Hamadeh v Spaulding
2015 NY Slip Op 30027(U)
January 8, 2015
Supreme Courty, New York County
Docket Number: 114060/09
Judge: Marcy S. Friedman

[* 1]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK – PART 60

PRESENT: Hon. Marcy S. Friedman, JSC

SAMER HAMADEH and ALISON HARMELIN,

Plaintiffs,

- against -

DAVID SPAULDING, et al.,

Defendants.

Index No.: 114060/09

DECISION/ORDER

MOTION SEQ. NOs. 001, 002, 003

This is an action for accountant malpractice. Plaintiffs Samer Hamadeh and Alison Harmelin, husband and wife, sue defendants David Spaulding, their accountant, his former firm Flowers and Becker LLP (Flowers), and his current firm Citrin Cooperman & Co., LLP. (Citrin). Defendants Spaulding and Citrin each separately move for summary judgment dismissing the complaint or, in the alternative, limiting plaintiffs' damages. Plaintiffs also move for summary judgment in their favor.

The following material facts are not in dispute: Defendant Spaulding prepared tax returns and provided tax-related advice to Hamadeh, prior to his marriage to Harmelin in April 2005. After the marriage, Spaulding prepared tax returns for plaintiffs jointly. (Joint Statement of Facts, ¶¶ 9, 2.) "In or around May of 2005, Hamadeh informed Spaulding that he had begun receiving serious inquiries from potential buyers interested in purchasing Vault [the company he founded], and requested tax planning advice to minimize the capital gains such a transaction would yield." (Id., ¶ 11.) "Spaulding advised Hamadeh that if he were to move to another state he would substantially reduce his potential tax liability upon Vault's sale." (Id., ¶ 12.) Hamadeh

and Harmelin purchased a home in Pennsylvania in 2005. (Hamadeh Aff., ¶ 13.) Throughout all or part of the tax years in question – 2005 through 2007 – plaintiffs also maintained a rental apartment at 200 West 58th Street in Manhattan. (Joint Statement of Facts, ¶¶ 6, 21.) Hamadeh sold his business in 2007. (Id., ¶ 19.)

As Spaulding explains in more detail: "In 2005, Hamadeh sought Spaulding's advice about changing his residence and domicile from New York to a neighboring state because Hamadeh wished to try to reduce his tax burden in the event he were to sell the company he founded. . . . There is no dispute that Spaulding advised Hamadeh that, to effect a change, Hamadeh could either buy a house in a new state and move out of New York entirely or buy a house in another state without giving up his 58th Street Apartment." (Spaulding Memo. In Opp. to Ps.' Motion at 5.) Spaulding contends, and Hamadeh does not dispute, that once Hamadeh decided to keep the New York apartment, Spaulding advised Hamadeh that Hamadeh "would have to do a lot of compliance" on the domicile issue in order to establish that his domicile had been changed from New York. (Id. at 5-6, quoting Hamadeh Tr. at 182.) Spaulding acknowledges, however, that "[i]n advising Hamadeh on changing his residence and domicile, Spaulding also told him that, since he planned to keep his Manhattan apartment, he could spend no more 183 days in New York, but that if Hamadeh came to New York for work, that day would not count as 'a day in New York' for purposes of the 183-day rule if he did not spend the night in New York." (Spaulding Memo. In Opp. to Ps.' Motion at 6-7.) Further, Spaulding forthrightly acknowledges that "his description of the 183-day rule was not correct, and that one's presence in New York for any part of a day counts as a day under the 183-day rule for determining statutory residency." (Id. at 7.)

For 2006, Spaulding prepared plaintiffs' New York City and State non-resident tax returns, and a Pennsylvania State personal return. (Joint Statement of Facts, ¶ 14.) Spaulding

joined Citrin as a salaried employee on August 13, 2007. (Id., ¶ 17.) In 2008, Spaulding, while an employee of Citrin, prepared plaintiffs' New York State nonresident tax return for 2007. (Id., ¶ 23.)

