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New York's Law of Tax Malpractice Damages: Balanced or Biased?

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NEW YORK’S LAW OF TAX MALPRACTICE DAMAGES:
BALANCED OR BIASED?

By

Jacob L. Todres*
I. Introductory

Generally, in the United States, when a tax advisor is negligent and causes damages to his or her client, the most commonly encountered recoverable direct damages include (1) additional taxes caused by the negligence, (2) interest paid to the government on any tax underpayment (3) penalties imposed by the government for a tax underpayment and (4) corrective costs incurred in attempting to mitigate all or some of the foregoing damages.\(^1\) In New York the first two types of damages – additional taxes and interest – are not recoverable. New York’s position on both of these elements of damages is based upon principles enunciated in *Alpert v. Shea Gould Climenko & Casey.*\(^2\)

*Alpert* involved a fraud cause of action asserted against two law firms involved with a tax shelter in which the plaintiffs invested and which turned out to be ineffective. The claim for back taxes was dismissed by the trial court on defendants’ motion for summary judgment. The reason for the dismissal was because the court held that under the facts of *Alpert* a recovery of back taxes would put the plaintiffs in a better position than if they had never invested in the tax shelter at issue.\(^3\) With respect to the recovery of the interest paid by the plaintiff on their tax underpayment, the First Department reversed the trial court’s denial of the defendants’ motion for summary judgment on this issue and held that such interest does not constitute damages; instead, it merely represents an appropriate charge to the plaintiffs for the tax money they held during a period of time when they were not entitled to hold such money.\(^4\)

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\(^1\) Jacob L. Todres, *Tax Malpractice Damages: a Comprehensive Review of the Elements and the Issues*, 61 Tax Law 705, 712 (2002) (hereinafter “Malpractice Damages”). Other types of damages may also be recoverable in appropriate situations. *Id.* at 736.


\(^3\) *Id.* 559 N.Y.S.2d at 315

\(^4\) *Id.*
In my view New York’s law should be changed with respect to both of these elements of damages and both should be recoverable as a matter of New York negligence law. As to the recovery of additional taxes, while Alpert’s conclusion that such taxes were not recoverable are likely correct under its facts, Alpert was addressing damages recoverable in a fraud cause of action. There is absolutely no reason or justification to extend this fraud measure of damages to recoveries in negligence causes of action. Indeed, the application of New York’s well established negligence damage principles would permit the recovery of such additional taxes. The theory of damages in the fraud arena is very different from the theory of damages in the negligence arena and it is inexplicable why the fraud rule was transplanted into the negligence arena.

As to Alpert’s position on the non-recoverability of interest, while the court’s position may have been both appropriate under its facts as well as a progressive divergence from the majority view at that time, this position should be changed. A recent line of cases outside New York has developed a more just and nuanced approach to this issue which permits a plaintiff to recover the difference, if any, between the interest paid the government and the actual earnings received by the plaintiff on the underpaid taxes. New York should adopt this position with respect to the recoverability of interest.

Before proceeding, it is necessary to clarify certain preliminary matters. With respect to additional taxes, it is very important to understand that this element of damages addresses only the additional taxes caused by a tax advisor’s negligence, not those taxes that a plaintiff would owe in any event. To illustrate, assume a plaintiff who would owe taxes of $100,000 if her or his tax return was properly prepared, but who paid taxes of $120,000 due to the negligence of the tax advisor (i.e. either deductions were omitted or taxable income was overstated). It is only the
recoverability of the additional $20,000 that is addressed. The basic, correct $100,000 of taxes owed the government may never be collected from the negligent advisor.5

With respect to damages for interest, this refers only to the interest charge imposed by a government on a tax underpayment. Whenever a tax advisor’s negligence results in a tax underpayment by the client, such interest will be incurred because federal,6 New York7 and probably most, if not all, other state laws8 impose an interest charge on tax underpayments. Other types of interest that might be recoverable in appropriate tax malpractice situations are not addressed.9

Generally, in a tax malpractice situation in the United States where an attorney or accountant was negligent in giving tax advice, the damages suffered are normally recovered by means of a malpractice suit. Although many different types of tort and contract claims are encountered,10 recovery in such situations is most often obtained under the traditional tort of negligence.11 The elements of this cause of action generally include (1) a duty owed by the defendant attorney or accountant to the plaintiff, (2) breach of the duty, (3) injuries suffered by the plaintiff, and (4) proximate causation between the breach of duty and the injuries.12 Although these four elements generally comprise the elements of this cause of action, some states, such as New York, list only three elements – negligence, proximate cause and damages –

5 The text assumes that statute of limitations has expired and it is no longer possible to obtain the overpayment by simply filing an amended return.
6 I.R.C. §§ 6621-22
7 N.Y. TAX LAW §684 (McKinney 2004)
8 See, e.g., CAL. REV. & TAX CODE §19101 (West 2001); TEX. TAX CODE ANN. §33.01 (Vernon 1998) [Others? Or secondary cite]
9 See e.g., Billings Clinic v. Peat Marwick Main & Co., 797 P.2d 899 (Mont. 1990) (interest differential between conventional borrowing and tax-exempt borrowing). See also Malpractice Damages, supra note 1 at 753.
10 Malpractice Damages, supra note 1 at 709-10.
12 Malpractice Damages, supra note 1 at 709, Wolfman et al, id., at § 601.2.1.
in effect, combining the first two elements.\textsuperscript{13} Other states sometimes add a fifth element – causation in fact.\textsuperscript{14}

In part II Alpert will be discussed. Since New York’s law on the recovery of interest, actually, on the non-recovery of interest, is more definitively established than its position on the non-recovery of additional taxes, interest will be discussed first in Part III and then additional taxes in Part IV. A conclusion is presented in Part V.

\section*{II. The Alpert Case}

In Alpert the plaintiff\textsuperscript{15} invested in a tax shelter whose chief attraction was the immediate deduction of advance minimum royalty payments for the right to mine coal in the future. Originally, the shelter program contained a tax opinion by one of the defendant law firms suggesting the advance minimum royalty payment was deductible when made. On December 16, 1977 the Income Tax Regulations were amended to disallow a deduction for such advance royalty payments. On December 19, 1977 a Revenue Ruling was issued by the IRS advising that such advance royalty payments could be deducted only over the period for which they were paid and not in the year of payment. In light of these developments, the original law firm, on or before December 21, 1977, withdrew its previous opinion and expressed doubts as to the immediate deductibility of the payments, making their earlier opinion useless to the promoter of the tax shelter. On December 20, 1977 the promoters of the tax shelter obtained an opinion from the second defendant law firm in which the validity of the Revenue Ruling was questioned.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{14} See, e.g., Dan B. Dobbs, THE LAW OF TORTS §114 (2000)
\item \textsuperscript{15} There were actually two plaintiffs in Alpert, but I will refer to only one plaintiff to simplify the presentation. Portions of this paragraph are adapted from Jacob L. Todres, Malpractice and the Tax Practitioner: An Analysis of the Areas on Which Malpractice Occurs, 48 Emory L.J. 547, 636-37 (1999).
\end{itemize}
\end{footnotesize}
Facing a substantial income tax liability for 1977, the plaintiff invested over $52,000 in the tax shelter on December 30, 1977 and claimed a deduction of over $216,000 on his 1977 federal income tax return for advance royalty payments. The IRS subsequently disallowed the deduction. In December 1986 the plaintiff paid over $117,400 in back taxes and over $165,800 in interest.\(^\text{16}\)

In 1984 this action was brought against the defendants for fraudulent misrepresentation, \textit{i.e.} for fraud.\(^\text{17}\) The plaintiff sought to recover lost profits as well as the tax benefits they would have obtained if they had not relied on the defendants’ opinions and, instead, invested in a viable tax shelter.\(^\text{18}\) After extensive discovery the defendants moved for partial summary judgment dismissing the plaintiffs’ claims for damages for the recovery of taxes and interest.\(^\text{19}\) The lower court granted defendants’ motion for partial summary judgment to the extent of dismissing damage claims for back taxes, but denied the motion with respect to interest. Both of these rulings were appealed by the losing parties.\(^\text{20}\)

Turning first to the damage claims for back taxes, the First Department affirmed the lower court’s dismissal. The First Department’s reasoning was as follows:

\begin{quote}
The recovery of consequential damages naturally flowing from a fraud is limited to that which is necessary to restore a party to the position occupied before commission of the fraud.
\end{quote}

* * *

\(^{16}\) \textit{Alpert, supra}, 559 N.Y.S. 2d at 313. Penalties were not assessed against the plaintiff. \textit{Id.}

\(^{17}\) Although the opinion notes that plaintiff was “claiming, \textit{inter alia}, fraudulent misrepresentation,” \textit{id.} at 314, indicating that other claims were also asserted, nevertheless, the First Department’s opinion refers only to the fraud cause of action throughout the opinion.

\(^{18}\) \textit{Id.}

\(^{19}\) \textit{Id.} The defendants also moved to dismiss claims for penalties incurred by plaintiff, but this is ignored since no penalties were imposed upon plaintiff. \textit{Id.} at 313.

