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Junior Accountants Held To Be Exempt From Wage and Hour Law Protections

By Katherine McAllister

IN A RECENT CASE WITH IMPORTANT IMPLICATIONS FOR ACCOUNTANTS, as well as other professionals, the Ninth Circuit Court of Appeals concluded that members of a class of unlicensed accountants were exempt from employee wage and hour protections under California law and were therefore ineligible to recoup overtime pay.[1] Reversing the district court's conclusion to the contrary, the Ninth Circuit, in *Campbell v. PricewaterhouseCoopers,* determined that the junior accountants who worked or had worked for PricewaterhouseCoopers (PwC) could fall within the "administrative" or "professional" exceptions to the state labor law as a result of their specific responsibilities and degree of independent judgment required by their positions. Because the rationale of the decision is consistent with the federal Fair Labor Standards Act (FLSA) and many of the other related state wage and hour laws, similarly-situated junior accountants in other states would likely be exempt from such requirements as well.

The California Labor Code, a state analogue to the FLSA, sets minimum wage and maximum hour requirements for covered employees, which are further elaborated by Wage Orders promulgated by the Industrial Welfare Commission (IWC).[2] Like the FLSA, these also provide exemptions from the law's protections for executive, professional, and administrative employees, as defined under state law. Although the California law expressly refers to the FLSA for interpretive guidance, it nevertheless has important differences, most notably in the "professional" exemption.

Under the FLSA, the professional exemption is relatively straightforward. To satisfy the exemption, employees must primarily perform work requiring advanced knowledge "in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction."[3] In California, by contrast, the professional exemption is further divided into two sub-parts: first, the law specifically excludes licensed practitioners of eight "enumerated professions," including law and accounting; and second, it excludes "learned professionals," with criteria tracking the FLSA's more general professional exemption.

Licensed accountants, one of the professions specifically enumerated under California law, were clearly exempt from the law's coverage under either federal or state law. The status of unlicensed, junior accountants performing similar duties under the direction of licensed supervisors, however, has remained open until this case.

At the district court, the class of unlicensed accountants convinced the judge of their non-exempt status under the administrative and professional exemptions by emphasizing the degree of supervision under which they worked. The junior accountants also urged the court to adopt their view of the construction of the Wage Orders, arguing that the court would render the "enumerated profession" exemption meaningless if all such employees could also qualify under the "learned professional" exemption. The Ninth Circuit made clear, however, that the unique set of duties associated with accountants under the PwC model rendered them exempt because they exercised a sufficient degree of independent judgment and were not subject to more than general supervision. Moreover, many in the class were involved in professional groups that had a say in subjects ranging from hiring to working conditions, which bolstered PwC's argument that they were exempt employees.

In addition, the Ninth Circuit was reluctant to affirm the District Court's opinion due to concerns that the doctrine would become difficult to limit. Courts could not logically distinguish between junior accountants and other unlicensed professionals such as recent law school graduates employed by law firms or prior to passing the bar or medical residents who have not yet been licensed to practice medicine, all of whom would be eligible for overtime pay were the district court's reasoning to prevail. To avoid these results, the Ninth Circuit concluded that the two categories under the California professional exemption need not be exclusive of each other but instead simply reflect two different standards for exemption. The enumerated profession exception thus constitutes an easier threshold for employers to reach without resorting to the difficulty of proving on an individual employee basis the employee's exempt status. Employers are not foreclosed from asserting the "learned professional" exemption for employees such as unlicensed practitioners of the learned professions.

Although *Campbell* was decided under California rather than federal law, it is nevertheless instructive for accountants in others states. Because the FLSA does not preempt states from creating their own wage and hour regulations provided that they are more generous to the employee than the federal scheme, many states have opted to extend minimum wage and overtime requirements beyond what is federally mandated. A number of states, however, simply defer to the FLSA when determining which employees fall into the administrative, executive, or professional exemptions. The Illinois Minimum Wage Law, for example, expressly refers to the FLSA and the associated federal regulations for determinations of an employee's exempt status. Similarly, in Texas, the state statute governing minimum wage adopts the minimum wage as set forth in the FLSA and applies its state law only to those employees who are not covered by the FLSA.[4]

By contrast, other states have taken an approach similar to California and have diverged from the FLSA's guidance with respect to exempt employees. Nevertheless, despite slight variations in the language of the New York overtime law and the FLSA, New York courts construing the state's administrative, executive, and professional exemptions have questioned "whether there is any practical difference between the two."[5] By extension, similarly-situated junior accountants in New York are likely considered exempt as well.