On or about June 26, 2008, plaintiffs received notice from the New York State Department of Taxation and Finance (NYSDTF or Department) that their state tax returns for 2006 and 2007 had been selected for audit. (Id., ¶ 24; NYSCEF Doc. 102.) On or about December 18, 2008, the NYSDTF expanded the audit to 2005 and indicated that it "would like to visit the issue of Mr. Hamadeh's domicile." (NYSCEF Doc. 104.) For the tax years 2005 through 2007, the NYSDTF prepared a working copy of a "Consent to Field Audit Adjustment," dated February 11, 2009, proposing an assessment of tax deficiencies, interest, and penalties for these three tax years in the total amount of $763,987. (NYSCEF Doc. 106). By "Stipulation for Discontinuance of Proceeding," signed by representatives of plaintiffs and the Division of Taxation on October 29 and 30, 2012, respectively, the parties settled the matter for tax years 2005-2007 for a deficiency in the amount of $478,049.75, with interest calculated to October 24, 2012 in the amount of $203,529.86. (NYSCEF Doc. 107.) On the same dates, October 29 and 30, 2012, plaintiffs and the Department executed a "Closing Agreement" settling a separate dispute over alleged deficiencies for tax years 2008 and 2009. The non-resident returns for these years were "accepted as filed," and the assessment was cancelled. (NYSCEF Doc. 172.)

The standards for summary judgment are well settled. The movant must tender evidence, by proof in admissible form, to establish the cause of action "sufficiently to warrant the court as a matter of law in directing judgment." (CPLR 3212[b]; Zuckerman v City of New York, 49 NY2d 557, 562 [1980].) "Failure to make such showing requires denial of the motion, regardless of the sufficiency of the opposing papers." (Winegrad v New York Univ. Med. Ctr., 64 NY2d 851, 853 [1985].) Once such proof has been offered, to defeat summary judgment "the opposing

party must 'show facts sufficient to require a trial of any issue of fact' (CPLR 3212, subd. [b]." (Zuckerman, 49 NY2d at 562.)

It is further settled that "[a] party alleging a claim of accountant malpractice must show that there was a departure from the accepted standards of practice and that the departure was a proximate cause of the injury. Thus, a plaintiff must establish, beyond the point of speculation and conjecture, a causal connection between its losses and the accountant's actions." (KBL, LLP v Community Counseling & Mediation Servs., 2014 NY Slip Op 08581, 2014 NY App Div Lexis 8509, * 2 [1st Dept Dec. 9, 2014, quoting Herbert H. Post & Co. v Sidney Bitterman, Inc., 219 AD2d 214, 223-224 [1st Dept 1996] [internal quotation marks omitted].)

Under New York Tax Law section 605 (b) (1), "[a] resident individual means an individual: (A) who is domiciled in this state [with exceptions not here relevant], or (B) who is not domiciled in this state but maintains a permanent place of abode in this state and spends in the aggregate more than one hundred eight-three days of the taxable year in this state" (with an exception not here relevant). As Spaulding concedes, this statute provides that "an individual is taxed as a resident if he is either a statutory resident or a domiciliary of New York." (Spaulding Memo. In Opp. to Ps.' Motion at 11 [emphasis in original].) As discussed above, Spaulding also does not dispute that he gave plaintiffs incorrect advice about the 183-day residence rule in that he did not inform plaintiffs that parts of days spent in New York, even without sleeping overnight in New York, would count toward the 183-day rule for purposes of determining whether a taxpayer is a "statutory resident."

In the NYSDTF's November 3, 2009 Report of Audit for the tax years 2005, 2006, and 2007 (NYSCEF Doc. 105), the auditor made two express findings with respect to "Residency." The first, under the heading "Domicile," stated: "The taxpayers' continuous maintenance of a New York residence, multiple ties to NYC and involvement in the community support the

auditor's conclusion that they never changed their NYC domicile." The second, under the heading "Statutory Residency," stated: "During the audit period, both taxpayers indicated on their joint returns as filed that they had spent an excess of 183 days in NYC. This, together with their maintenance of a NYC apartment for more than 11 months in each year (PPA), made them statutory residents." The Report further stated: "The Auditor's position is that not withstanding [sic] the domicile issue, the taxpayers' [sic] would be statutory residents for the entire audit period."

In arguing that plaintiffs cannot establish that they committed malpractice, both Spaulding and Citrin contend that plaintiffs must prove not only that plaintiffs could have avoided taxation as statutory residents if Spaulding had provided different advice about the number of days they could spend in New York, but also that they could have avoided taxation as non-domiciliaries. They further contend that plaintiffs cannot establish that they changed their domicile from New York to Pennsylvania, as evidenced by the finding in the Report of Audit to that effect, as well as by defendants' analysis of plaintiffs' failure to satisfy the elements necessary to establish a change of domicile. (See Spaulding Memo. In Opp. to Ps.' Motion at 12-14; Citrin Memo. In Support of Citrin Motion at 13-17.) Put another way, defendants argue that because plaintiffs cannot show that they changed their domicile, they would have been subject to taxation as New York residents, regardless of whether the NYSDTF concluded that they were statutory residents. Spaulding concludes that plaintiffs cannot establish that his advice was the "proximate cause" of their increased tax liability. (Spaulding Memo. In Opp. to Ps.' Motion at 14.) Citrin posits that plaintiffs' failure to change their domicile from New York was an "independent cause" of their tax liability. (Citrin Memo. In Reply to Citrin Motion at 6.) Defendants both argue in effect that Spaulding's incorrect advice on the statutory residency must

have been the sole proximate cause of the NYSDTF's assessment of deficiency and interest charges upon plaintiffs.