\(^{20}\) \textit{Id.} at 314. Plaintiff also cross-moved for leave to amend the complaint, but this aspect of the opinion is ignored since it is not relevant to the issues discussed in this article.
In the instant case, recovery of back taxes would place plaintiffs in a better position than had they never invested in the . . . [tax shelter].\textsuperscript{21}

The court also refused to consider the tax benefit plaintiff could have obtained from investing in some other, valid tax shelter because “[i]t is also well settled that the victim of fraud may not recover the benefit of an alternative agreement overlooked in favor of the fraudulent one.”\textsuperscript{22}

As to damages for interest paid to the IRS, the First Department reversed the lower court and held the recovery of such amounts was also precluded in New York.

In \textit{Freschi v. Grand Coal Venture} . . . [citation omitted], a case involving violations of Federal securities law, the United States Court of Appeals found that a defrauded investor in a coal mine tax shelter, similar to the one herein, was not entitled to recover interest paid to the IRS upon disallowance of tax deductions. The court reasoned that such interest was not damages suffered by plaintiff but rather was a payment to the IRS for his use of the money during the period of time when he was not entitled to it. There is support for such a result in New York case law as well . . . Moreover, the equities militate in favor of barring recovery of such interest rather than allowing plaintiffs the windfall of both having used the tax moneys for seven years and recovering all interest thereon.\textsuperscript{23}

Although \textit{Alpert} has been utilized in determining damages recoverable in tort causes of action, it must be noted first and foremost, that \textit{Alpert} is purely a fraud case. With respect to the substantive issues, the opinion never even mentions, much less addresses, any other possible cause of action that one might have expected to encounter such as negligence, malpractice, breach of contract, etc. Also, in analyzing \textit{Alpert} it is essential to recognize that \textit{Alpert} decides three distinct issues, the first two of which pertain to back taxes: (1) back taxes may not be recovered as damages; (2) a victim of fraud may not recover the benefit of an alternative

\textsuperscript{21} \textit{Id.} at 315.

\textsuperscript{22} \textit{Id.}

\textsuperscript{23} \textit{Id.}
agreement overlooked in favor of the fraudulent one: and (3) interest paid to the IRS on a tax underpayment is not recoverable as damages.

Since *Alpert* seems to have gained the most prominence both in New York and elsewhere with respect to the nonrecoverability of interest, I will focus on this issue first.

**III. Nonrecoverability of Interest as Damages**

**A. Within New York**

Although *Alpert* was not decided by the New York Court of Appeals, it is recognized nevertheless, both inside and outside of New York, as the case in which New York adopted the position that interest paid to a government with respect to a tax underpayment is not recoverable as damages. The reasoning for this position is that such interest is not damages but simply a payment for the use of money during a period of time that the government, not the plaintiff, was entitled to such use. If such interest were recoverable as damages, the plaintiff would have the windfall of having both the use of the money and also recovering the interest thereon.

Approximately twelve years after *Alpert* another panel of the same First Department that decided *Alpert* decided *Jaimie Towers Housing Co. v. Lucas* which seems fundamentally inconsistent with *Alpert*. In *Jaimie Towers* the plaintiff, a residential housing cooperative,

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27 *Alpert*, supra 559 N.Y.S.2d at 315.

28 745 N.Y.S.2d 532 (1st Dept. 2002).
incurred over $470,000 in interest when its managing agent failed to timely pay New York City real estate taxes for the 1991/1992 tax year. In this suit the plaintiff was seeking to recover the interest from its former managing agent and its former accountant. The lower court dismissed the complaint on defendants’ summary judgment motion based upon *Alpert*. The First Department reversed, holding *Alpert* inapposite. The First Department’s analysis, in its entirety follows:  

Here, however, plaintiff, allegedly through no fault of its own, was unnecessarily caused to pay $472,043 in interest to the City due to its managing agent’s failure to timely pay certain real estate taxes for the 1991/1992 tax year. As such, the recovery of such interest as an element of its damages would not constitute an impermissible windfall or put plaintiff in a “better position” than it was in prior to its managing agent’s alleged misfeasance… and it should be entitled to prove such damages, if any. Those would ordinarily be measured not by the difference in interest rates charged by the City and the IRS, but by the actual amount of interest and late charges paid to the City due to the alleged misfeasance, subject to any offset of the actual income derived from the funds in question during the relevant period of time. (citation omitted).

It is very difficult to understand why *Alpert* is distinguishable. In both situations the plaintiff ended up retaining possession of money he, or it, was not entitled to. In *Jaimie Towers* it was due to the error of the managing agent in not paying real estate taxes. In *Alpert* it was due to the error of the tax advisor in advising the plaintiff that he had legitimate tax reductions. In both situations the plaintiffs had the use of money until the error was discovered and the money repaid. Yet in *Jaimie Towers* the First Department held the recovery of interest was not an *impermissible* windfall, while in *Alpert* it held it would be.

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29 *Id.* at 533.
30 *Id.* at 533-34.
31 In *Jaimie Towers* the measure of damages adopted by the court was the difference between the interest paid reduced by the actual income derived from the money during the relevant time. *Id.* at 534.
While there are some salient factual differences between the cases, the differences are inconsequential. For instance, in *Alpert* the plaintiff intentionally sought the tax shelter and intentionally utilized it and paid less taxes than otherwise would have been payable, while in *Jaimie Towers* the underpayment arose inadvertently due to an error. Also, *Alpert* involved underpayment of income taxes while *Jaimie Towers* involved underpayment of city real estate taxes. However, these seem to be distinctions without differences, since in both instances the end result is identical -- each plaintiff had use of a sum of money to which he, or it, was not entitled.

Despite the fact that *Jaimie Towers* seems to be fundamentally inconsistent with *Alpert*, many later cases simply cite *Alpert* for the no-recovery-of-interest proposition and never even bother to cite *Jaimie Towers*. While some cases do address the existence of *Jaimie Towers*, and attempt to distinguish it, their reasons for distinguishing it do not seem compelling. For instance, in *Thies v. Bryan Cave LLP*, a case involving a suit against two law firms that gave opinions with respect to investments in an ineffective tax shelter, the court distinguished *Jaimie Towers* because in *Thies* the plaintiffs intentionally decided not to pay the taxes in question. It is difficult to comprehend why this makes any difference. In both instances the plaintiff had the use of tax money that belonged to the government. And *Jaimie Towers* held that in such circumstances a plaintiff may recover as damages the difference between the interest paid the government and the actual income earned by the plaintiff on these funds.

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34 Id.
35 Id. at *5.
Similarly, in *Shalam v. KPMG LLP*, which also involved a suit against a tax advisor for advice to invest in a bad tax shelter, the First Department held interest was not recoverable based upon *Alpert*. The court held *Jaimie Towers* was distinguishable because it involved “negligence by an accountant or other agent resulting in exposure to liability that would not have been incurred, 'but for their accountant's negligence.'”*\(^{37}\) Again, whether paying interest for the use of funds one is not entitled to does or does not constitute recoverable damages should not depend on how the funds were obtained. Also, the lower court in *Shalam* seems to have decided that *Alpert* governed rather than *Jaimie Towers* since the facts of *Shalam* and *Alpert* were more analogous, since each involved a bad tax shelter.*\(^{38}\)

While *Alpert* has been followed with respect to the nonrecoverability of interest and *Jaimie Towers* has been virtually invisible, in *Apple Bank for Savings v. PricewaterhouseCoopers, LLP*\(^{39}\) a trial court within the First Department followed *Jaimie Towers* and had a very original and novel interpretation limiting what *Alpert* stood for with respect to the recoverability of interest. In *Apple Bank* the issue before the court involved whether the defendant accounting firm gave the plaintiff bank incorrect advice concerning the tax consequences of a stock redemption by the bank from the estate of its sole shareholder. The case arose on the defendant’s motion for summary judgment dismissing the complaint.*\(^{40}\) Although most of the decision involved statute of limitations issues, one of the grounds asserted for dismissal was that under *Alpert* any interest and back taxes incurred by the bank were not recoverable. In denying the motion for summary judgment, the court combined the issue of the

\(\text{References:}\)

*Alpert*, 843 N.Y.S.2d 17 (1st Dept. 2007).

*Jaimie Towers*, Id. at 19.


*Id.* at *1-3.
recoverability of interest together with the issue of the recoverability of back taxes and treated them together. The court read *Alpert* very narrowly to prevent the recovery of interest and back taxes only where the plaintiff inevitably would have incurred the tax liability even if the plaintiff had not relied on the faulty tax advice. “However, if the tax liability would have been avoided but for the erroneous advice, it appears that … interest would be recoverable in order to make the plaintiff whole.”  

As authority for this proposition the court cited *Jaimie Towers* and *Penner v. Hoffberg Oberfest Burger & Berger*.  

*Penner*, however, is a very short opinion in which the court’s entire focus on the recovery of interest (and back taxes) was to uphold the lower court’s dismissal of plaintiff’s cause of action “since plaintiff’s tax liability was not attributable to an act or omission on defendants’ part.”  