In Florida, the minimum wage is mandated by the State Constitution.[6] Although it increases the federally-required minimum wage by a dollar per hour, the provision itself otherwise expressly contemplates turning to the FLSA for all questions of construction. As a result, the exempt status of junior accountants in Florida should likewise mirror the result under the FLSA.

Campell represents a victory for employers, but there are still important steps that employers must take to be entitled to claim these exemptions under the FLSA or other states' laws. For instance, to satisfy the executive, administrative, and professional exemptions under the FLSA, as well as many of the corresponding exemptions under state law, an exempt employee must be "paid on a salary basis" of at least the minimum set forth in the Code of Federal Regulations or the state law, if applicable.[7] Moreover, if an employer docks an employee's wages for failing to work a full shift or for disciplinary reasons, courts will infer that the employee is not legitimately being paid a salary but is instead receiving an hourly wage, which renders the exceptions inapplicable.[8] In addition, as the Ninth Circuit in *Campbell* indicated, exemption from wage and hour laws turns on both the actual and the expected job responsibilities of the employee, a principle equally supported by the FLSA itself. This both ensures that employers use job descriptions realistically and not merely as a pretext to exempt certain employees improperly, and also shields an employer from underperforming employees' claims of exemption resulting from their failure to meet the employer's reasonable expectations about job duties. Employers must thus ensure that job descriptions are reasonably accurate in order to secure the exempt status of employees under the FLSA and analogous state laws.

Ultimately, the FLSA, like the California Industrial Welfare Commission's regulations, requires a case-by-case inquiry to determine an individual employee's exempt status. By paying special attention to the issues described above, however, employers will be well on their way to securing exemption.

[1] *See Campbell v. PricewaterhouseCoopers,* No. 09-16370, 2011 WL2342740 (9th Cir. June 15, 2011).

[2] *See* 29 U.S.C.A. § 213 (West 2010); CAL. CODE REGS. tit. 8, § 11040 (1)(A)(1)-(3) (Barclays 2011).

[3] *See* 29 C.F.R.§ 541.300 (a).

[4] Like the FLSA, Texas also has an exemption for "bona fide executive, administrative, or professional" employees. *See* TEX. LAB. CODE ANN. §62.153(1) (Vernon 2011) Tex. Labor Code Ann. § 62.153

[5] *See Scholtisek v. Eldre Corp.,* 697 F. Supp. 2d 445, 463-64 (W.D.N.Y. 2010).

[6] *See* FLA. CONST. art. 10 §24

[7] *See* 29 C.F.R. 541.100 (a). The current minimum weekly salary for executive employees, for instance is $455 per week. *Id.*

[8] *See Auer v. Robbins,* 519 U.S. 452, 457, 117 S. Ct. 905, 909, 137 L. Ed. 2d 79 (1997).

The Kovel Principle: Recent Developments and Practice Suggestions

By Jason Burke

IT IS UNSURPRISING THAT, IN MANY COMPLEX LEGAL CASES involving financial issues, attorneys routinely retain accountants to help them better understand the case. Frequently in this process, accountants gain and provide sensitive information that the client and attorney would prefer to keep confidential. So what protection does the law provide to protect information from accountants who are retained to assist attorneys and clients in understanding complex accounting concepts necessary to create a strong case? And how can the accountant avoid being forced to testify against a client? As with many areas of the law, the answer is not simple. It depends not only on the state that you are in but whether you are in federal or state court.