Defendants do not cite any case law in the accountant malpractice context which holds that the malpractice must have been the sole proximate cause of the plaintiff's injury. As discussed above, cases in the accountant malpractice area have used the term "a proximate cause" in articulating the standard that the plaintiff must prove. In the legal malpractice context, an often-cited formulation of the standard of proof requires that three elements be established: "(1) the negligence of the attorney; (2) that the negligence was the proximate cause of the loss sustained; and (3) proof of actual damages. It requires the plaintiff to establish that counsel failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession and that 'but for' the attorney's negligence, the plaintiff would have prevailed in the matter or would have avoided damages." (Ulico Cas. Co. v Wilson, Elser, Moskowitz, Edelman & Dicker, 56 AD3d 1, 10 [1st Dept 2008] [internal quotation marks omitted, citing AmBase Corp. v Davis Polk & Wardwell, 8 NY3d 428, 434 [2007].) In other legal malpractice cases, however, the courts have held that the attorney's malpractice must have been "a" proximate cause of the plaintiff's injury. (See 180 E. 88th St. Apt. Corp. v Law Off. of Robert Jay Gumenick, P.C., 2010 NY Slip Op 33848 [U], 2010 NY Misc Lexis 6878 [Sup Ct, NY County] [discussing varying formulations of attorney malpractice standard], affd 84 AD3d 582 [1st Dept 2011].) The Second Department has expressly held that these varying formulations of the proximate cause standard ("a" as opposed to "the" proximate cause) have "no substantive import," and that the "but for" standard for attorney malpractice cases does not require proof that the defendant attorney's negligence was the "sole proximate cause" of the plaintiff's losses. (Barnett v Schwartz, 47 AD3d 197, 203-205 [2d Dept 2007].) Although the First Department has not expressly so held, it recently approvingly cited the Second

Department's holding. (See Borges v Placeres, 2014 NY Slip Op 08910, 2014 NY App Div Lexis 8822 [Dec. 23, 2014] [citing Barnett in holding that the trial court's jury charge appropriately provided that defendant attorney's malpractice must be a "substantial factor in causing plaintiff's harm"].)[1]

The court assumes that the "but for" standard from the legal malpractice context applies equally to accountant malpractice claims. For purposes of this motion, however, the court need not reconcile the differing interpretations of this standard because, even in its most rigorous application, the standard is clearly satisfied by the evidence in the record. The NYSDTF's finding that plaintiffs were statutory residents was an independent basis, sufficient without more, on which tax liability could have been imposed on plaintiffs. In recommending the assessment, the auditor expressly found that plaintiffs were liable as either "statutory residents" or domiciliaries for the proposed assessment for the 2005-2007 tax years. (NYSDTF Report of Audit [NYSCEF Doc. 105]: "[N]ot withstanding [sic] the domicile issue, the taxpayers' [sic] would be statutory residents for the entire audit period"].) By settling the audit, rather than continuing to litigate their Article 78 petition, plaintiffs thus avoided New York State tax liability on either of these wholly independent grounds.

The court further holds that Spaulding's incorrect advice to plaintiffs on how to avoid statutory residency status proximately caused plaintiffs' liability for taxation as statutory residents for tax years 2006 and 2007. Defendants assert that Hamadeh could not have avoided exceeding the 183-day threshold for statutory residency due to his business commitments and the apparent focus of his personal life in New York. (Citrin Memo. In Support of Citrin Motion at

[1] It is noted, however, that this Department has distinguished the "but for" standard for legal malpractice from the "considerably lower" substantial factor standard applicable to fiduciary duty claims against non-attorneys. (Ulico Cas. Co., 56 AD3d at 10, citing Weil, Gotschal & Manges, LLP v Fashion Boutique Short Hills, Inc., 10 AD3d 267, 271 [1st Dept 2004].)

