Giving Useful Tax Planning Advice

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Giving Useful Tax Planning Advice
By Heather M. Field

Heather M. Field is a professor of law at the University of California Hastings College of the Law.

In an effort to ease the transition from school to practice, Field provides guidance to early-career tax lawyers about how to turn their growing knowledge of the tax law into useful client advice. This article is dedicated to Field’s father, Harry, who taught her to “read to misunderstand.” Although Field’s father’s legal expertise is not in tax law, he shared many lessons about life and lawyering that Field found invaluable in tax practice. She regularly shares those lessons with her students (sometimes to their chagrin), and she includes some here.

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A. Introduction

Practicing lawyers know that when advising clients, it is not enough just to know the law. Substantive knowledge is necessary, but it is far from sufficient. Turning substantive tax knowledge into useful tax advice can be quite a challenge, particularly for new and aspiring tax lawyers. Giving useful advice is a skill, combining counseling, communication, and judgment, among other talents. Of course, this skill is developed over the course of a career, so there are limits on what law schools can do to prepare students to take their legal knowledge out of the classroom and into the real world. Nevertheless, as both a law professor and former tax practitioner, I want to help with the transition from school to practice.

Thus, this article identifies eight steps that can help new and aspiring tax lawyers to better use their substantive tax knowledge to provide client advice, particularly when representing business clients in the transactional tax setting. Specifically:

1. Understand the economics.
2. Realize that tax isn’t everything.
3. Empower, don’t just impede.
4. Develop professional legal judgment about risk.
5. Respect the lawyer’s role.
6. Speak the client’s language.
7. Appreciate the relationship dynamics.
8. Know what you know.

These steps may sound easy, but often they are not. And while I did my best to follow them when I was in practice, I am certain that there were times when I could have been more successful. So, don’t despair if you, too, try to implement these suggestions but feel like you occasionally fall short.

B. Eight Suggestions for Giving Useful Advice

1. Understand the economics. It seems almost obvious to say that an understanding of the economics of any transaction is essential to a tax lawyer’s ability to provide useful advice on that transaction, but I think it would be difficult to overstate the importance of this. By “understand the economics,” I mean several things.

I want to be clear about what I am not doing in this article. This discussion is not about the importance of working hard, expanding substantive expertise, developing business, or giving back to the community. Those things are important, but my goal here is narrower: to share a few thoughts that may help new tax lawyers become more effective client advisers.


Some lawyers may find my remarks obvious, while others may disagree with how I picture the role of lawyer. Although the strategies discussed here could be categorized differently, added to, or combined, I hope this discussion resonates with experienced tax lawyers and provides assistance to newer ones.

By useful tax advice, I mean informative and understandable advice that comprehensively addresses the client’s objectives (including tax objectives) and gives the client an appreciation of the benefits and risks of a decision, thereby putting the client in a position to make an educated choice.

I have had the good fortune to see some superb lawyers in action, masterfully advising clients.

I say this with great respect for clinics and other curricular innovations that give students a taste of practice.
a. Develop your general business acumen. Many lawyers have little business background before attending law school. You probably developed some background from your tax and business law courses in law school. Even so, understanding the economics may be more challenging for some lawyers than for others. And there is always more to learn, even for the business-savvy lawyer.

If you do not know anything about finance, business, or accounting, it is time to learn. At the very least, you should be able to read basic financial statements, you should understand the concept of the time value of money, and you should know a little about valuation techniques. You can start developing your money sense by reading The Wall Street Journal or by taking a continuing legal education course on accounting or finance for lawyers.7

b. Get a feel for the overall business and financial position of the client. Learning about your client’s business and finances gives you insight into what your client’s objectives are likely to be. This will help you talk to your client about its goals and will help you gauge whether particular tax consequences are likely to be problematic. For example, a company with a lot of income but extremely tight cash flow is likely to be especially averse to recognizing a large amount of current gain. In contrast, a company that has a large amount of net operating losses may not object to undertaking a taxable transaction.

Also, if you sound knowledgeable about your client’s business, that can inspire your client’s confidence. Talk to your colleagues about the client’s business. Spend a few minutes on your client’s website. If the client is a public company, look at its most recent annual report.8 That is a worthwhile use of relatively little time.

c. Follow the money. You should understand the economics of the particular transaction. Draw a picture illustrating the flow of money, other assets, and services. Who gets what in exchange for what? How is each party getting value from the transaction? Following the money will help you identify potential discrepancies that could raise business and tax issues.