The best starting point for understanding the accountant's privilege—a derivative of the attorney-client privilege—is the classic 1961 case *United States v. Kovel,* 296 F.2d 918 (2d Cir. 1961). In this case, the Second Circuit elucidated when the firmly-accepted attorney-client privilege, which protects communications between a lawyer and a client in order to incentivize "full and frank disclosure," would apply to non-lawyer third parties. In that case, involving an accountant, the court analogized the accountant to a foreign language translator, observing that "[a]ccounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases."

Quite simply, the court held that because the presence of a foreign language translator would not destroy the attorney-client privilege, neither would the presence of an accountant who is necessary to "translate" the client's financial story effectively to an attorney. But the court also included two important caveats in its opinion that have been crucial to subsequent interpretations. First, it stated that the presence of the accountant must be "necessary, or at least highly useful" for effective attorney-client communication. Second, it observed

that "if what is sought is not legal," no privilege exists.

Forty years after *Kovel* was decided, it is still cited repeatedly by myriad federal and state courts that are faced with the issue of the derivative accountant's privilege. Perhaps the ends of the interpretative spectrum are best exemplified by two recent state cases—the Massachusetts Supreme Judicial Court case, *Commissioner of Revenue v. Comcast Corp.,* 901 N.E.2d 1185 (Mass. 2009) and the Delaware Court of Chancery case *Re: 3Com Corp. v. Diamond II Holdings, Inc.,* 2010 WL 2280734 (Del. Ch. 2010).

In *Comcast,* the Massachusetts court observed that disclosure of privileged attorney-client communications to a third party would generally undermine the privilege. Yet the court, citing to *Kovel,* found that a derivative attorney-client privilege for accountants did exist. In shaping the contours of such a privilege, however, the court was extremely restrictive. Most notably, the court interpreted *Kovel*'s requirement that the communications be "necessary, or at least highly useful" to mean only "'necessary' for 'effective consultation.'" In so holding, the court noted that "courts have rejected claims that the derivative privilege applies where an attorney's ability to represent a client is improved, even substantially, by the assistance of an accountant." With such an exacting "necessity" requirement, Massachusetts' high court has effectively limited the derivative privilege to only a narrow subset of cases.

In contrast, Delaware's Court of Chancery in *3Com* outlined a much broader view of the derivative privilege. In this case, the Delaware court was forced to decide whether to apply Massachusetts or Delaware law in determining whether an accountant could invoke the derivative privilege. Delaware law requires that the person making the disclosure regarded it as confidential and that the law is prepared to respect that objective manifestation as reasonable. In the context of an investment banker—quite analogous to an accountant—a Delaware court in *Jedwab v. MGM Grand Hotels,* 1986 WL 3426 (Del. Ch. 1986), noted that if seeking third-party advice is "prudent," the privilege would not be waived. Thus, whereas Massachusetts courts rejected privilege claims even where an attorney's abilities are substantially improved by an accountant's help, Delaware only requires that enlisting an accountant be prudent.

Despite this liberal approach, the majority of courts have narrowed the privilege in a way very similar to the position taken by Massachusetts. For example, in *Cavallaro v. United States,* 284 F.3d 236 (1st Cir. 2002), the court stated that the accountant's aid must be "nearly indispensible." In *Delta Fin. Corp. v. Morrison,* 820 N.Y.S.2d (N.Y.Sup.Ct. 2006), a New York court approvingly reiterated the standard expressed by the Second Circuit in *United States v. Ackert,* 169 F.3d 136 (2d Cir. 1999): to invoke the privilege, the accountant must be functioning only as an intermediary translator between the attorney and client. To this end, how important the accountant's input was to the attorney's performance has no bearing on whether privilege exists. Further, a California federal court in *United States v. ChevronTexaco,* 241 F.Supp.2d 1065 (N.D.Cal. 2002), expanded on *Kovel*'s statement that only legal advice-and not accounting services are privileged. Although accounting services may be thought of as inherently legal, as they are based on laws such as the Internal Revenue Code, the court found that that does not make accounting advice privileged. Thus, the court held that the privilege could not be extended to situations where the accountant is giving advice based on the Revenue Code, even when such help was useful to the attorney.