This hardly seems an adequate basis for such a dramatic narrowing of *Alpert* from simply holding there is never any recovery of interest in such situations because the payment of interest does not constitute damages.

While *Apple Bank* is a recent and most interesting limitation of *Alpert*, (a) it is a lower court holding, (b) *Apple Bank* was reversed by the First Department on statute of limitations grounds; (c) *Penner* seems to be very weak, if any, authority, and (d) in light of the history of invisibility of *Jaimie Towers*, it is unclear how strong the *Jaimie Towers* precedent is. Accordingly, it is impossible to assess whether *Apple Bank* has effectively restricted *Alpert*’s holding with respect to the nonrecoverability of interest as damages in tax malpractice situations.

A lower court recently did follow *Apple Bank* on this point.

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41 Id. at *18-19. The court’s holding also applied to the recoverability of additional taxes caused by the defendant’s negligent advice.
42 Id. The court actually cited *Penner* first as a parenthetical.
43 Supra, 755 N.Y.S.2d at 836.
44 70 A.D.3d 438, 895 N.Y.S.2d 361, 362-63 (1st Dept. 2010). The First Department held there was no continuous representation and therefore the statute of limitations barred plaintiff’s cause of action.
**B. The National Picture**

Nationally, three views have developed with respect to the recoverability of interest on a tax underpayment. The majority view, which is the more established traditional view, is that such interest is recoverable from a defendant just like any other damages proximately caused.

The minority view, which is the New York view, absolutely prohibits the recovery of such interest. This view developed in the decade from approximately 1986 to 1996. A third “modern” view which initially started in 1999 is an intermediate new that permits the recovery of such interest, but only to the extent it exceeds the interest actually earned by the plaintiff on the underpaid taxes.  

In *Recovery of Interest*, I attempted to tally the number of states following each view based on reported cases. Subject to a number of caveats, I concluded that as of June, 2009, thirteen or, probably, fourteen states followed the traditional majority view, four states, and the fourteenth state that probably also belongs in this group is Oregon, (McCulloch v. Price Waterhouse LLP, 971 P.2d 414 (Or. Ct. App. 1998)).
including New York followed the minority view, and seven states (plus the federal district court in Oregon) followed the intermediate, “modern” view. The starting point in analyzing this area is the traditional and majority view that permitted the recovery of interest on underpaid taxes as a simple application of traditional tort damage principles. Under traditional tort doctrine, a plaintiff may recover all damages proximately caused by a defendant’s negligence. But for defendant’s negligently incorrect advice that caused the plaintiff to underpay his taxes, the interest would not have been incurred. It is therefore held to be recoverable.

Over time, a great injustice was perceived with the traditional approach since the recovery of such interest as an ordinary element of recoverable damages resulted, or could result, in a windfall for the plaintiff. The plaintiff would now enjoy both the use of the underpaid tax money and also recover the interest paid for the use of this money. This caused the birth of the minority view which absolutely prohibited the recovery of this interest as damages. According to the minority view, the interest charged for a tax underpayment is not a penalty imposed on the plaintiff. Instead, it is merely a justified charge for the use of money belonging to the government that was wrongfully held by the plaintiff. If the plaintiff is permitted to recover this


52 See Recovery of Interest, supra note ____ at (FNS 11 & 15)

53 See generally, Recovery of Interest, supra note ____ at [notes 10-11, & 105-6, p. 22]

54 Id. at [notes 16-18, ?]
interest from the defendant, it would result in an interest-free loan to the plaintiff for the period the taxes were unpaid.\textsuperscript{55}

While the minority view remedied the problem of unjust enrichment of the plaintiff, it created a different injustice. It failed to compensate the plaintiff who did not earn as much with the underpaid tax money as he paid the government for the use of this money. By absolutely prohibiting the recovery of interest, the minority view irrebuttably presumed that the value of the underpaid tax money to the plaintiff was always exactly equal to the interest paid to the government and that these amounts always net out, leaving no injury and no recoverable damages.\textsuperscript{56} However, there are several practical problems with this assumption. Initially, the minority’s approach assumes the plaintiff has available money to invest equal to the tax underpayment, the earnings on which will offset the interest paid on the tax underpayment. Frequently, a plaintiff will not have available funds to invest, so there will not be earnings to offset the interest paid the government.\textsuperscript{57} Also, even if adequately liquid, a plaintiff often will not be able to earn a rate of return on his/her investible funds as high as that charged by the government. Additionally, there may be significant hardship to a plaintiff who must make an unexpected payment to the government that is also ignored by the minority view.\textsuperscript{58}

To remedy these problems inherent in the minority view, the modern, intermediate view developed that avoided irrebuttable presumptions and attempted to apply more exacting and precise justice. Under this modern view interest could be recovered as damages, but only when, and to the extent, the interest paid the government on the tax underpayment exceeded the amount

\textsuperscript{55} Id.
\textsuperscript{56} Id. at [notes 28-29]
earned on this money by the plaintiff. Proving this interest differential could be quite burdensome and the placement of the burden of proof could be determinative of whether any interest damages would actually be recovered. To address this issue, the modern view has developed two different approaches with respect to the placement of the burden of proof. Each state adopting this view selected the approach most consistent with its tort law. Under one approach there is a basic assumption that the victimized plaintiff is entitled to recover all interest paid the government, but the defendant may present evidence of any amounts earned by the plaintiff on the tax underpayment in reduction of plaintiff’s damages. The burden of proof is thus upon the defendant. The other approach seems to assume that generally interest on a tax underpayment is not recoverable, but if a plaintiff establishes the existence of an interest differential, the differential is recoverable as damages. The burden of proof is therefore on the plaintiff.

C. Alpert’s No Interest Recovery Rule Should be Changed

New York’s position, adopted in Alpert, that interest on a tax underpayment may not be recovered as damages in a tax malpractice action should be changed. In accordance with the national trend, New York should adopt the modern view and permit the recovery as damages of any differential between the interest paid the government on a tax underpayment and any earnings realized on this money by a plaintiff. In accordance with established New York

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59 Id. at The seminal cases for this view are Ronson v. Talesnick, supra note 51, and Streber v. Hunter, supra note 51.
60 Id. at [notes 31-49]. This is the approach of Ronson, id (New Jersey). O’Bryan v. Ashland, supra note 51, (South Dakota) followed this approach though it refused to explicitly decide this point.
61 Id. at [ ]. Other jurisdictions that seem to follow this approach include Pennsylvania, Amato v. KPMG L.L.P., supra note 51, Nebraska, Frank v. Lockwood, supra note 51, Massachusetts, Miller v. Volk, supra note 51, and perhaps the federal district court of Oregon, King v. Deutsche Bank AG, supra note 51.
62 Since it is still too early to predict whether Apple Bank, 2009 N.Y. Misc. LEXIS 1176 (Sup. Ct. N.Y. Co. 2009), rev’d, 70 A.D.3d 438, 895 N.Y.S. 2d 361 (1st Dept. 2010), has successfully limited the scope of Alpert’s strict no-interest-recovery position, it will be ignored herein. Regardless of whether Alpert is still in full force, or somewhat limited, it should be abandoned in favor of the modern view.
principles that a plaintiff in a tort action must prove his or her damages,\textsuperscript{63} New York should impose the burden of proving the interest differential on the plaintiff.

The weakness of \textit{Alpert}'s no interest recovery position is especially evident when viewed through a national lens. Of the three positions nationally on this issue, the no interest recovery position is a very distinct minority view.\textsuperscript{64} This view has gained no new adherents since it was originally developed from approximately 1986 to 1996.\textsuperscript{65} Furthermore, and more telling, since 1999 when the new, more nuanced and more just modern view arose, all cases deciding this issue as a matter of first impression adopted the modern view.\textsuperscript{66} Outside of New York, only two cases decided since the advent of the modern view in 1999 have followed the no-interest-recovery view and both did so under the constraint of \textit{stare decisis}.\textsuperscript{67}

The no interest view should be changed not simply as a matter of blindly following the leader or a current fad, but because the rationale for the approach is no longer compelling when compared with the modern view. The critique of the rationale of the no interest view by proponents of the modern intermediate view seems correct. The rationale for the no interest view enunciated by \textit{Alpert} is that the interest charge is not damages but rather a payment for the use of money during a period of time the plaintiff was not entitled to the money.\textsuperscript{68} As indicated above, apart from the question of whether the plaintiff actually had available to invest an amount equal to the tax underpayment, the \textit{Alpert} rationale assumes the plaintiff would earn a rate of

\begin{footnotes}
\item[63] See e.g., Vooth v. McEachen, 181 N.Y.28, 31 (1905); Quinn v. Van Pelt, 56 N.Y. 417 (1874).
\item[64] See supra text accompanying notes 46-50.
\item[65] See Recovery of Interest, supra note 24 at [ ].
\item[66] See cases at note 51, supra. See also Recovery of Interest, supra note 24 at [ ].
\item[68] \textit{Alpert}, Supra, 559 N.Y.S. 2d at 315.
\end{footnotes}
return on the money as high as that charged by the government for the tax underpayment.\textsuperscript{69} This assumption is frequently incorrect -- and it seems absurd to elevate the assumption to an irrefutable presumption. This is especially true when the existence of any interest differential can effectively be handled jurisprudentially by imposing the burden of proving it either on the plaintiff or the defendant as different adherents of the modern view have done.\textsuperscript{70}

While \textit{Alpert} did not dwell at length on the no interest recovery issue, but simply adopted the rationale stated in \textit{Freschi v. Grand Coal Venture},\textsuperscript{71} I believe \textit{Alpert} was very discerning and progressive when handed down. At that time the prevailing view was the majority view that simply awarded interest as a routine element of recoverable damages. By adopting the rationale of the federal securities law, \textit{Alpert} avoided the injustice inherent in the majority view that resulted in a windfall to plaintiffs at the expense of defendants. Along the way, \textit{Alpert} was instrumental in the development of the minority view nationally.