For example, does a party appear to be getting something for nothing? Consider a term sheet indicating that your client is going to contribute $5 million to a company in exchange for preferred stock. If the term sheet also indicates that your client will receive a warrant to buy common stock, know that the client is not getting the warrant for free. Rather, the client is buying an investment unit, and the $5 million aggregate purchase price generally must be allocated between the preferred stock and the warrant based on their relative fair market values.9 That allocation affects the client’s basis in the preferred stock, which may create adverse tax consequences.10

Is a step missing? Imagine a term sheet provides that a corporation is selling an asset, and in exchange, the corporation’s sole shareholder is receiving $1 million from the buyer. If you try to draw the movement of money and goods, the arrows will not connect. The corporation sells the asset, but the consideration ends up in the shareholder’s hands. A step is missing — either the corporation sells the asset in exchange for the money and then distributes the cash to the shareholder, or the corporation distributes the asset to the shareholder, who then sells the asset for cash.11 Either way, the missing step has tax consequences.12

Further, if a transaction’s terms reflect something to which rational actors13 would not agree, say something. Inquire. The discrepancy might be easily explainable. But you might discover a side deal that could have tax consequences, or you might catch a business error.

d. Be clear about the client’s economic objectives. In addition to understanding the overall economics of the transaction, you should understand the specific business objectives that your client is trying to accomplish in the deal. This will help you find alternative ways to achieve those objectives if one proposed course of action is problematic for tax or other reasons (see point 3, infra). This will also help you differentiate between big and small money issues, so that you can ensure that

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7The Practising Law Institute regularly offers a “Pocket MBA” for lawyers, available at http://www.pli.edu/Content/Seminar/Pocket_MBA_Finance_for_Lawyers_Fall_2011/N-1z13h0Z4k7ID=100815.

8This can easily be found using EDGAR, available at http://www.sec.gov/edgar/searchedgar/webusers.htm.

9Specifically, the corporation will recognize any corporate-level gain, whether on the distribution of any appreciated assets to the shareholder or on the sale of any appreciated assets, and the shareholder will be taxed on the distribution (of the assets or cash proceeds) as a dividend to the extent of corporate earnings and profits. Sections 301 and 311(b).

10By this, I mean utility-maximizing taxpayers who measure utility in money.
you are fighting for the things that are most important to your client. And, this allows you to confirm that the deal articulated in the transaction documents matches your client’s understanding of the deal; mismatches do occur.14

2. Realize (and recognize) that tax isn’t everything (that is, it’s not about you). Immersion in the world of tax makes it easy to focus on tax issues to the exclusion of other business (and nonbusiness)15 considerations. But, as I frequently tell my students, business people do business things for business reasons. Tax is often one business reason — and sometimes tax considerations weigh heavily in clients’ decision-making — but tax is not the only issue.16

   a. Appreciate that paying tax is not always bad. One of the easiest ways to have no federal income tax burden is to make no money. Of course, that is not what people typically want. Rather, they generally seek to maximize the bottom line. For example, a client who is subject to a combined federal and state tax rate of 40 percent generally will prefer to invest in a taxable corporate bond that bears 6 percent interest rather than a tax-free municipal bond that bears 2 percent interest (assuming — and this is a big assumption — that the client considers the bonds to be otherwise equivalent investments).17 In other words, the alternative that creates a lower tax bill is not always the better economic choice.

   Just as it is not always disadvantageous to pay taxes, it is not always advantageous to have a deduction. “It’s deductible” is not the same as “it’s free.” Similarly, advising a client to spend money that it otherwise would not have spent, solely to get a deduction, is like encouraging the client to buy 35 cents for the cost of a dollar. That is a bad trade.18

   b. Don’t overlook accounting considerations. Public companies may care more about the accounting treatment of a transaction than the tax treat-

14 Some mismatches are blatant. Others you will discover if you read the language in the transaction document to see how it could be misunderstood or misinterpreted by a zealous litigator.

