SECTION OF TAXATION OF
THE DISTRICT OF COLUMBIA BAR¹
ON THE PROPOSAL TO IMPOSE A SALES AND USE TAX
ON PROFESSIONAL SERVICES,
BILL 8-520**

**BEFORE THE COMMITTEE ON FINANCE AND REVENUE
OF THE
COUNCIL OF THE DISTRICT OF COLUMBIA**

March 16, 1990

Members of the Committee:

- Robert N. Weiner
Chair, Council on Sections
- Jonathan N. Eisenberg
Vice Chair, Council on Sections

- Charles F.C. Ruff
D.C. Bar President
- Sara-Ann Determan
D.C. Bar President-Elect

- Andrew H. Marks
Board of Governors Liaison

- Katherine A. Mazzafetti
D.C. Bar Executive Director
- Lynne M. Lester
Sections Manager

My name is Jane C. Bergner. I appear before you today as Chair of the Section of Taxation of the District of Columbia Bar to offer for your consideration our Section's comments on the proposal to impose a 5-percent District of Columbia sales tax on the services of attorneys and other professionals. As Chair of our Section's Steering Committee, I can speak only for the approximately 1,400 members of our Section and not for the District of Columbia Bar or the Bar's Board of Governors. Because our Section is comprised of tax specialists, however, we believe that we can make a useful contribution to the Council's deliberations on the tax proposal.

¹ The views expressed herein represent only those of the Section of Taxation of the District of Columbia Bar and not those of the District of Columbia Bar or the Bar's Board of Governors. The Section of Taxation is comprised of approximately 1,400 members.

Statement of the Section of Taxation of
 The District of Columbia Bar on Bill 8-520
 March 16, 1990
 Page 2

Summary of the Section of Taxation's Position

Our Section believes that Bill 8-520 presents serious legal, practical and policy problems which militate against its passage by the Council. In our view, if this Bill is passed: (1) it will be subject to serious constitutional challenges; (2) it will put District of Columbia attorneys and other covered professionals at a competitive disadvantage when compared to their counterparts practicing in other jurisdictions, including Maryland and Virginia; (3) it will present significant problems in determining whether certain services are performed in D.C. and, in that context, create attorney-client privilege problems; (4) it may place attorneys in the position of providing prohibited advances to their clients, thereby creating conflicts of interest in violation of the Rules of Professional Conduct; (4) it will impose additional financial burdens on District of Columbia residents who have a limited ability to pay for legal services, including nonprofit organizations and individuals involved in actions such as divorce, child custody, personal injury, eviction and contract enforcement; (5) it will adversely impact small and minority D.C. businesses which retain attorneys; (6) it will unfairly tax services, such as lobbying, performed by an attorney or principals in a law firm which, if performed by a non-lawyer, would not be taxed; (7) most importantly, in the end, it will impact adversely on the District of Columbia's finances by diminishing the revenues of D.C. law firms and causing both a flight of law firms to the burbs and a reallocation of legal work to suburban offices of D.C. firms,

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 3

thereby decreasing the demand for goods and services and the tax base in the District of Columbia.

The Possibility of a Constitutional Challenge

Time does not permit me to go into at length the constitutional problems inherent in Bill 8-520, but I will outline them briefly. A significant number of attorneys practicing in the District of Columbia, including those who reside in jurisdictions other than D.C., have national practices which involve largely representation of clients before Federal governmental agencies and the Congress of the United States. The District of Columbia courts have consistently held that an office established in the District solely for the purpose of contacts with Federal agencies is an insufficient basis for personal jurisdiction because, if the District were to exercise such jurisdiction, it would place an impermissible burden on the First Amendment constitutional right of the people to petition the Government for the redress of their grievances. It would seem that the same rationale would apply to attorneys who maintain offices in the District of Columbia for the principal purpose of representing clients in their disputes before Federal agencies, such as the Internal Revenue Service, and in litigation which may ensue in the Federal courts located here, such as, for example, the United States Tax Court and the United States Claims Court.

Similarly, lobbying activities on behalf of clients who are, in effect, petitioning Congress would also come within United States citizens'

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 4

First Amendment right to petition the Government for a redress of their grievances, and representation of clients in such matters should not be subject to taxation under the United States Constitution.

Taxation of the receipts from governmental representation, such as lobbying activities performed by attorneys, is all the more objectionable when one considers that gross receipts of non-lawyers who perform governmental representation would not be subject to taxation under the Bill. A number of law firms practicing in D.C. currently have affiliated organizations -- not now within the aegis of their firms -- which perform consulting services that include governmental relations. New Rules of Professional Conduct which have been issued by the District of Columbia Court of Appeals would permit non-lawyers to become principals in law firms effective January 1, 1991. It may be that, as a result of these new Rules, a number of law firms will bring within their firms principals who previously performed lobbying and consulting services in the context of a separate organization. If this does occur, under Bill 8-520 activities which would be untaxed if they were still conducted separately will be subject to taxation.