After adopting the \textit{Freschi} rationale that interest did not constitute damages and noting the existence of a New York case that was arguably consistent, the \textit{Alpert} court added:

\begin{quote}
Moreover, the equities militate in favor of barring recovery of such interest rather than allowing plaintiff the windfall of both having used the tax moneys for seven years and recovering \textit{all} interest thereon.\textsuperscript{72}
\end{quote}

(emphasis added)

This sentence demonstrates that the court was weighing only two choices: awarding plaintiff all the interest, and thereby giving him a windfall, or awarding no interest. The court chose the latter. Apparently, the middle ground that later became the modern view of awarding plaintiff only the actual interest differential and thereby eliminating the windfall element, was

\textsuperscript{69}See supra, text accompanying notes 56-58.  
\textsuperscript{70}See supra, text accompanying notes 59-61.  
\textsuperscript{71}767 F.2d 1041 (2d Cir. 1985), vacated on other grounds, 478 U.S. 1015 (1986) on remand, 800 F.2d 305, decision amended, 806 F.2d 17 (1986).  
\textsuperscript{72}\textit{Alpert}, supra, 559 N.Y.S.2d at 315.
not on the court’s radar screen. Today, when the middle ground is available, it should be the course of choice. The course chosen by Alpert was simply a reaction – really an overreaction against – the unjust majority approach where the only perceived options were to award all interest or no interest.

There is yet an additional reason why Alpert’s no-interest-recovery rule should not be, and, perhaps, never should have been applied to tax malpractice cases. As will be developed more fully in Part IV, Alpert is purely a fraud case. The opinion does not even mention any other possible cause of action. Tax malpractice cases are tort cases, typically negligence cases. And the measure of damages in each area is very different from the other. In fraud situations the measure of damages in New York is determined under the “out-of-pocket” rule. Under this rule damages are determined very narrowly. They are intended solely to compensate the defrauded party for the difference between the amount paid and the value of what was received as of the time of the transaction. What the defrauded party might have gained such as lost profits may not be recovered. In negligence cases, the measure of damages is intended to compensate the injured party so that he may recover the difference between what was actually received and what would have been received with non-negligent performance, including any lost profit.

While Alpert held that interest paid a government on underpaid taxes does not constitute damages and is not recoverable in a fraud context, perhaps a different result might have been reached if the broader negligence measure of damages had been applied. In any event, though perhaps different from additional taxes, here too a more deliberate and thoughtful analysis seems required before simply applying a holding from a fraud case to a negligence situation.

73 See supra, text accompanying notes 10-11.
74 See infra, text accompanying notes 82-93 and 97-103.
75 Id.
76 See infra, text accompanying notes 110-24.
IV. *Alpert* and Taxes

A. *Alpert’s and the Fraud Measure of Damages*

In contemplating the impact of *Alpert* on the issue of whether taxes incurred by a victim of tax malpractice are recoverable from a negligent professional, the issue is not really what *Alpert* did, but rather what has been done with *Alpert*. *Alpert* involved only a fraud cause of action, and *Alpert’s* holdings on the tax issues—that taxes are not recoverable and that any tax savings that might have been realized from an alternative investment are not relevant—seem correct, and a simple application of traditional New York law as to the fraud measure of damages. As such, *Alpert* has been followed in fraud cases\(^{77}\) and expressly approved by the New York Court of Appeals.\(^{78}\) However, this fraud measure of damages has been transported to negligence situations without any analysis, and without even any acknowledgement that a rule of damages in one area of law is being extended into another area.\(^{79}\) Based on a simple review of New York’s approach to damages in the fraud and negligence areas, it is clear that the fraud measure of damages is not proper in a negligence context. This is problematic both because it may lead to an incorrect result in any given situation, but also, and more importantly, even where the correct ultimate result is reached, because the rule of law pertaining to negligence damages is being distorted.

Rather than summarize *Alpert’s* holdings with respect to the recovery of taxes, it is more efficient to simply quote them since the entire holdings on taxes are contained in two paragraphs.

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To briefly review the facts, with respect to the recovery of taxes incurred by the plaintiff who purchased an invalid tax shelter about which the defendant law firms had given opinions, the lower court in *Alpert* granted the defendants’ motion for partial summary judgment dismissing plaintiff’s claim for back taxes. In affirming this portion of the lower court’s holding *Alpert* stated:80

The IAS court was correct in rejecting plaintiff’s damage claims for back taxes. The recovery of consequential damages naturally flowing from a fraud is limited to that which is necessary to restore a party to the position occupied before commission of the fraud. *Hotaling v. Leach & Co.*, 247 NY 84, 87 [1928] [citing *Reno v. Bull*, 226 NY 546]; *Cayuga Harvester v. Allis-Chalmers Corp.* (95 AD2d [*72] [4th Dept 1983]), wherein plaintiff recovered the value of crops destroyed by repeated breakdowns of farm equipment it was fraudulently induced to purchase, is not to the contrary. In *Cayuga Harvester*, the Fourth Department found that the destruction of the plaintiffs’ crop was a direct result of defendants’ fraud and placed plaintiff in a far worse position than had it not purchased the equipment. By contrast, in the instant case, recovery of back taxes would place plaintiffs in a better position than had they never invested in the … [tax shelter].

It is also well settled that the victim of fraud may not recover the benefit of an alternative agreement over-looked in favor of the fraudulent one. … Hence, plaintiffs’ argument that but for the fraud they would have invested in some other tax shelter must fail. (citations omitted).

What is very clear from this excerpt is that *Alpert* is opining as to damages recoverable in a fraud cause of action. The court reiterates several times that it is addressing the “damages naturally flowing from a fraud” and what “the victim of fraud” may or may not recover.81 As such, the opinion is simply following well settled precedent and is not especially noteworthy except, perhaps, as to its application in a tax shelter situation.

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81 *Id.*
In New York, the current view of the damages recoverable in a fraud action dates back over ninety years to *Reno v. Bull*.\(^{82}\) *Reno* involved a suit to recover damages for fraud and deceit by a plaintiff who was induced to purchase stock in a corporation based upon misrepresentations of the corporation’s assets and prospects. In setting forth the correct measure of damages, the New York Court of Appeals held the purpose of damages in such situations is to indemnify the injured party “for the actual pecuniary loss sustained as a direct result of the wrong.”\(^{83}\) No element of profit may be awarded. Under the facts of *Reno*, such damages would be the difference between the $5,000 paid for the stock and the actual value of the stock received.\(^{84}\)

Almost nine years after *Reno* the New York Court of Appeals revisited this issue, again in the context of a suit for damages sustained when the plaintiff was induced by fraudulent representations to purchase a bond for investment.\(^{85}\) In *Hotaling* the court reaffirmed its holding in *Reno* that the measure of damages for fraud is “indemnity for the actual pecuniary loss sustained as a direct result of the wrong”\(^{86}\) and that ordinarily, when fraud induced the purchase of property, the damages would be the difference between the amount paid and the value of the property received.\(^{87}\) The court went on to explain the reason for this is that the seller’s fraud is normally completed at the time of sale of the property. Any subsequent changes in value of the article are due to later decisions, such as, whether to hold or dispose the asset, and are not attributable to the fraud at the time of the sale.\(^{88}\) The court went on to caution that the fraud measure of damages was not intended to be inflexible, and that even consequential damages might be appropriate:

\(^{82}\) 226 N.Y. 546 (1919).

\(^{83}\) *Id.* at 553.

\(^{84}\) *Id.* The court also permitted the recovery of interest.

\(^{85}\) *Hotaling v. A.B. Leach & Co.*, 247 N.Y. 84(1928).

\(^{86}\) *Id.* at 87 (quoting *Reno v. Bull*).

\(^{87}\) *Id.* at 87-88.