Some courts have taken a slightly looser view of the privilege—though few go as far as Delaware. The Northern District of Illinois in *Heriot v. Byrne,* 257 F.R.D. 645 (N.D.Ill. 2009), recognized that confidential attorney-accountant communications are necessary in today's marketplace. In that case, the court seemed willing to extend the privilege when the accountant was retained to help give legal advice and when that advice was at least useful. The Eastern District of Texas, in *Ferko v. National Ass'n for Stock Car Auto Racing,* 218 F.R.D. 125 (E.D.Tex. 2003) held that privilege could attach where an attorney hires an accountant for a specific purpose—significantly relating to the legal dispute—and

where the accountant's help enables the giving of legal advice.

Overall, it is clear that, with few exceptions, no matter where in the United States an accountant is located, it will be fairly difficult to invoke the derivative privilege due to courts' generally narrow view of it. However, there are a few takeaway messages for all accountants:

1. Although the majority of courts are not as explicit as the court was in Ferko, it is always a good idea for an accountant to be retained by an attorney only for a specific purpose in a specific legal dispute. This practice helps show a court the exact nature of the necessity and proves that the accountant is not merely being kept on retainer for general accounting help.
2. The purposes for which the accountant is being retained should be clearly expressed in writing. These purposes should be centered on helping the attorney better understand the client's situation by simply "translating"; an accountant should not give his or her independent advice.
3. The writing stating the purposes for which the accountant is being retained should very explicitly state that the accountant's help is necessary for the attorney to communicate with and understand the client. The emphasis here should not be on how the accountant's help will improve the representation, but rather how the accountant is necessary to bridge a communicative impasse that will significantly impair an attorney's representation of a client.

Ultimately, iterations of the standard vary from state to state and federal district to federal district. It is always a good idea for an accountant to find out where he or she might be subject to jurisdiction as a result of consulting on a legal matter and understand the exact contours of the derivative privilege doctrine in those jurisdictions. ■

Textron Revisited: Tax Accrual Workpapers Work Product Protection Issue Has Produced New Work Product Definition

By John B. Connarton, Jr., P.C.

WHAT STARTED AS A 2003 IRS AUDIT OF TEXTRON, INC. and its multitude of subsidiaries with respect to the tax years 1998 to 2001 has now, following four separate court decisions, resulted in not only a ruling on the issue in question but also a new test for determining the application of the work product privilege itself.

As with many companies, Textron prepares "tax accrual work papers" which list possibly questionable positions Textron was taking on its tax returns so as to estimate the likelihood that these positions might not withstand an IRS challenge and to establish reserves reflecting the additional tax liability that might result from a required revision of those positions. Such reserves are noted in the company's financial statements which, pursuant to federal securities laws, must be certified by an independent auditor. As a result of the IRS noticing potential tax shelter transactions, it issued an administrative summons pursuant to I.R.C. 7602 for the tax accrual work papers for Textron's 2001 tax returns. Textron refused to comply and the IRS sued to enforce the subpoena.

Textron took the position that it had created the documents in anticipation of a dispute with the IRS regarding the tax

returns The IRS countered that these types of documents were created in the ordinary and normal course of business to comply with securities regulations and, therefore, no privilege would apply. The United States District Court of Rhode Island ruled in favor of Textron on its work-product protection claim finding that Textron's ultimate purpose in preparing the documents was to ensure that it was adequately reserved with respect to potential disputes or litigation with the IRS and that the documents would not have been prepared at all "but for" Textron's anticipated possibility of litigation with the IRS. *United States v. Textron,* Inc., 507 F. Supp. 2d 138 (D. R.I. 2007)

Issues as to the existence of work product privilege protection have generally been decided by reference to one of two main tests. The "because of" test, accepted in a majority of federal jurisdictions including, previously, the First Circuit, determines whether a document was prepared "in anticipation of litigation" by analyzing if "in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained *because of* the prospect of litigation". The more restrictive minority test used in the Fifth Circuit requires that the "primary motivating purpose behind the creation of the document was to aid in possible future litigation".