We suggest that there will be a number of meritorious constitutional challenges to the legislation before you.

The Competitive Disadvantage in Which the Bill Would Place Attorneys

Washington attorneys and other professionals would stand to lose substantial business to competing law firms in other jurisdictions,

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 5

particularly to firms in nearby Maryland and Virginia where office rentals and overhead costs are already significantly lower than those in D.C. There are a number of matters where attorneys practicing in the contiguous jurisdictions could just as easily represent clients as attorneys in D.C., including estate planning, negligence and the drafting of documents such as contracts. As I mentioned earlier, the costs of practicing in these jurisdictions are already lower than those in D.C. When Washington attorneys are forced to add a 5-percent tax to their bills, clients may take their business to other attorneys, where the work can be done at a lower cost.

With respect to national representation of clients, Washington law firms frequently compete with attorneys in other large cities for business. When potential clients -- including large corporations who are vigilantly watching their costs -- learn that there is an additional 5-percent cost in retaining a law firm in D.C., they may well give their business to the law firms in other states which do not have an add-on 5-percent tax.

While it this may sound like a "pocketbook" argument on the part of attorneys, I would point out that a diminishment in the income of attorneys resident in Washington due to the placement of business in other jurisdictions by former and prospective clients will have the effect of lowering the income tax base of the District of Columbia both in terms of the income of attorneys who themselves are residents and in terms of the District residents whom law firms employ. Moreover, we have a legitimate concern

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 6

about the District engaging in actions which injure its residents financially.

Problems Inherent in Determining Whether Legal Services Are Performed in the District of Columbia

The tax would be an administrative problem both for the District and for those who would be required to comply with it. Sales and use taxes were originally designed for transactions involving the purchase at retail of tangible personal property. Thus, transactions traditionally subject to the tax have generally been easily identifiable and, for the most part, have occurred entirely within the taxing jurisdiction.

A sales tax on the services performed by attorneys and other professionals in the District of Columbia raises complicated issues. First, an attorney does not typically sell his or her services in a single transaction but may spend days, months or even years advising his or her client or representing his client in complex litigation. Often an attorney receives a retainer payment from a client to be applied to billings for both current services and future services which have yet to be performed, as well as for disbursements. Is that entire retainer subject to tax before the attorney has even performed the services to which it relates, and how is an allocation to be made between current and anticipated services and disbursements so that the appropriate amount is subject to taxation? Moreover, should disbursements be subject to the collection of tax by an attorney?

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 7

The problems inherent in determining whether the legal services performed in the District by firms whose practice is national, and even international, are daunting. For example, suppose a Washington attorney mails a legal opinion to a client which results both from services performed outside the District and legal research performed in the District; what portion, if any, of the attorney's receipts would be subject to sales tax within the District? Traditionally, if goods are sold to a purchaser who resides outside of the taxing jurisdiction, they are not subject to sales tax by the jurisdiction. Does the same rule apply when an attorney's "product" is provided to a non-District client?

If attorneys are required to make allocations between receipts for services within and without the District, in order to subject only those receipts from clearly identifiable D.C. services to taxation, and if such allocations are subject to audit by the District in order to determine their correctness, significant attorney-client privilege problems arise. As you know, communications between attorneys and their clients are confidential under long-promulgated codes of professional conduct. Many attorneys send detailed invoices to their clients which set out the nature of the legal services performed for such clients. If such attorneys were required to divulge these communications in the course of compliance audits by the District government, they would most likely be unable to comply unless disclosure was authorized by their clients. In fact, there is a significant question as to whether, absent authorization, attorneys may

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 8

divulge even the names of their clients without running afoul of the Code of Professional Conduct. At the moment, for example, there is litigation between the Internal Revenue Service and 956 defense lawyers because, under legislation, the IRS has sought the names of the attorneys' clients who paid large fees with cash. In response to summonses issued by the IRS, these lawyers maintain that producing such records violates their client's right to confidentiality. While we realize that this is a problem unique to the imposition of a sales tax on attorneys, nevertheless, we want to alert the Council in advance to what is certain to be a legal challenge if attorneys must comply with certain tax-administration directives.

We would also point out that the District is still "recovering" from the tremendous manpower drain that was necessitated by its previous effort to impose a commuter tax on professionals. Is the District prepared to incur again the additional costs associated with auditing sales tax returns to prevent evasion and check compliance?

The Additional Financial Burdens that Would Be Imposed upon Small and Minority Businesses, as well as on Clients with a Limited Financial Capacity

I have already mentioned the adverse impact that the Bill would have on Washington attorneys who perform traditional legal services. To the extent that District residents do not take their business to attorneys practicing elsewhere, the Bill will impose a significant additional cost on those who have the least capacity to pay -- D.C. residents who retain

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 9

attorneys to represent them in matters such as eviction, divorce, child-custody, personal injury, etc. and small and minority businesses that need legal advice in order to prudently manage their operations, operations which, in turn, provide employment for District residents and, thereby, expand its income tax base. Moreover, there is no relief in the Bill for nonprofit charitable organizations which benefit District residents. These organizations regularly need legal advice. To the extent that they have to pay an additional 5-percent tax for that advice, they will have fewer assets with which to benefit District residents.