\(^{88}\) *Id.* at 88.
[p]roximate damages may not be fixed by arbitrary rule. Sometimes other damages flow from fraud in inducing a purchase, besides the difference between the price paid and the value of the article received. Consequential damages may also be awarded.89

Only eight years after Hotaling the Court of Appeals again reiterated its Reno articulation of the measure of damages for fraud. Sager v. Friedman90 involved a plaintiff who was fraudulently induced to lend money to a corporation. The president of the corporation had obtained the loan, in part by giving as security for the loan certain shares of stock of another corporation he owned. He mislead the plaintiff as to the value of the security shares by failing to inform him of certain substantial debt owed by that corporation.91 In distinguishing the measure of damages for fraudulent misrepresentation from that for breach of contract the court stated that in fraud situations, the injury is the inducement to make a contract that would not otherwise have been made. “[T]he measure of damages is indemnity for loss suffered through that inducement.”92 The court added that all profit elements are excluded from damages and that damages consist solely of “indemnity for the actual pecuniary loss sustained as a direct result of the wrong” and that this is “the difference between the value of the bargain which a plaintiff was induced by fraud to make and the amount or value of the consideration exacted as the price of the bargain.”93

With the measure of damages for fraud having been firmly established by the Court of Appeals and having since been applied by the lower courts,94 the holding in Alpert was very much in line with the New York precedent. When the plaintiff in Alpert

89 Id. at 92.
90 270 N.Y. 472 (1936).
91 Id. at 477.
92 Id. at 481.
93 Id. (citing Reno v. Bull, 226 N.Y. 546, 553).
was defrauded when sold an ineffective tax shelter, all he was entitled to was the
difference between what he paid and what he received—presumably the amount paid less
any value of the tax shelter assets. Of course, he could not recover any tax benefits
sought, since that type of recovery would give him the benefit of what he was promised,
which is precisely what Reno held was not recoverable. Subsequently, since a plaintiff in a
fraud suit is only entitled to be made whole as of the time of the transaction, such a
plaintiff cannot be heard to argue that he could have invested in an alternative
arrangement that would have provided him with an effective tax shelter, since that would
be the recovery of either profit or of indirect consequential damages. In addition, the
existence or availability of such an alternative arrangement would normally be
undeterminable and speculative, and not recoverable for these reasons as well.

Subsequent to Alpert, the New York Court of Appeals again reiterated that the
measure of damages for fraud in New York is still the Reno “out-of-pocket” rule and also
approved Alpert’s holding that in such cases there is no recovery of any income taxes
paid. In Lama Holding Co. v. Smith Barney Inc. the plaintiffs were a group of
corporations which owned almost twenty-five percent of the defendant Smith Barney
Inc., a brokerage firm. Giving in to pressure by the defendant, the plaintiff agreed to vote
its shares in the defendant in favor of a merger of the defendant into another entity, and to
otherwise not block the merger. When the plaintiff was originally structured to hold the
Smith Barney stock on behalf of foreign investors, it was structured so that any sales of

95 In Reno the measure of damages utilized by the lower court that was overturned was “‘the difference between the
value of the stock at the time it was sold to… [plaintiff] and the value of the stock as it would have been at that time
if the representations were true.” Reno, supra, 226 N.Y. at 552-53.
96 See e.g., Lama Holding Co. v. Smith Barney Inc., 88 N.Y.2d 413, 422 (1996) and Dress Shirt Sales v. Hotel
97 Lama Holding Co. v. Smith Barney Inc. id at 421-23.
98 Id.
the stock at a profit would not be subject to United States income taxation. Unbeknownst to the plaintiffs, the law was changed about six months before the merger and the plaintiffs later learned they had an unexpected tax liability of $33 million. They then brought this action asserting their consent to the merger was fraudulently induced, and seeking the $33 million as damages. 99 Although the Court of Appeals affirmed the Appellate Division’s dismissal of plaintiffs’ action, it extensively discussed the fraud measure of damages.

In *Lama* the Court of Appeals, citing *Reno*, stated that “‘the measure of damages is indemnity for the actual pecuniary loss sustained as a direct result of the wrong’ or what is known as the “out-of-pocket” rule.” Under this rule, the court continued, the loss is computed as the difference between what the plaintiff paid and the value of what it received. A plaintiff could recover its losses but not what it might have gained nor any profit it might have realized absent the fraud. 100 Under the facts of *Lama*, the court held there were no damages because the price received for the Smith Barney stock in the merger was twice the shares’ fair market value. 101 Any possible alternative arrangement that might have avoided the United States income tax could not be a basis for damages, since such arrangement was “undeterminable and speculative.” 102 As to recovery of the taxes paid, the court stated these may not be recovered under the out-of-pocket rule, and endorsed Alpert’s analysis that the recovery of such taxes would put *Lama* in a better

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99 *Id.* at 418-20. There were also a number of other causes of action asserted.
100 *Id.* at 421.
101 *Id.* at 422.
102 *Id.*
position than if it had retained the shares. Such amounts apparently are beyond what is necessary to restore the plaintiff to the position occupied before the fraud.

B. New York’s Negligence Measure of Damages

In attempting to ascertain the New York measure of damages in a negligence cause of action (excluding personal injury situations), I was struck by the fact that there does not appear to be a clear, well defined articulation of a standard that one may easily point to. Unlike the fraud measure of damages that has been reaffirmed many times by the Court of Appeals and has an attractive short-hand label, the “out-of-pocket” rule, the negligence measure of damages is difficult to articulate. A simple analog to the fraud’s “out-of-pocket” label, does not seem to exist. Similarly, the cases seem to raise different formulations of the measure of damages. While the cases seem to want to make the plaintiff whole, they often do not explain their concept of “whole.” For instance, does “whole” include any profit or consequential gains that non-negligent performance would have generated, or is it limited to actual pecuniary loss, akin to the fraud’s “out-of-pocket” measure of damages? A very poignant illustration of this is Solin v. Domino, Jr. In Solin the plaintiff was given incorrect advice by his insurance agent/financial advisor and by the insurance company as to the tax consequences of cashing in an annuity policy. When it turned out the tax bill was $600,000 rather than the promised $200,000 the plaintiff sued for damages. Since the defendant “conceded he had made a ‘mistake,’” the issue on the defendant’s motion to dismiss centered on damages. While there were a number of potentially interesting side issues raised in the opinion, the federal trial judge, sitting in diversity,

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103 Id. at 422-23.
105 Id. at *1-4. The plaintiff also argued that if he were furnished accurate information about his potential tax liability, he would have rolled over his annuity into another annuity thereby deferring all tax liability. Id. at *4.
106 Id. at *4.
applied the fraud, out-of-pocket measure of damages, and rather directly sidestepped addressing the New York negligence measure of damages: “[t]abling the legal question whether benefit-of-the-bargain damages are recoverable in a negligence action under New York law…. “

Although perhaps not glaringly obvious, and lacking a catchy label, the New York measure of damages in malpractice situations involving attorneys and accountants is very different from the fraud “out-of-pocket” approach. The recovery available to an injured party is the difference between what was obtained by the plaintiff and what would have been obtained with non-negligent performance.

In *Flynn v. Judge*, the plaintiffs were removed as executors and trustees of the estate of their father. They brought this action against the defendant, who was their attorney, claiming his negligent advice caused them to lose their positions and the income they would have received. In reviewing the trial court’s dismissal of the plaintiffs’ causes of actions, the Second Department stated:

> the measure of damages is the difference in the pecuniary position of the client from what it should have been had the attorney acted without negligence….

The court then quoted the following:

> ‘In actions against attorneys for negligence or wrongs, the debt lost and cost sustained through their negligence furnish, when the action can be maintained, the obvious measure of damages, where this measure definitely exists. *In other cases the plaintiff is entitled to be in the same position as if the attorney had done his duty!*

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107 *Id.* at *7-8.
108 *Id.* at *9.
110 *Id.*
111 *Id.*, 133 N.Y. Supp. at 795-96.
112 *Id.* at 796.
113 *Id.* (quoting Weeks on Attorneys at Law (2d. ed.) § 319).
In *Campagnola v. Mulholland, Minion & Roe*\(^{114}\) the New York Court of Appeals addressed the proper measure of damages in an attorney malpractice situation.\(^{115}\) The majority’s opinion was ambiguous concerning the precise scope of damages recoverable. It stated that where a plaintiff asserts causes of action in both negligence and contract the measure of damages in a legal malpractice action is generally the same. “The object of compensatory damages is to make the injured client whole. Where the injury suffered is the loss of a cause of action, the measure of damages is generally the value of the claim lost.”\(^{116}\) While the majority’s opinion is not specific about what it means to make the injured client “whole,” the concurrence by Judge Kaye is much more explicit:\(^{117}\)

> In lawyer malpractice cases, as in all negligence cases, the focus in damages inquiries must be on the injured plaintiff—not on whether damages will unduly harm the wrongdoer defendant—the objective being to put the injured plaintiff in as good a position as she would have been in had there been no breach of duty.

In *Sanders v. Rosen*,\(^{118}\) which also was an attorney malpractice case, the court seemed to spell out what it means to make an injured party whole:\(^{119}\)

> [D]amages for malpractice are also limited to pecuniary loss—i.e., the difference between the action result achieved and that which should have been accomplished, and the financial loss thereby sustained.