On appeal, a three judge panel of the First Circuit in January of 2009 affirmed the decision of the District Court finding that where the function of the documents was to analyze litigation for the purpose of creating and auditing a reserve fund, the "driving force behind the preparation" of the documents was the need to reserve money in anticipation of disputes with the IRS. The court also rejected the IRS argument that a business or regulatory purpose for preparing such documents precluded the application of the work-product doctrine, in that ". . . dual purpose documents created because of the prospect of litigation are protected even though they were also prepared for a business purpose." With the IRS already moving to establish a requirement that uncertain tax positions of corporations and certain business taxpayers be separately disclosed on a new "UTP" Schedule and claiming that the burden would be slight in light of FIN 48 disclosure requirements under GAAP, the IRS sought further review of the *Textron* decision by the entire First Circuit, i.e., *en banc* review.

In late August, the *en banc* decision was issued by the full First Circuit court and, somewhat surprisingly, reversed the earlier decisions by finding that the work product privilege did not apply to tax accrual work papers. *U.S. v. Textron,* 577 F. 3d 21 (1st Cir. 2009). According to the court, Textron's tax accrual work papers were prepared for regulatory reporting purposes and not *"for use in litigation".* The court then went on to apply this apparently new *"for use"* test and seemingly rejected the concept of dual purpose documents and material prepared both for business reasons and in anticipation of litigation. According to the court, the use of the phrase *"prepared in anticipation of litigation"* as found in Rule 26 of the Federal Rules of Civil Procedure did not mean *"prepared for some purpose other than litigation"* but, instead, meant *"only that the work might be done for litigation but in advance of its institution. . . . It is not enough to trigger the work product protection that the subject matter of a document relates to a subject that might be conceivably litigated. . . . It is only work done in anticipation of or for a trial that it is protected."* 577 F. 3d at 29-30. In a dissenting opinion issued by two judges that were part of the panel decision, it was noted that *" . . . [T]his decision will be viewed as a dangerous aberration in the law of a well established and important evidentiary doctrine. . . . In straining to craft a rule favorable to the IRS as a matter of tax law, the majority has thrown the law of work-product protection into disarray."*

Textron sought further review from the U.S. Supreme Court relying on the argument that the Federal Circuits were already split on the application of the work product privilege and that the First Circuit *en banc* decision added a third test to apply which, unlike the "because of" and "primary purpose" tests, appears to reject the concept of dual purpose documents being covered by the work product privilege at

all. On May 24, 2010, the Supreme Court, without comment, declined to review the First Circuit *en banc* decision leaving that decision as the last word from the courts.

The ultimate decision in the *Textron* decision is of substantial note to the accounting profession whether or not one might believe that the provisions of FIN 48 and the current implementation of the UTP Schedule for Form 1120 have lessened its effect. In short, in preparing tax accrual work papers whether for SEC requirements, FIN 48 or the UTP Schedule, care should be given not to include any materials which include the mental impressions of and/or advice from attorneys. In addition, care should also be taken before disclosing tax accrual work papers to independent auditors and these independent auditors should not be allowed to keep copies of any such work papers. In fact, a record should be kept with respect to anyone that is given access to these work papers so as to protect against a claim of waiver of the privilege. As an accountant, one should now assume that your tax accrual work papers will be subject to discovery by the IRS and act accordingly.

Beyond the accounting profession, however, lawyers should become familiar with the language and concepts used by the First Circuit in its *en banc* decision. The court's language, while dealing with tax accrual work papers, was certainly not limited to that type of situation. The court's statement redefining what most lawyers would have assumed to be the definition of " in anticipation of litigation" by limiting the scope of the privilege to material specifically *prepared for use at trial"* may well have a chilling effect on the entire litigation process.

To Make Or Not To Make a Statement: Fraud Liability Under SEC Rule 10b-5 Narrowed

By Cheryl A. Waterhouse

FOR PROFESSIONAL ADVISORS SUCH AS ACCOUNTANTS AND ATTORNEYS, the recent Supreme Court case of *Janus Capital Group, Inc. v. First Derivative Traders,* 131 S. Ct. 2296 (2011) provides clearer protection from primary liability for fraud under the Securities and Exchange Commission ("SEC") Rule 10b-5. The Court held that, with respect to misstatements in prospectuses and offering documents, the only entity which can be held liable "is the entity with authority over the content of the statement and whether and how to communicate it," or the entity that has the legal obligation to file the statement. The preparer, publisher or disseminator of the statement is not liable as the "maker," having only suggested what to say.

