New York State Bar Association
Committee on Professional Ethics

Opinion No. 1162 (01/17/2019)

Topic: Referral Fees

Digest: A lawyer who forms a tax credit business may not pay referral fees to other lawyers unless the lawyer or his law firm could pay such referral fees under Rule 1.5(g) or 7.2. A lawyer who is an employee of a tax credit business owned by non-lawyers may receive a referral fee from the business if none of the lawyer's activities as an employee constitute the practice of law. A lawyer who is a non-employee consultant to a tax credit business may receive a referral fee if the lawyer is not involved in the underlying transaction, obtains informed client consent, and satisfies Rule 1.8(f); if the lawyer is involved in the underlying transaction, then the lawyer must advise the client of the referral fee and credit the client with that fee.

Rules: 1.5(g), 1.7(a), 1.7(b), 1.8(f), 5.4(d), 5.7, 5.8, 7.2

FACTS

1. The inquirer, a patent attorney licensed in New York, seeks to start a business ("RD1") that would advise clients on applying to the Internal Revenue Service for research and development tax credits and prepare the necessary applications to the IRS. The inquirer characterizes these R&D tax credit services as non-legal, because the IRS authorizes certain qualifying non-lawyers who are licensed as Enrolled Agents to engage in this business. We are told that the factors that determine whether something is eligible for a tax credit are the same as those that determine patentability. The inquirer envisions that at least some of the clients of RD1 would also be clients of the inquirer's law firm. The inquirer intends either to obtain an Enrolled Agent license or to hire licensed Enrolled Agents in order to become competent to prepare the necessary IRS filings.

2. Alternatively, the inquirer would work for, or collaborate with, another R&D tax credit business ("RD2") as an Enrolled Agent or a consultant, such as a marketing consultant. As part of that engagement, the inquirer would market the firm's services to select industries.

3. In either case, the inquirer would market the tax credit services to intellectual property attorneys to encourage them to refer their clients to the tax credit business, whether RD1 or RD2. These marketing efforts may include conducting presentations or sharing materials on the relevant subject matter. At the present time, the inquirer tells us, it is usually a company's accountant that refers the company to an R&D tax credit business to see if the company is eligible for the tax credit.

4. The inquirer asks whether RD1 or RD2 could pay referral fees to the lawyers who refer their clients. We answer questions only about a lawyer's own proposed conduct. While that includes questions about a business owned by the lawyer, our jurisdiction does not include questions about the conduct of third parties – in this case, RD2.

QUESTIONS

5. May RD1 pay referral fees to lawyers who refer clients to RD1?

6. May the inquirer receive referral fees from RD2 if the inquirer (a) is employed by RD2 but does not have an ownership interest in RD2, or (b) has no affiliation RD2 but merely refers clients to it?

OPINION

Lawyer-Owned Tax Credit Firm

7. Lawyers have traditionally provided both legal and nonlegal services to their clients. *See* N.Y. State 206 (1971) (conditions under which dual practice is permissible). Since the publication of N.Y. State 206, this committee has issued opinions regarding the implications under the rules of legal ethics of dual practice of legal and nonlegal services. *See, e.g.,* N.Y. State 536 (1981) (financial planning business); N.Y. State 687 (1997) (lawyer-insurance broker); N.Y. State 711 (1998) (same); N.Y. State 784 (2005) (entertainment management).

8. We addressed the issues arising in dual practice most recently in N.Y. State 1155 (2018). As explained in that opinion, two issues raised by multidisciplinary practice are: (a) the potential

conflict of interest under Rule 1.7 of the N.Y. Rules of Professional Conduct (the "Rules") if the lawyer's interest in the nonlegal service will have an adverse effect on his or her independent professional judgment on behalf of the client in the legal services, and (b) whether the Rules as a whole (for example, the rules on confidentiality, conflicts, or, as here, payment of referral fees) will apply to the lawyer's provision of the nonlegal services as well as the legal services.

9. Before a lawyer may provide both legal and nonlegal services to the same client, the lawyer must determine whether doing so would violate Rule 1.7(a), which prohibits a lawyer from representing a client (absent the client's informed consent) if a reasonable lawyer would conclude there is significant risk that the lawyer's professional judgment on behalf of the client would be adversely affected by the lawyer's own financial, business or other personal interests. Whether a significant risk exists that the lawyer's professional judgment will be adversely affected will depend upon the size of the lawyer's financial interest in the nonlegal services, and whether the lawyer's actions in the legal matter may affect the lawyer's ability to receive the nonlegal fees. If there is a significant risk that the lawyer's professional judgment will be adversely affected by the non-legal financial interests, the lawyer must disclose that possibility to the client, but may proceed with the representation if the conflict is subject to consent and the lawyer obtains informed consent, confirmed in writing. *See* Rule 1.7(b)(4); *see also* Rule 1.7(a), Cmt. [10] (a lawyer may not allow related business interests to affect representation, for example, by referring clients to an enterprise in which the lawyer has an undisclosed financial interest).