Finally, the well known New York requirement that in a malpractice suit against an attorney for the loss of a cause of action there often needs to be a trial within a trial\(^{120}\) is simply a


\(^{115}\) The issue before the court was whether in a legal malpractice action the defendant attorney could offset against any recoverable damages the contingent fee provided for in the retainer agreement concerning the underlying personal injury claim. *Id.* at 39. Here the defendant attorney settled the plaintiff’s personal injury claim with the insurer of the car which hit the plaintiff. The attorney failed to give notice of the accident to the plaintiff’s insurer thereby losing coverage under plaintiff’s policy with much higher limits. *Id.* at 40-41.

\(^{116}\) *Id.* at 42.

\(^{117}\) *Id.* at 45-46.

\(^{118}\) 159 Misc. 2d 563, 605 N.Y.S.2d 805 (Sup. Ct. N.Y. Co. 1993).

\(^{119}\) *Id.* at 572, 605 N.Y.S.2d at 810.
direct application of this measure of damages. The “trial” of the underlying lost cause of action within the malpractice trial is simply the method utilized to established what the negligent attorney should have accomplished which is the reference point in defining the extent of the recoverable injury suffered by the injured plaintiff.

While the malpractice or negligence measure of damages seems identical with the “benefit-of-the-bargain” rule of damages utilized in breach of contract cases in New York, since the cases do not affix the “benefit-of-the-bargain,” or, indeed, any label to this measure of damages, I will refer to them as “expectancy” damages--the difference between the expected non-negligent performance of the tax advisor and actual performance.

While, perhaps, all the intricacies of New York expectancy damages in tax malpractice situations may not yet have been addressed, it seems clear that such expectancy damages are much broader than “out-of-pocket” damages available in fraud actions. In fraud actions the plaintiff is generally made whole by receiving the difference between what he received and what he gave up. Profits that may have been anticipated are not recoverable. In expectancy damages the plaintiff may recover the entire difference between what the expected, non-negligent

121 The classic description of breach of contract damages is contained in Sager v. Friedman, 270 N.Y. 472 (1936):

   The measure of damages which flows from a breach of contract is the difference between the value of what has been received under the contract and the value of what would have been received if the contract had been performed according to its terms.... The injured party is entitled to the benefit of his bargain as written and is entitled to damages for the loss caused by failure to perform the stipulated bargain.

Id. at 481. This seems virtually identical with the definition of attorney malpractice damages as the difference between the injured party’s position and “what it should have been had the attorney acted without negligence.” Flynn v. Judge supra, 133 N.Y. Supp. at 796.
122 See e.g., Solin v. Domino, Jr., 2009 U.S. Dist. LEXIS 51405 (S.D.N.Y. 2009) where the federal judge specifically sidestepped whether benefit-of-the-bargain damages are recoverable in negligence in New York. Id. at *9.
123 See generally Malpractice Damages, supra note 1.
performance would have resulted in and what was actually received.\textsuperscript{124} This does not exclude recovery of any expected profits, as “out-of-pocket” fraud damages does.

Where the advice sought is tax advice, it would seem inevitable that expectancy damages would include any extra taxes caused by the advisor’s negligence. While authority in New York on this may be scarce,\textsuperscript{125} there are many examples of such recoveries in other states. For instance, recovery of additional taxes has been awarded where: (1) an attorney for an estate filed the estate tax return late, thereby preventing the estate from utilizing the alternate valuation date;\textsuperscript{126} (2) an attorney/return preparer advised that certain deductions be taken in a later year and when the error was discovered it was too late to file amended returns for the earlier years in which the deductions should have been claimed;\textsuperscript{127} (3) an “attorney” failed to obtain long-term capital gain treatment that was obtainable with better planning;\textsuperscript{128} and (4) erroneous advice resulted in the receipt of taxable rather than tax-free disability benefits.\textsuperscript{129}

The crucial issue in expectancy damages is to distinguish between additional taxes caused by the negligence, and those taxes that are unconnected with the negligence and which would have been incurred in any event. The former are recoverable, the latter are not.\textsuperscript{130}

\textsuperscript{124} Any costs incurred would also be recoverable. Sanders v. Rosen, 159 Misc.2d 563, 572, 605 N.Y.S.2d 805, 810 (Sup. Ct. N.Y. Co. 1993).
\textsuperscript{125} See i.e., Proskauer Rose Goetz & Mendelsohn v. Munao, 270 A.D. 2d 150, 151, 704 N.Y.S. 2d 590 (1st Dept. 2000).
\textsuperscript{126} Cameron v. Montgomery, 225 N.W.2d 154, 155 (Iowa 1975).
\textsuperscript{128} Pytka v. Gadsby Hannah, L.L.P., No. 01-1546 BLS, 2002 Mass. Super. LEXIS 461 at *8 (Mass. Super. Ct. 2002). Here the individual defendant was not actually an attorney though he was held out to be an attorney and of counsel at the defendant law firm. The court treated him as if he were an attorney. \textit{Id.} at *19.
\textsuperscript{129} Jamison, Money, Farmer & Co. v. Standeffer, 678 So.2d 1061, 1066-68 (Ala. 1996). For other examples, see Malpractice Damages, \textit{supra} note 1 at 713-14.
\textsuperscript{130} See generally Malpractice Damages, \textit{supra} note 1 at 712-13.
of their accountants’ negligence, plus incidental damages. The [plaintiffs] should not recover as damages all taxes owed. . . .

C. Extension of Alpert’s Fraud Measure of Damages to the Negligence Arena

Although the measure of damages in fraud is so very different from the measure of damages in negligence, a number of cases have ignored this difference and simply relied upon Alpert in deciding negligence cases. It seems almost beyond comprehension why the courts do not even acknowledge, much less explain why, they are taking a rule from one area of law and are simply applying it in another, very different area. To make matters worse, they are also ignoring long-established precedent in the negligence area. Perhaps the most egregious example is Gertler v. Sol Masch & Co. Gertler involved an action against an accountant for professional malpractice. Fraud was never even mentioned in the opinion. In affirming the trial court’s directed verdict dismissing the complaint, the First Department, citing only Alpert held simply, “taxes and tax interest are not recoverable under New York law.” While Gertler said so, there simply is no such rule in the negligence arena.

Similarly, in Solin v. Domino, Jr., a federal district court sitting in diversity and applying New York law simply applied the fraud “out-of-pocket” rule as the measure of

131 Thomas v. Cleary, 768 P.2d 1090, 1092 n.5 (Alaska 1989). See also Hosfelt v. Miller, No. 97-JE-50, 2000 Ohio App. LEXIS 5506, at *14 (Ohio Ct. App. Nov. 22, 2000) (Although necessary taxes may not constitute an injury to a client’s interests, taxes which could have been avoided by the exercise of the knowledge, skill and ability ordinarily possessed and exercised by legal professionals under similar circumstances can be considered as an injury.) Id. at *14.
133 Id.
134 Id. at 283.
damages for a negligence and malpractice cause of action.\textsuperscript{136} The court then proceeded to hold, citing \textit{Alpert}, that the defendant could not recover his tax payment because that would place him in a better position than he held prior to the misrepresentation.\textsuperscript{137} Again, this does not seem to be an accurate statement of the \textit{Flynn v. Judge} expectancy rule of damages in the negligence arena.

While \textit{Alpert}, under its facts, may have been correct not to award back taxes to the plaintiffs because any such award would have put them in a better position than if they had never invested in the tax shelter at issue,\textsuperscript{138} there is no reason for the result in this particular fraud situation to be both transplanted to the negligence area and also to be elevated into an across-the-board rule of law. For instance, under the \textit{Flynn v. Judge} measure of damages, the additional taxes incurred due to a tax advisor’s negligence in the following previously mentioned illustrative situations should be recoverable just as they were held to be recoverable in other states:

1. where the benefit of utilizing the alternate valuation date for estate tax purposes was lost due to the late filing of the estate tax return by the estate’s attorney\textsuperscript{139}.

2. where the tax advisor incorrectly advises a deduction be taken in a later year rather than in the proper earlier year and the benefit of the deduction is lost;\textsuperscript{140}

3. where a client fails to obtain favorable long term capital gain treatment that otherwise would have been available because the advisor miscalculated the holding period necessary to obtain long term treatment,\textsuperscript{141} and

\textsuperscript{136} \textit{Id.} at *7.
\textsuperscript{137} \textit{Id.} at *8.
\textsuperscript{138} \textit{Alpert, supra,} 559 N.Y.S.2d at 314-15. The court never explained what it meant by this statement. In fraud, the purpose of damages is to restore the party to the position occupied immediately before the commission of the fraud. \textit{Id.} at 314. Presumably, any recovery of taxes would enrich the plaintiff vis-à-vis never having invested in the tax shelter, notwithstanding the shelter’s promise of a large tax reduction.
\textsuperscript{139} \textit{See e.g.}, Cameron v. Montgomery, 225 N.W.2d 154, 155 (Iowa 1975).
\textsuperscript{140} \textit{See e.g.}, King v. Neal, 19 p. 3d 899, 900-01 (Okla. Civ. App. 2001).
4. where an advisor gives incorrect advice as to how to purchase insurance coverage and the benefits later received are taxable rather than tax-free.\textsuperscript{142}

In each situation, the additional taxes would not have been incurred but for the advisor’s negligence, and should be recoverable.