17-18.) The uncontradicted evidence shows, however, that Hamadeh scrupulously followed Spaulding's advice on statutory residency by keeping detailed diaries of every day he was present in New York, for all or part of the day, in tax years 2006 and 2007. (NYSCEF Docs. 153, 154.)[2] This evidence supports plaintiffs' prima facie showing that Spaulding's incorrect advice proximately caused their liability for New York State taxes as statutory residents for these years. Given plaintiffs' showing of Hamadeh's compliance with Spaulding's advice, defendants' assertion that plaintiffs would have exceeded the183-day threshold in 2006 or 2007, regardless of that advice, amounts to pure speculation or conjecture, and thus fails to raise a triable issue of fact as to causation.[3]

Moreover, the fact that plaintiffs settled the audit for tax years 2005 through 2007 (see "Stipulation for Discontinuance of Proceeding" [NYSCEF Doc. 107]) does not bar the malpractice claim, as plaintiffs have shown that the settlement was "effectively compelled by the mistakes of counsel." (See Angeles v Aronsky, 109 AD3d 720, 722 [1st Dept 2013].)

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[2] As of August 2007, when Spaulding joined Citrin, Hamadeh had not yet met the statutory residence threshold as he had been present in New York only158 days, according to Hamadeh, or 166 days, according to Citrin. (Ps.' Memo. In Opp. to Ds.' Motions at 18.)

[3] In concluding that plaintiffs make a prima facie showing that Spaulding's advice proximately caused their liability for New York State taxes as statutory residents, the court does not rely on plaintiffs' contention that the NYSDTF's acceptance of plaintiffs' non-resident filings for tax years 2008 and 2009 demonstrates that they were also domiciliaries in tax years 2005 through 2007. The 2012 Closing Agreement (NYSCEF Doc. 172), by which plaintiffs and the New York State Commissioner of Taxation and Finance settled the Department's claim for tax deficiencies for 2008 and 2009, stated in the Wherefore Clause that the parties "seek to resolve their differences and enter into this Agreement giving due regard to the previously unresolved issues of fact and law regarding the liabilities of the Taxpayers for the subject tax and interest for the Taxable period." It further stated that the parties therefore agree that "tax years 2008 and 2009 are accepted as filed" and the assessment by the Department is cancelled. This Agreement makes no finding of fact as to plaintiffs' status as out-of-state domiciliaries in 2008 and 2009 or in any prior year. Moreover, plaintiffs' status as domiciliaries is irrelevant to plaintiffs' claim in the instant action because, as held above, plaintiffs' status as statutory residents was an independent, self-sufficient basis for imposition of New York State resident tax liability upon them.

The court further holds that Citrin demonstrates as a matter of law that it is not liable for the assessments for tax years 2005 and 2006, as Spaulding was not employed by Citrin at the time he gave the tax advice regarding plaintiffs' statutory resident status for those years. Citrin fails, for the reasons just stated, however, to raise a triable issue of fact as to whether Spaulding's advice proximately caused plaintiffs' liability for taxes for 2007 as statutory residents.

Spaulding contends that the malpractice claim against him based on tax year 2005 should be dismissed because plaintiffs maintained a New York City apartment for the entire year, did not purchase their Pennsylvania house until October 2005, after the 183-day statutory residence threshold, and were therefore statutory residents in 2005. Plaintiffs do not raise a triable issue of fact as to whether Spaulding's advice caused them to acquire statutory resident status in 2005 and, indeed, do not oppose the branch of Spaulding's motion for dismissal of malpractice claim for this tax year.

The court turns to the parties' claims with respect to damages and, specifically, to defendants' contentions that certain damages were not proximately caused by Spaulding's incorrect advice. Citrin claims that it should not be held liable for plaintiffs' attorney's fees in connection with the audit because plaintiffs obtained "a less favorable result" than was offered by the NYSDTF prior to their engagement of counsel. (Citrin Memo. In Support of Citrin Motion at 20.) In particular, although the settlement achieved a reduction of the principal amount initially assessed by the Department and the removal of penalties, Citrin contends that the interest assessment arose over the period the audit was contested, thus increasing plaintiffs' liability by approximately $12,500. (Id.) Plaintiffs do not appear to dispute this contention. However, neither plaintiffs nor defendants submit New York legal authority on whether attorney's fees in connection with an audit are available as an item of damages for accountant

malpractice and, if so, what standards apply – e.g., prevailing party – in awarding such fees.[4] The court therefore cannot determine plaintiffs' entitlement to attorney's fees on this record.

Assuming arguendo that attorney's fees may be available, the court rejects Citrin's further argument that it is not liable for attorney's fees incurred by plaintiffs in connection with the audit, because the audit would have occurred in any event with respect to the 2005 and 2006 tax years before Spaulding began his employment with Citrin. (Citrin Memo. In Support of Citrin Motion at 19.) Citrin does not make any showing that the attorney's fees cannot be apportioned, if appropriate, to tax years 2005, 2006, and 2007, individually. (See generally Ravo v Rogatnick, 70 NY2d 305, 310 [successive tortfeasor is ordinarily liable only for the separate injury or aggravation his conduct caused].)