The Court provided its interpretation of the language of Rule 10b-5, which makes it unlawful for any person:

> (b) To make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security.

17 CFR §240.10b-5(6)(emphasis supplied). The Court ruled that one "makes" a statement by stating it, and the word "make" in the Rule does not mean "create" as in to make or create a chair. Using the analogy of the speechwriter and a speaker, the Court explained that the speechwriter drafts the speech, but it is the speaker who has control over what he or she says, and takes the credit or bears the blame for what is said. This reasoning, and the decision, protects secondary

actors, including accountants and attorneys, for the most part, from being subject to primary liability pursuant to Rule 10b-5.

The facts of the case before the Court involved a class of shareholders in Janus Capital Group, Inc. ("JCG") which is a publicly traded company that created the Janus mutual funds. The funds are organized in a trust, the Janus Investment Fund ("JIF"). JIF hired Janus Capital Management ("JCM"), a mutual fund investment adviser. The shareholders sued JCM and JCG for violations of Rule 10b-5 and §10(b) of the Securities and Exchange Act of 1934. The shareholders alleged that JCG and JCM caused mutual fund prospectuses, which contained misstatements, to be issued which caused the JCG shareholders to incur losses. The alleged misstatements concerned a trading strategy called market timing, which can exploit certain time delays in determining mutual fund valuations. Although the prospectuses stated the funds were not intended for market timing, the Attorney General for New York had filed a complaint against JCG and JCM alleging they had made secret arrangements to permit market timing. Once the complaint was public, investors withdrew money from the funds, JCM's management fees decreased and JCG's value fell as well.

JCG's shareholders filed a class action lawsuit alleging violations of Rule 10b-5 and §10(b) as well as a claim against JCG for liability as a "controlling person" under §20(a) of the act. A Rule 10b-5 action, which was the subject of the decision, requires proof of a) a material misstatement or omission; b) scienter (knowledge of wrongdoing); c) a connection between the wrongdoing and the purchase of sale on a security; d) reliance by the plaintiff; e) loss; and f) loss causation. The Supreme Court had previously held that private parties can sue others for violations of 10b-5, although that is not specifically stated in the statute. The Court has also held that aiders and abettors, who substantially assist but do not make the alleged statements, may not be sued by private parties under Rule 10b-5; only the SEC may bring claims against such entities. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164 (1994). In addition, in *Stonebridge Investment Partners, LLC v. Scientific-Atlanta, Inc.,* 552 U.S. 148 (2008), the Court held there is no liability pursuant to Rule 10b-5 for third parties who participate in deceptive acts that the issuer then uses to manipulate its financial statements. The Court continued this narrowing of the scope of liability under Rule 10b-5 in Janus. The Court confirmed that there is an implied private right of action but limited the potential liability to a person or entity "that ultimately has authority over a false statement."

The Court found that the word "make" should not be interpreted to permit private parties to sue an entity who only provides the false or misleading information the issuer puts in its statements. Drafting the statement is insufficient for liability. The Court rejected the Government's analogy that an investment advisor is similar to a playwright whose script is recited by an actor. Instead, the Court relied on the corporate formalities that the entities observed. Because the fund, JIF, was a separate legal entity, it and only it, not its investment advisor, had ultimate authority over the statements in the prospectuses, and only it could be held liable as having "made" the statements.

The dissent, written by Justice Breyer and joined by three other Justices, determined that JCM could have "made" the false statements in the prospectuses. In doing so, it relied on prior rulings that corporate officials and others can, at times, be held liable for having made materially false statements even when in a document the officials do not legally control. Such individuals can include lawyers and accountants who are not named, but who prepared or certified the registration statement. The dissent cited to the Denver Central Bank case as well as other cases which stated that accountants and attorneys can be found liable as primary violators under 10b-5 for securities fraud. The dissent also relied on the close relationships between JCM, JCG and the funds, JIF. In addition, it pointed out that the majority opinion may well create a "loophole" wherein guilty management fools an innocent board with ultimate control over a misstatement; in such a case neither may be held liable under the "ultimate

authority" rule of the majority's decision.