Similarly, while \textit{Alpert’s} holding “that the victim of fraud may not recover the benefit of an alternative agreement overlooked in favor of the fraudulent one”\textsuperscript{143} may have been correct in that case, this too should not be extended as absolute doctrine in the negligence area. In \textit{Alpert} the attorneys who rendered opinions concerning the subject tax shelter had absolutely no connection with, or even notice of, what other investments the investors might have been considering. The alternative investment was completely extraneous to the defendants’ role in the shelter at issue. Contrast this with a situation in which a layman who is considering investing in one of two tax shelters seeks advice from an expert as to which shelter is efficacious. Here, if due to negligence, the advisor advises the purchase of option B rather than option A and it turns out that B is invalid while A is valid, the additional taxes incurred ought to be recoverable. But for the negligence, the client’s pecuniary position would have been better by the taxes that could have been saved.

An interesting case study in the jurisprudential mischief created by applying \textit{Alpert’s} fraud measure of damages in the negligence arena is provided by \textit{Solin v. Domino}.\textsuperscript{144} In \textit{Solin} the basic analysis is flawed, since the court utilized the fraud measure of damages rather than the negligence measure of damages in dismissing the plaintiff’s cause of action on a motion to dismiss. However, the alternative holding in \textit{Solin} that the

\textsuperscript{142} See \textit{e.g.}, Jamison, Money, Farmer & Co. v. Standeffer, 678 So. 2d 1061, 1066-68 (Ala. 1996).

\textsuperscript{143} \textit{Supra}, 559 N.Y.S.2d at 315

\textsuperscript{144} 2009 U.S. Dist. LEXIS 51405 (S.D.NY. 2009)
plaintiff cannot recover any damages since the only damages asserted were speculative, might plausibly be a correct result, even if the proper legal standard had been applied.

In *Solin* the plaintiff,145 under the federal court’s diversity jurisdiction, sued his insurance agent/financial advisor for professional malpractice and negligent misrepresentation.146 The crux of the complaint was that the defendant understated the tax that would be incurred if the plaintiff were to cash in his annuity policy. The plaintiff had an annuity worth approximately $3.2 million. The plaintiff was contemplating one of two courses of action: (1) whether to surrender the annuity, pay the taxes and invest the balance in a taxable account; or (2) whether to roll over the annuity tax-free into another annuity.147 If the second option was selected, no taxes would be currently incurred, but would be deferred until the new annuity was cashed in. Based on the defendant’s advice that approximately $200,000 of taxes would be incurred currently if option one was chosen and the annuity cashed in, the plaintiff chose option one. It later turned out that the actual tax liability was over $600,000 rather than the advised $200,000. When confronted about the discrepancy, the defendant admitted that he had made a mistake. This suit was commenced because the plaintiff asserted he would have selected the second option, if he had been given accurate advice.148

At the beginning of its analysis the court in *Solin* noted that to recover under either of the asserted causes of action, the plaintiff would have to prove proximate and

145 There were actually two plaintiffs in *Solin*; Daniel Solin, individually, and as trustee of the Daniel R. Solin Trust. *Solin, supra* 2009 U.S. Dist. LEXIS 51405 at *1. For ease of presentation they are treated as one plaintiff since the issues for both were identical and the court also treated them as one.
146 In the final footnote of the opinion the court noted that since the plaintiff’s cause of action was defective because it failed to assert any recoverable damages, the court did not need to address the defendant’s alternative argument that New York law does not recognize a professional malpractice cause of action against financial advisors. *Id.* at *11-12 note 7. The discussion herein also does not address this contention.
147 *Id.* at *2-3. See I.R.C. §1035.
148 *Id.* at *4.
actual damages. Speculative damages were not recoverable under New York law. The court noted that damages were speculative when the fact that damages were incurred is uncertain, not merely when the amount of the damages was in dispute.

The applicable measure of damages, according to Solin, was that “[a] victim of negligence and malpractice may recover his out-of-pocket expenses that flow from the wrongful conduct (i.e. indemnity for actual pecuniary loss).” The court went on to hold that taxes were not recoverable by the plaintiff for two reasons. First, based on Lama Holding Co., because the tax liability was caused by plaintiff having recognized taxable gain, not because of any misrepresentation by the defendant. And second, because any recovery of taxes would put the plaintiff in a better position than he held prior to the misrepresentation. For this latter proposition the court relied on Alpert.

With all due respect, the court utilized the fraud measure of damages of both Lama Holding and Alpert as the rule of recoverable damages for the torts of professional malpractice and negligent misrepresentation. The court did not even note the transplantation of a fraud rule into the negligence area. Even worse, the court seems to have elevated statements in each of the fraud cases that may have been perfectly appropriate in their original contexts and made them into absolute tort rules that have no basis and make no sense in the tort arena. These rules are that taxes may never be

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149 Id. at *5.
150 Id. at *6-7
151 Id. at *7.
152 Id.
153 Supra, 88 N.Y. 2d at 422.
154 It should be noted that in Solin the plaintiff first solicited and received the tax advice before cashing in the annuity. 2009 U.S. Dist. LEXIS 51405 at *3. This is in contrast to the situation in Alpert in which the plaintiff engaged in his normal economic endeavors during all of 1977 and purchased the tax shelter on December 30th of that year. 559 N.Y.S. 2d at 313.
155 Id. at *8
recovered (under the out-of-pocket rule, which does not apply in tort cases) and that a recovery of back taxes would always put a plaintiff in a better position than before the wrong. Finally, it is suggested that the court’s approach, if followed, will make it impossible to ever recover the most elemental type of damages incurred in a tax malpractice context --additional taxes.

Solin also gave short shrift to the plaintiff’s alternative argument that he ought to be able to recover as damages the difference between the taxes incurred on cashing in the annuity and what he would have incurred by utilizing the other option of deferring the tax by exchanging the annuity for another annuity. According to the court, such damages were speculative and not recoverable. They were speculative because the amount of taxes ultimately incurred is not knowable because they will depend upon such factors as when the future tax liability will be incurred, what the plaintiff’s tax rate will be at that time, and whether there will have been any changes in – perhaps even elimination of --the tax law. The court also rejected the plaintiff’s attempt to shift the speculativeness problem to the defendant by arguing that the plaintiff was entitled to recover the full $600,000 of taxes currently paid and if the defendant wanted to reduce this amount by any taxes that would be incurred in the future, the defendant had the burden of proof on this offset. Since the defendant certainly could not prove this amount of any offset due to its inherent speculativeness, the plaintiff, it was argued, should therefore be able to recover all the taxes paid currently.

It is suggested that a correct analysis of the Solin facts would be as follows. Initially, the proper measure of damages in this malpractice situation would be, not the

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156 Id. at *7-8.
157 Id. at *9-10.
158 Id. at *10-11
fraud out-of-pocket rule, but the expectancy (really, benefit-of-the-bargain) measure of damages of *Flynn v Judge*. Under this rule of damages a plaintiff could recover the difference between what his pecuniary position would have been if the tax advice were non-negligent and his present pecuniary situation. If extra taxes were caused by the negligent advice such amounts would be recoverable.

Applying this rule to the *Solin* facts, it is clear, as the court found, that there was no issue as to the defendant’s negligence or proximate cause. The only issue for decision was damages - whether the plaintiff proved his damages. At this point, *Solin*’s analysis of the plaintiff’s alternative argument and the court’s discussion of the speculativeness of the damages and who has the burden of proof is completely apropos. It would be a perfectly proper result for the court to hold that in New York the plaintiff has the burden of proving damages as an element of his cause of action. That, to do so, that plaintiff had to establish the difference between the currently incurred taxes, and what would have been incurred had he chosen the other option of deferring his taxes by rolling over his old annuity into a new one. Not being able to prove this amount because of the speculativeness of the future taxes and not being able to shift this burden of proof onto the defendant, the *Solin* result of granting the defendant’s motion to dismiss would be correct, or at least, arguably correct.

Although the lower court in *Apple Bank for Savings v. PricewaterhouseCoopers* also applied *Alpert* in a tort context, the opinion is

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159 Supra, 133 N.Y.S. 794.
160 Id. at 796.
162 See Malpractice Damages, supra note 1 at 758 for a fuller discussion of this issue.
noteworthy and merits discussion for two reasons. First, and most importantly, the court seems to have instinctively fathomed the correct standard for when taxes ought to be recoverable in tort situations and it interpreted Alpert and some its progeny as standing for this result. Second, as did a number of other cases, the court combined its analysis of the recovery of taxes and of interest and treated them as a unit. While taxes and interest are often considered together, it is suggested that under Alpert this is not correct since the underlying rationale for each item is very different. It is also suggested that while the court’s conclusion as to the recoverability of taxes may have reached an ultimately correct result, its conclusion (analysis?) as to interest was not correct.