Possible Conflict-of-Interest Problems

While we realize that this point may be unique to attorneys, the Bill presents a potential conflict of interest between attorneys and their clients. Subject to contingent-fee arrangements, the current District of Columbia Code of Professional Responsibility for lawyers and the newly issued Rules of Professional Conduct prohibit an attorney from acquiring a possessory interest adverse to a client or, in the context of administrative proceedings or litigation, from advancing or guaranteeing financial assistance to a client, except for the expenses of the proceedings or litigation itself or, effective January 1, 1991, medical or minimum living expenses during the litigation if a client is financially unable. Traditionally, court costs alone could be advanced.

Under the Bill as we read it, if a client were to pay for legal services but fail to pay the District sales tax, then the attorney himself

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 10

or herself would have to pay the tax, with the right of an unsecured creditor against his or her client. If this were to arise in the context of a lawyer's representation in administrative proceedings or litigation, the attorney would be placed in the position of advancing costs for his or her client. Based upon our legal research, we doubt that an advancement of District sales tax would be considered a cost of either the litigation or the administrative proceedings. As a result, District attorneys might be prohibited from paying the sales tax. Indeed, in a recent decision, the United States Tax Court permitted an attorney to withdraw from representation of his client because the client had failed to pay the attorney's invoices and the Court viewed the attorney's, resulting interest in the client's potential for recovery as violative of the Canons of Ethics.

The Diminishment of the District's Tax Base

In the end, what would happen, in our view, as a result of the imposition of a sales tax is that lawyers who could just as easily practice in the suburbs -- and at a lower cost -- will flee to nearby Maryland and Virginia. In addition, there are a large number of multi-city law firms with offices located in the District. They will succumb to the pressure to reassign work to their offices in other cities. Such a reassignment will only benefit those other cities.

Some large firms in the District already maintain offices in Maryland and Virginia. Since a number of their attorneys who reside in those jurisdictions may be delighted to practice law there as well, they may

Statement of the Section of Taxation of
The District of Columbia Bar on Bill 8-520
March 16, 1990
Page 11

associate themselves with those offices and perform their legal services in Maryland and Virginia. What this will mean is a shrinking of the size of D.C. firms, and perhaps even an elimination of some firms, with a concurrent growth in firms practicing in Maryland and Virginia. The result will be that less District residents will be employed by District law firms, and the vendors used by those firms will be from other taxing jurisdictions. This will, of course, decrease both the demand for goods and services and the tax base in the District.

Conclusion

Our Section of Taxation has worked with the Department of Finance and Revenue in the past. Indeed, its Deputy Director has appeared on panels at a number of meetings of our Section and, most recently, last June at the annual meeting of the Bar itself. All of us who work in the District are well aware of the District's need for revenues. We do not believe, however, that such a need should be met by passage of the Bill currently before you, and we urge you not to regard the bill as a "quick fix." Instead, we urge you to rely upon us, as the Department of Finance and Revenue has done in the past, to work with you to evaluate alternative methods of raising the revenues that the District needs.

Thank you for permitting me to testify before you today.²

² A list of the names and professional affiliations of the members of the Steering Committee of the Section of Taxation is annexed to this testimony.

SECTION OF TAXATION, DISTRICT OF COLUMBIA BAR

STEERING COMMITTEE MEMBERS

Jane C. Bergner, Esquire, Chair
Faith and Zell, P.C.
2300 M Street, N.W.
Suite 600
Washington, D.C. 20037
(202) 293-1600

Collette C. Goodman, Esquire
Shea & Gardner
1800 Massachusetts Avenue, N.W.
Washington, D.C. 20036
(202) 775-3028

Nell A. Hennessy, Esquire
Willkie Farr & Gallagher
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036
(202) 328-8000

Gerald A. Kafka, Esquire
Steptoe & Johnson
1333 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 429-6271

Stephen A. Nauheim, Esquire
Anderson, Hibey, Nauheim & Blair
1708 New Hampshire Avenue, N.W.
Washington, D.C. 20009
(202) 483-1900

Celia L. Roady, Esquire
Ginsburg, Feldman & Bress
1250 Connecticut Avenue, N.W.
Seventh Floor
Washington, D.C. 20036
(202) 637-9196

Bradley M. Seltzer, Esquire
Sutherland, Asbill & Brennan
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2404
(202) 383-0159

Charles B. Temkin, Esquire
Shaw, Pittman, Potts & Trowbridge
2300 N Street, N.W.
Washington, D.C. 20037
(202) 663-8425