15 By this, I mean the nonlegal, human component of the transaction (see point 7, infra).

16 The economics of a transaction include the tax consequences. Thus, this point is a corollary to point 1, supra. However, “tax tunnel vision” merits separate attention because tax advisers must remember how their advice fits into the bigger picture. Thanks to Noah Metz, my research assistant, for the term “tax tunnel vision.”

17 The 3.6 percent after-tax return on the taxable bond exceeds the 2 percent return on the tax-free bond.

18 It is very different if you are advising your client about the deductibility of an expenditure that the client already made, or of an expenditure that serves an important nontax purpose.

   ment. For example, a public company may prefer to accelerate income to maximize the year’s earnings as reflected on the financial statements, even if that will increase the company’s taxable income (and hence, tax bill) for the year.19 Accounting issues can be critically important for clients, so be sensitive to how your client balances the tension between tax and accounting (and other nontax) objectives.

   c. Apply tax practitioner rules of thumb wisely. The common wisdom suggests that taxpayers should defer income and accelerate deductions. But, following the common wisdom can be a mistake. For example, a client with NOLs that are about to expire may prefer to accelerate income to monetize the NOLs that might otherwise be forfeited. And a client may prefer to defer a deduction if the client is already in a significant loss position.

3. Empower, don’t just impede. Lawyers have a reputation for being deal-killers. And sometimes, a lawyer must say no (see point 4, infra). But clients generally want their lawyers to do more than just prevent problematic deals from occurring.

   a. Strive to say ‘no, but’ rather than just ‘no.’ Rather than thinking of your role as someone who tells the client what it cannot do, try thinking of yourself as the adviser who tells your client what it can do. In addition to informing a client that its proposal has adverse tax consequences, suggest alternatives that improve the tax result while still accomplishing the client’s nontax objectives.

   For example,20 consider an acquisition of your client (the target corporation) that is intended to qualify as a reorganization under section 368 and that is preliminarily structured as a reverse triangular merger with consideration that is 50 percent cash and 50 percent stock.

   You are correct if you tell your client that the target shareholders will be fully taxable on their dispositions of the target company stock.21 If your advice ends there, however, you likely leave your client frustrated and wondering how to accomplish the deal. Instead, consider telling your client that the transaction as structured will not qualify for tax-favored treatment, but that you can suggest other structures that are likely to yield better tax results while helping the client achieve its nontax
goals. For example, if the 50/50 cash/stock split of the consideration is critical to the deal, you can suggest a direct merger, a forward triangular merger, or a merger of the target company into a limited liability company that is wholly owned by the acquirer.

Try to leverage your creativity and your knowledge of the tax rules to help your client achieve its business objectives in tax-efficient ways.

4. Develop professional legal judgment about risk.

a. Expect uncertainty. When you provide tax planning advice, there will be risk, and there will be uncertainty. But clients seek out legal advisers for their professional judgment in precisely those situations. You will need to be able to evaluate the magnitude of the risk inherent in a position, determined without regard to the audit lottery. That is true whether you are providing tax advice when it is uncertain how the law applies to a known set of facts (for example, whether a particular business expenditure is currently deductible or whether it must be capitalized), when the law is clear but the facts to which it applies are uncertain (for example, whether a client should make a section 83(b) election for property that is subject to forfeiture), or when both the law and the facts are subject to some uncertainty (for example, to what extent a preferred return on a partnership interest will be treated as a guaranteed payment).

b. Know when to say when. Some tax positions create too much risk, so you must know when you have to say “no” to a client. You generally cannot advise a client to take an undisclosed position on a return unless there is substantial authority for the position. The standards are higher if you are advising on a tax shelter or a reportable transaction, or if you are otherwise providing a covered opinion. And of course, you cannot help a client commit fraud or mislead the IRS.

You protect yourself from professional and monetary sanctions and you protect your client’s interests if you know when to say when. Unfortunately, clients do not always follow their lawyer’s advice. If despite your best advice and guidance your client insists on doing something that you have told it that it cannot do, you may need to withdraw.