As discussed previously, in Apple Bank the plaintiff bank alleged that the defendant, its accounting firm, gave it incorrect advice as to the tax consequences of redeeming stock from the estate of its deceased sole shareholder. As a result it incurred additional taxes and interest. The defendant moved for summary judgment dismissing the complaint, primarily on statute of limitations grounds and also because back taxes and interest are not recoverable under New York law. In addressing the latter issue, the court commenced its analysis with Alpert’s holding that the plaintiff could not recover the back taxes and interest “because the plaintiff inevitably would have incurred the tax liability if it had not invested in the disallowed tax shelter.”

Addressing the recovery of both back taxes and interest, the court concluded that under New York law back taxes

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165 See id.
166 See supra text accompanying notes 39-45.
168 Id.
169 Id. at *6
and interest are recoverable if the plaintiff’s tax liability would have been avoided but for the erroneous advice. Where the tax liability was inevitable, the court held there can be no recovery of interest and taxes since a recovery would create a windfall for the plaintiff.\textsuperscript{170}

While the court’s conclusion with respect to the recovery of taxes in New York is ultimately correct, the analysis is not. The starting point in the court’s analysis should not have been \textit{Alpert} but rather \textit{Flynn v Judge}. Under \textit{Flynn}’s expectancy measure of damages in negligence, a plaintiff may recover the difference between what his pecuniary position would have been if the advice received were non-negligent and his present pecuniary situation.\textsuperscript{171} Under this standard it directly follows that any additional taxes that would have been avoided with non-negligent advice would be recoverable.

As to the \textit{Apple Bank} court’s analysis of the recoverability of interest, it is suggested that if the court’s starting point was \textit{Alpert}, which it was, its analysis and conclusion is incorrect. The reason for this is because the crux of \textit{Alpert}’s holding that interest is not recoverable is because the court did not view the payment of interest as damages. It was merely an appropriate charge for the plaintiff’s use of the government’s tax money during the time the plaintiff was not entitled to the money. Under \textit{Alpert}’s presumption that the value of the money to the plaintiff always equals the interest charge paid the government, there simply are no damages to recover. Under this analysis, interest should never be recoverable, even when the back taxes were avoidable with non-negligent advice.

\textsuperscript{170} \textit{Id.}

\textsuperscript{171} \textit{Flynn, supra}, 133 N.Y.S. at 796.
V. Conclusion

Although I have previously stated my view that Alpert’s holdings prohibiting the recovery of both interest on a tax underpayment and additional taxes should be changed and that such recoveries should be allowed in New York in negligence causes of action, a considered analysis of Alpert must extend beyond a simple conclusion that Alpert was wrongly decided. In fact, Alpert was correctly decided. Alpert involved a fraud cause of action. In deciding that additional taxes were not recoverable and that any tax savings that could have been obtained by an investment in another viable tax shelter was irrelevant, Alpert was simply applying well defined and well established principles governing the recovery of fraud damages in New York. These principles were established in 1919 in Reno v. Bull172 and followed consistently since then.173

With respect to Alpert’s holding that interest on a tax underpayment was not recoverable, again it is impossible to simply suggest that this holding is erroneous. In fact, the holding was quite progressive and very perceptive of a wrong outcome resulting from the majority view’s simplistic allowance of the recovery of such interest as a normal element of recoverable tort damages.174 While Alpert was addressing a fraud cause of action, it very perceptively understood, and held, that interest on a tax underpayment does not factually constitute damages. The plaintiff had use of the government’s tax money for some period of time when not entitled to the money, and simply reimbursing the government for wrongly hypothecating the use of the money was, according to Alpert very appropriate. In fact, according to the court, if such interest were recoverable,

172 226 N.Y.546 (1919).
173 See supra, text accompanying notes 82-93 and 97-103.
174 See supra, text accompanying notes 71-72.
plaintiffs would always have the unwarranted windfall of having had the interest-free use
of money. Probably the harshest criticism possible of this holding of Alpert is that the
court was not prescient enough to recognize the criticism that would be leveled at this
result by the later, modern view. However, Alpert represented an appropriate,
evolutionary step in the development of the law on the recoverability of such interest.
Now, that the modern view has taken root which permits the litigants to establish
precisely whether more interest was paid to the government than was earned by having
use of this money, this view is superior to Alpert’s approach and New York should adopt
it. Arguably, this was accomplished by Jamie Towers,\textsuperscript{175} but, as indicated previously,\textsuperscript{176} Jamie Towers has been completely overshadowed by Alpert despite the fact that it was
decided later by the same court that decided Alpert.

In contemplating the current state of New York law governing the damages
recoverable by an injured plaintiff from a negligent tax advisor, it is most perplexing why
the courts did not, and still do not, simply apply New York’s traditional negligence
expectancy measure of damages in this area. In 1912 Flynn v. Judge\textsuperscript{177} very clearly
articulated that the measure of damages in such negligence situations is the difference
between the plaintiff’s present economic position and what it would have been with non-
negligent performance. This negligence measure of damages was endorsed by the New
York Court of Appeals in 1990,\textsuperscript{178} and has been applied by other lower courts.\textsuperscript{179} Why
have the courts extended the holdings of Alpert, a fraud case, to the tax malpractice area,

\textsuperscript{175} 745 N.Y. 5.2d 532 (1st Dept 2002).
\textsuperscript{176} See text accompanying notes 28-38, supra.
\textsuperscript{177} 149 A.D. 278, 133 N.Y.S. 794 (2d Dept. 1912).
\textsuperscript{178} Campagnola v. Mulolland, Minion & Roe, 76 N.Y.2d 38, 556 N.Y.S.2d 239 (1990)
\textsuperscript{179} See e.g., Sanders v Rosen, 159 Misc. 2d 563, 605 N.Y.S.2d 805 (Sup. Ct. N.Y.Co. 1993). [Other cases?]
instead of applying the directly relevant negligence measure of damages that has been New York law for almost a hundred years?

With respect to Alpert’s holding that interest is not recoverable, perhaps it can be suggested that since this involved a theory under which no damages were found to exist as a factual matter, it was permissible to utilize this same theory even in a negligence context. However, there seems to be no jurisprudential justification for taking Alpert’s holdings with respect to taxes and transporting them to the negligence arena.

There might be one rather cynical explanation of why Alpert, rather than longstanding negligence principles was applied in this area, and that is to minimize potential damages faced by errant professionals. Under Alpert additional taxes and interest on a tax underpayment are not recoverable from a negligent defendant, while such amounts¹⁸⁰ would be recoverable under traditional negligence doctrine. New York has a record of being very protective of its defendant professionals -- attorneys and accountants, -- and, correspondingly, very parsimonious towards injured plaintiffs. For instance, New York has a very strict rule for when the statute of limitations commences in such situations. It commences when the malpractice act was performed, despite the fact that the injury might not be discoverable for some period of time.¹⁸¹ There is no suspension of the statute while the wrong could not reasonably have been discovered.¹⁸² Similarly, New York has very strict privity rules limiting who may bring a malpractice cause of action.¹⁸³

¹⁸⁰ With respect to interest, only the interest differential should be recoverable.
¹⁸² See e.g., Williamson, id.
¹⁸³ See e.g., Estate of Schneider v. Finmann, 15 N.Y. 3d 306, 907 N.Y.S.2d 119 (2010) in which the New York Court of Appeals reaffirmed the general application of “strict privity” in estate planning malpractice claims, though it held the personal representative of an estate does have privity to sue a negligent estate planner on behalf of the estate. Id., 15 N.Y.3d at 309-10.
Also, in a four to three opinion, the New York Court of Appeals recently refused to modify existing principles of agency law and the *in pari delicto* defense to somewhat weaken current protection afforded to errant or negligent gatekeeper defendants. The minority characterized the effect of the majority opinion as effectively preclude[ing]… litigation by derivative plaintiffs or litigation trustees to recover against negligent or complicit outside actors - - even where the outside actor, hired to perform essential gatekeeping and monitoring functions, actively colludes with corrupt corporate insiders.

It would be quite disheartening to imagine that New York’s jurisprudence was being distorted simply to achieve a pro-defendant, anti-plaintiff result.

In conclusion, it is rather inexplicable why *Alpert’s* holding as to the fraud measure of damages was ever applied to govern the recoverability of additional taxes in the negligence arena of tax malpractice. As to the extension of *Alpert’s* no-interest-recovery rationale to the tax malpractice area, while this might originally have seemed acceptable or, at least, justifiable, not as a matter of negligence doctrine, but as a theory addressing the factual existence or nonexistence of damages, it no longer seems appropriate in light of the subsequent development of the modern approach that precisely measures any damages resulting from the payment of interest to a government. The proper course of action seems obvious. New York should revert to its longstanding traditional negligence measure of damages in the tax malpractice segment of the negligence arena. Expectancy damages should be recoverable. This would include additional taxes as well as any interest differential between the interest paid the government and the interest earned by the plaintiff on the underpaid taxes. In accordance

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185 *Id* at 477
with its long standing jurisprudence of requiring a plaintiff to prove his damages, the burden of proving the amount of the interest differential should be upon the plaintiff.