

## **Too Many Clients: A Cautionary Note on Payroll Tax Cases.**

When an employer falls behind on payments of taxes withheld from employees' paychecks, the IRS tends to take prompt enforcement measures. In addition to taking action against the employer, the government will generally look at individuals associated with the employer to determine whether they are potentially liable under Section 6672 of the Internal Revenue Code, which imposes potential liability for any shortfall in withholding upon "[a]ny person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof." I.R.C. § 6672(a).

Under Section 6672, the determination of who is a responsible party is fact sensitive, and it is possible in many situations that more than one individual may be deemed to be responsible by the IRS. These factors create some potential problems for both clients and lawyers, as illustrated by a recent case from the District of Maryland.

In *Hudak v. United States*, 2012 U.S. LEXIS 181709 (D. Md. Dec. 26, 2012) a lawyer had simultaneously represented a related group of corporations, their owner, Timothy Hudak, and their chief financial officer, Dwight Mules, in proceedings before the IRS relating to payroll taxes. After an initial meeting that Hudak, Mules and the attorney had with the IRS, the attorney warned both Hudak and Mules that they had potential exposure under Section 6672 of the Code and that they might have antagonistic defenses, as each might seek to escape liability by pointing the finger at the other. *Hudak*, 2012 U.S. LEXIS 181709, slip op. at \*2. The attorney then separately advised both Hudak and Mules that if they wanted to assert antagonistic defenses, they would need to retain separate counsel. *Id.* at 2-3. Apparently, an agreement was reached that the attorney would represent the corporations, Hudak and Mules before the IRS with the understanding that neither Hudak nor Mules would assert inconsistent individual defenses. *Id.* at 3. Proceedings before the IRS apparently centered upon a contention "that due to certain action and/or inaction by the Government, neither Hudak nor Mules could be held liable as responsible persons." *Id.*

The IRS initially assessed Hudak and collected a portion of the taxes due from him; Hudak sued for a refund, and the Government filed a counterclaim against Hudak and a third party complaint against Mules. *Id.* at 4. Mules then filed a motion to disqualify Hudak's counsel, who had previously represented both Hudak and Mules before the IRS.

In addressing the motion to disqualify, the district court quickly concluded that Mules had an attorney-client relationship with Hudak's counsel and that the lawsuit was at least substantially related to the prior IRS administrative proceeding, if not the same matter. *Id.* at \*7-\*9. Turning to the question whether Hudak and Mules had materially adverse interests, the Court recognized that they might have common interests on some issues, but nonetheless concluded that "so long as the instant lawsuit presents a contention by Hudak and/or Mules that the other is a 'responsible person,' there are materially adverse interests . . . ." *Id.* at 10.

The district court then turned its attention to the question whether there was appropriate informed consent by Mules to the attorney's representation of Hudak in litigation after the IRS proceedings. Because there was no written consent as required by Maryland's version of Model Rule of Professional Conduct 1.9, the court held that informed consent was not present. *Id.* at \*10-\*11 This left the Court to focus on a remedy; the attorney asserted that he could actively

represent both Hudak and Mules on the same defense that had been presented before the IRS; the court, while recognizing that this might be permissible remedy in a particular case, decided that the sounder course was to disqualify the attorney, leaving open the possibility that its order might be modified as the parties' contentions became clearer. *Id.* at 16-17.

The district court's decision is a sound one. It does, however, have some adverse consequences:

- The lawyer, who appears to have acted in good faith, has to worry about fall-out from the disqualification order;
- Hudak now needs a new lawyer and will incur significant expense as a new attorney gets up to speed on the case.

The district court's opinion suggests that the problem might have been avoided if the lawyer had secured a written waiver by Mules. For my part, I am not so sure that would have solved the problem; under Section 6672, it seems virtually inevitable that a business owner and a chief financial officer are going to have adverse interests in most cases. Written consent, while required, is not conclusive, as the consent must be shown to be informed to pass muster under the Rules of Professional Conduct.

What information would be required for consent to be informed? There is probably a lot of room for argument on this issue, and I could certainly see situations in which it could open up a can of worms for the clients and the lawyer. This may be a situation in which the wiser course would have been to hire separate counsel for Mules and then enter into a joint defense agreement that permitted the corporation's lawyer to present a common defense before the IRS.

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