5. Respect the lawyer’s role.

a. Do more than spout the tax law. Some lawyers believe that their only responsibility is to explain the law to the client. I disagree. I believe that a lawyer also should help the client understand how the tax law applies to its factual situation, articulate alternative courses of action, explain the range of possible tax consequences (including possible penalties and opportunities to avoid them), be clear about the tax and nontax trade-offs of the alternatives, and provide professional legal judgment about the better way to proceed.
b. But do not usurp the client’s business decision-making role. For business decisions, you are only an adviser; you are not the decision-maker. You can guide and caution, but the client is responsible for taking your legal advice into account when making business decisions. But sometimes clients are uncertain, sometimes they are silent while they think, and sometimes they ask you what they should do. When lawyers see voids, they often want to fill them. Silence has a way of encouraging lawyers to talk, but you need to know when to keep your mouth shut. So, beware of respecting your role as a legal adviser. Do not substitute your legal acumen for the client’s business judgment.

c. Accept that your tolerance and appetite for risk may be different from your client’s. Generally, the client should decide how much tax risk to take. That is a business decision. The client may be more or less risk averse than you and may not make the same choice that you would make for yourself. That is OK. Ultimately, a client may opt to accept increased tax risk to reduce nontax risk, and the client may make a rational business decision to take a tax position for which there is, for example, only substantial authority. The standards that govern tax practice allow you to help the client take that position even if you would not take it on your own behalf. You have met your ethical obligations and have served your client as long as you have given comprehensive advice about the risks and said no when necessary (see point 4, supra).

6. Speak your client’s language.

a. Learn your client’s lingo. It is your responsibility to ensure that you understand your client. You should know basic finance jargon. For example, if you deal with public companies, terms like “EBITDA,” “GAAP,” and “LIBOR” should be part of your vocabulary. You should be familiar with terminology used in your client’s industry. For example, if you represent real estate clients, you should know what a triple-net lease is and what an HVAC system is (see point 1, supra).

b. Translate tax into English. You should know your client’s lingo, but you should not assume that your client knows yours. To be understood, ensure that you articulate your advice at the appropriate level of sophistication for the audience. Generally, you can use shorthand tax section references when speaking with opposing tax counsel or with the client’s internal tax people. But it generally is inadvisable to be a “codehead” with clients and nontax colleagues. When talking to someone whose expertise is not tax law, do not say, “There is a 163(l) problem.” That makes you look arrogant and impedes real communication. Translate “tax-ese” into English. Consider instead, “With these proposed terms, the corporation would not be able to take a deduction for interest payments made on this debt because a substantial amount of the interest is payable in stock.” Then, if that tax result is problematic, discuss alternatives that might better suit the client’s objectives (see point 3, supra).

c. Ensure your advice is communicated to the decision-maker. Be wary of playing “telephone.” If you are not giving your advice directly to the decision-maker, make sure that your advice is correctly transmitted. It is easy for someone to turn your nuanced answer into a sound bite that fails to reflect what you really said. For example, if you explain the above interest deductibility issue to an intermediary, the intermediary might tell the client, “The tax folks said you cannot pay the interest in stock,” which is, of course, not what you said. Rather than letting someone else pass along your tax advice, try to communicate it directly. Assuming that is appropriate given your organization’s structure, attend the meeting, be on the phone call, or send an e-mail.

d. Be sensitive to differences. Remember that social and business norms can vary by culture, region, industry, etc. Those norms can dictate appropriate attire, etiquette for greetings, and customs regarding the exchange of business cards, among other things. If you understand your client’s background, you may be able to help your client feel more comfortable, which may increase its receptivity to your advice. At the very least, you can try to avoid offending your client.

7. Appreciate the relationship dynamics. When advising clients, it is important to remember the human component of tax law and the noneconomic aspects of client advising. Whether your client is an

uncertainty). In contrast, a partnership that liquidates in accordance with a fixed economic waterfall provides clarity about the partners’ ultimate economic entitlements (economic certainty), but there is more risk that the partnership allocations will not be respected or that there will be a capital shift on liquidation (tax uncertainty). Reg. section 1.704-3(b)(2).

34At some level, almost all determinations, including legal determinations, can be characterized as business decisions, so you need to develop your judgment about which decisions the client wants you to make and which it does not, which varies from client to client.