The majority's decision does provide a clearer standard for professional advisors, however, and one that is favorable for accountants and attorneys. An amicus brief filed by the Center for Audit Quality ("CAQ"), a public policy organization run by leaders from public company accounting firms, the AICPA and the investor and issuer community, stressed that clear and appropriate liability standards are paramount in order for auditors to assess their potential risks or they will have to stop performing services or raise their prices in order to provide such services, which are necessary to and benefit investors as well as public companies. CAQ advocated that auditors should only be responsible for their own statements. Thus, the CAQ argued that, for auditors to be held liable, they must actually make the alleged misstatement and the misstatement must be attributed to them. *Janus's* holding, based on the "ultimate authority" test, comes close to meeting what the CAQ requested.

Going forward, despite *Janus,* attorneys and accountants still need to be cautious, because:

– primary liability under 10b-5 may still exist for direct public statements made by and attributed to a lawyer or accountant,
– the SEC retains enforcement authority over aiders and abettors,
– "control person" liability under §20 remains; and
– state law fraud claims may have a broader reach.

With respect to Rule 10b-5 claims, however, *Janus* creates more predictability and less uncertainty as to liability. *Janus* provides protection for most such liability for advisors such as accountants and attorneys. ■

Reporting Requirements for Residents Maintaining Foreign Bank and Financial Accounts

By Gwen P. Weisberg

THE INTERNAL REVENUE SERVICE ("IRS") AND THE FEDERAL GOVERNMENT, including the Department of Homeland Security, have become increasingly active in the investigation and prosecution of persons who have failed to file either income tax returns or Reports of Foreign Bank and Financial Accounts ("FBAR"). The identity of persons required to engage in such reporting is becoming more broadly interpreted to include even those present in the United States as lawful permanent residents ("LPR") and those possessing non-immigrant visas.

An FBAR is required to be filed by "any United States person who has a financial interest in or signature authority or other authority over any financial account in a foreign country, if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year." TDF 90-22.1. The IRS defines a "U.S. person" as one who is a citizen or resident of the United States, a domestic partnership, a domestic corporation, and a domestic estate or trust." Announcement 2010-16.

There are several different tests applicable under both the Immigration and Nationality Act ("INA") and the Internal Revenue Code ("IRC") for determining who is a "resident" for purposes of compliance with FBARs. Under the INA, an LPR is one who has the right to permanently reside in the United States. Under the IRC, a foreign national is a resident subject to taxation if: 1) he has been an LPR for any part of the calendar year; or 2) has a "substantial presence" in the United States. Substantial presence is defined as: a) one who has been present in the United States for at least 31 calendar days during the current year; and b) 183 days during the 3-year period immediately prior to the current year. IRC 7701(b)(3). Because of the latter definition, not only LPRs and U.S. Citizens are affected by the FBAR requirement, but those holding non-immigrant visas are also subject to the filing requirement.

Many types of accounts, bank accounts, certificates of deposit, securities accounts, life insurance policies with cash surrender values, some pension funds and mutual funds are subsumed within the FBAR requirement. Penalties range from $10,000 for a "non-willful" violation to the greater of $100,000 or 50% of the account for a "willful" violation. 31 U.S.C. 5321(a)(5). Non-compliance is also criminally prosecuted as conspiracy to defraud, filing false tax returns, and income tax evasion. For immigration purposes, non-compliance can result in a conviction for a crime of moral turpitude and/or for aggravated felony, thereby leading to inadmissibility and/or removal from the United States.

It is incumbent upon legal and tax professionals to advise their clients and, where necessary, their clients' foreign national employees, of the FBAR requirement as it applies to the definition of United States person, including the "substantial presence" and LPR interpretations. If one determines that a client, or its employee, was subject to the FBAR requirement, but failed to file one, the FBAR should be late-filed and the tax returns should be reviewed for compliance. ■

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The Accountant/Attorney Liability Reporter

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