Citrin also contends that in the face of the findings in the NYSDTF Report of Audit that plaintiffs were statutory residents of New York, plaintiffs failed to mitigate damages because they did not file amended tax returns with the Pennsylvania tax authority, withdrawing their claim that they were Pennsylvania residents and seeking a refund on the ground that they owed Pennsylvania taxes at a lower non-resident rate. (See Citrin Memo. In Support of Citrin Motion at 23.) Citrin provides no support whatsoever for this claim that it would have been appropriate for plaintiffs to file amended Pennsylvania returns at the same time they were contesting the New York State audit finding that they were New York statutory residents. The claim is accordingly rejected.

Citrin further claims that plaintiffs are not entitled to a "gross up" on the damages incurred as a result of the incorrect tax advice – i.e., an amount to compensate them for any tax

[4] Proskauer Rose Goetz & Mendelsohn L.L.P. v Munao (270 AD2d 150, 151 [1st Dept 2000]), on which plaintiffs primarily rely, states in dictum that the extent to which a client "incurred taxes and related expenses they would not otherwise have incurred but for [an attorney's malpractice] . . . goes to the issue of [the client's] damages. . . ." The Court did not reach the issue of damages on the motion to dismiss before it.

they will incur in the year of a judgment or settlement in the instant action for such damages. (Citrin Memo. In Support of Citrin Motion at 21.) Notwithstanding the extensive body of law on this issue, plaintiffs' and defendants' discussion of the issue is, at best, cursory, and both parties fail to address authority on whether an award of damages for accountant malpractice, in particular, will be held taxable by the New York and federal taxing authorities. The court will accordingly defer decision on this issue.

The parties similarly fail to submit reasonably comprehensive authority on whether, or to what extent, the interest to which plaintiffs agreed in the 2012 settlement of the audit is recoverable as an element of damages. Significantly, they fail to submit authority on the impact on plaintiffs' entitlement to such interest of the facts that plaintiffs did not pay the interest accrued on the NYSDTF's proposed assessment between the 2009 date of the proposed assessment and the 2012 settlement, and that, insofar as appears from the record, plaintiffs also had not paid the interest to which they agreed in the settlement, as of the date of filing of these motions. Put another way, the parties do not address whether the interest is an element of damages that was proximately caused by defendants' tax advice. (See generally Penner v Hoffberg Oberfest Burger & Berger, 303 AD2d 249, 249 [1st Dept 2003] [holding that interest is not properly awarded in an accountant malpractice case where the "plaintiff's tax liability was not attributable to an act or omission on [defendant accountant's] part"]; see also Alpert v Shea Gould Climenko & Casey, 160 AD2d 67, 71-72 [1st Dept 1990].)

It is accordingly hereby ORDERED that plaintiffs' motion for summary judgment is granted to the following extent: Plaintiffs Samer Hamadeh and Alison Harmelin are awarded judgment as to liability for damages incurred as a result of accounting malpractice as against defendant David Spaulding for tax year 2006, and as against defendants Spaulding and Citrin Cooperman & Company, LLP (Citrin), jointly and severally, for tax year 2007. Such damages

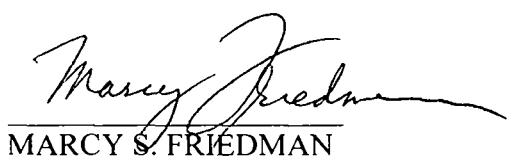
shall include the principal amount of the assessment for said tax years, as set forth in the Stipulation for Discontinuance between plaintiffs and the NYSDTF, dated October 2012 (NYSCEF Doc. 107). The court reserves decision on whether the said damages shall also include: the interest on the principal amounts set forth in the aforesaid Stipulation for Discontinuance; statutory interest on the judgment amount pursuant to CPLR 5001; plaintiffs' attorney's fees in connection with the audit and if so, whether Spaulding and Citrin are jointly and severally liable for the amount of such attorney's fees for the entire audit, or whether such attorney's fees should and, if so, can be apportioned to tax years 2005, 2006, and 2007, individually. Pursuant to a separate order of the same date, the matter shall be referred to a Special Referee to hear and report with respect to all damages issues; and it is further

ORDERED that the motion of defendant David Spaulding for summary judgment is denied; and it is further

ORDERED that the motion of defendant Citrin for summary judgment is denied.

This constitutes the decision and order of the court.

Dated: New York, New York
January 8, 2015



MARCY S. FRIEDMAN