35By tax risk, I mean risk arising from the possibility that facts may not turn out a particular way or that a tax position, if challenged, may not be sustained on the merits. I am not talking about when a client wants to play the audit lottery.
individual, a group of individuals, or an organization (represented by individuals), you are dealing with people. And things like emotions, biases, and interpersonal relationships can affect what advice you give, how it is given, and how it is received.

a. Realize that relationships change over time. The client’s perspective on the world and relationships with other parties can evolve. Optimism can turn to pessimism. Synergistic business combinations can devolve into contentious litigation. Today’s best friends can become tomorrow’s mortal enemies.

Thus, your advice must account not only for the current status of the parties, but also for the ways in which things might change. You cannot predict everything that could go wrong, but you should try to prepare for contingencies. What are the things that are most likely to create conflict? What risks might your client be underestimating? Why might your client (or another party) want to get out of its commitment? It is often better to identify and address those issues before relationships sour or conditions change.

b. Beware of over-lawyering. While it is important to prepare for contingencies, over-lawyering can hasten the disintegration of relationships between your client and the other parties to a transaction. Be careful that your efforts to protect your client do not create animosity or distrust where none was present.

c. Bear in mind that people on the same side don’t always agree. Relationship issues do not only arise between parties on different sides of a transaction. Whenever the client includes or is represented by more than one person, relationship issues can also arise among members of the client group.

Different client representatives may have different visions of the objective of the transaction. They may have different risk appetites; for example, the client’s general counsel might be more risk averse than the CEO. They may have different personal stakes in the ultimate result; for example, different deal structures may yield different bonuses or post-transaction positions. And different client representatives may just not like each other; office politics can affect even professional, rational people.

So, be certain that your understanding of the “client’s” objectives really reflects the collective goals (see point 1, supra). Be sure that your advice is not altered when one client representative reports to another (see point 6, supra). Be clear about who makes final decisions (see point 5, supra). Managing the challenges of representing a group is easier if you appreciate the relationship dynamics.

d. Don’t make it personal. Remember that this is business. You are giving ex ante planning advice about a transaction. The negotiations, deal terms, and language are not about you as an individual, so don’t take them personally. Another lawyer may be criticizing your position on an issue, but they are generally not criticizing you. And, even if you are the subject of a personal attack, don’t respond in kind. Making things personal undermines your professional reputation and may hurt your client’s interests.

8. Know what you know. You will get questions from clients and colleagues that you cannot answer off the top of your head. That is OK. It is a frequent occurrence for new tax lawyers, and it happens to even the most experienced and sophisticated lawyers. So how do you respond?

a. Know what you don’t know. If you do not know the answer, do not guess. Saying that you don’t know generally is better than giving incorrect advice. You can say that you don’t know, and that you will check and get back to the client. If you think you know, give a tentative response, and tell the client that you want to double-check to confirm.

That said, it is a skill to say “I don’t know” in a reassuring way. You generally want to communicate that it is perfectly reasonable that you do not know the answer and that the client can still have confidence in you, your expertise, and your advice. Some of the best senior lawyers are incredibly adept at this, so listen and learn when your senior colleagues face this situation.

b. And know what you should know. While you can tell clients that you do not know the answers to some of their questions, you cannot (and should not) do that in response to every question. Similarly, you can flag some tax issues for further inquiry, but you undermine your client’s confidence in you if you repeatedly raise (or, worse, manufacture) potential issues that turn out to be just fine.

37Over-lawyering can also threaten your relationship with your client.

38For this discussion, I assume that it is clear that you represent the group and not any one individual and that no ethical problems arise from divergent opinions among members of a client group.

39This is the oft-told story of the boy who cried wolf.
So, it is critical to develop your substantive expertise. When you do not know the answer to a question, learn the answer and reflect on your knowledge. Should you have known? Or is the issue sufficiently obscure that it is reasonable that you did not know? Be honest. If you find yourself in the former situation, work to broaden and deepen your knowledge.

C. Conclusion

Many challenges await aspiring tax lawyers: Find a job. Repay student loans. Balance work life and personal life. Become accustomed to keeping track of time in six-minute increments. Adapt to the professional work environment. Prove your worth to colleagues and clients. Learn as much substantive tax law as possible. Keep up with changes to the tax law. And figure out how to translate substantive knowledge into useful legal advice. I hope that the strategies described here will help law school graduates face that challenge as they develop their understanding of what it means to be a lawyer and as they become legal advisers, particularly in the transactional tax setting.