10. The other issue in multidisciplinary practice is whether the Rules apply to the conduct of the lawyer's rendition of nonlegal services, in this instance through RD1. We believe that the Rules do apply. In N.Y. State 779 (2004), which involved tax services that could be performed by CPAs and Enrolled Agents, we explained that, even when the services can be performed by both lawyers and non-lawyers (such as preparing tax returns), when the services are performed by a lawyer designated as such, the services constitute the practice of law and the lawyer, in performing them, is governed by the rules of lawyer conduct. Since it seems likely when the

inquirer is marketing to intellectual property lawyers that the inquirer will inform the targets that the inquirer is a lawyer, we believe that the services RD1 will provide should be considered legal services and therefore subject to the Rules.

11. Rule 5.7(a) independently supports this conclusion. That Rule says that a lawyer or law firm "that provides service to a person that are not distinct from legal services being provided to that person by the lawyer or law firm is subject to these Rules with respect to the provisions of both legal and nonlegal services." In N.Y. State 1135 ¶¶ 7-8 (2017), we said that, in determining distinctness, one should look to the substance of the service to be provided, the proposed recipient, and the degree of integration of the two services. Here, some of the clients to whom RD1 would provide tax credit services would also be clients in the inquirer's law firm. We are told that the same factors that would render something patentable (the inquirer's legal business) are the very factors that relate to whether a company may receive a tax credit for the same thing. When a lawyer provides both legal services (patent eligibility) and non-legal services (tax credit eligibility) based upon the same operative facts and criteria, the two services are necessarily integrated and are therefore not distinct within the meaning of Rule 5.7(a). *See also* N.Y. State 1015 ¶ 14 (2014) (legal and nonlegal services provided in the same matter are not distinct). As a result, the provisions of the Rules apply to the nonlegal services.

12. Prominent among these is Rule 7.2, which prohibits a lawyer from compensating a person to recommend or obtain employment of a client, with certain exceptions. Rule 7.2 provides:

> (a) A lawyer shall not compensate or give anything of value to a person or organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client, except that:
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> (1) a lawyer or law firm may refer clients to a nonlegal professional or nonlegal professional service firm pursuant to a contractual relationship with such nonlegal professional or nonlegal professional service firm to provide legal and other professional services on a systematic and continuing basis as permitted by Rule 5.8, provided however that such referral shall not otherwise include any monetary or other tangible consideration or reward for such, or the sharing of legal fees; and
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> (2) a lawyer may pay the usual and reasonable fees or dues charged by a qualified legal assistance organization or referral fees to another lawyer as permitted by Rule 1.5(g).

13. Thus, Rule 7.2 prohibits the payment of referral fees for the referral of business to RD1, unless one of two exceptions applies: (a) the existence of a contractual relationship permissible under Rule 5.8, or (b) the referral fees comply with the provisions of Rule 1.5(g). Here, the first exception is inapplicable because Rule 5.8 extends only to nonlegal services provided by professionals listed in Section 1205.3 of the Joint Appellate Division Rules, none of which includes a business like RD1, and, in any event, Rule 5.8(a)(2) bans a lawyer from giving any monetary benefit to the non-legal professional service firm for a referral. The second exception does not apply because Rule 1.5(g) permits a lawyer to divide a fee for legal services with another lawyer not associated the same law firm only when either (a) the division is in proportion to the services performed by each, or (b) by a writing given to the client, each lawyer assumes joint responsibility for the representation – conditions not contemplated in the inquirer's proposal.

14. Accordingly, because Rule 7.2 applies to the lawyer's conduct through RD1, the inquirer may not pay referral fees to lawyers who refer clients to RD1.

Non-Lawyer-Owned Tax Credit Firm

15. Lawyers occasionally refer a client to another service provider. Rule 5.8(c) says that its restrictions on multidisciplinary practice do "not apply to relationships consisting solely of non-exclusive reciprocal referral agreements or understandings between a lawyer or law firm and a nonlegal professional or nonlegal professional service firm." This has differing implications depending on whether the lawyer is an employee or an outside consultant to RD2.

16. Whether or not the inquirer, as an employee of RD2, may accept a referral fee from RD2 for marketing services depends on the precise conduct in which the lawyer would be engaged. If the lawyer is engaged in purely marketing activities (for instance, drafting advertising copy), and not in the practice of law, then the referral fee would be permissible. Whether certain activities comprise the practice of law is a legal question regulated by, among other things, criminal statutes; legal questions are beyond our jurisdiction to resolve. If, however, the lawyer's

marketing activities for RD2 would involve the lawyer in applying law to specific facts in order to identify targets for RD2's business, a very significant question could arise whether the conduct constitutes the practice of law when a lawyer is engaged in such conduct. In that event, the lawyer could not be employed by an entity owned by non-lawyers owing to statutes and rules barring the practice of law in or with entities that non-lawyers own. *See* N.Y. State Business Corporation Law § 1503 (non-lawyer may not own an interest in a professional services corporation authorized to practice law); N.Y. State Judiciary Law § 495 (corporation or voluntary association may not practice law except in certain instances inapplicable here); Rule 5.4(d) (a "lawyer shall not practice with or in the form of an entity authorized to practice law" if "a nonlawyer owns any interest therein").

17. If the lawyer is not an employee of RD2, then the lawyer would be able to receive a referral fee – even if the lawyer is engaged in the practice of law in making the referral – as long as the lawyer is not otherwise involved in or benefitting from the underlying transaction and the client gives informed consent to the lawyer's receipt of the fee under Rule 1.8(f). Rule 1.8(f) says:

> A lawyer shall not accept compensation for representing a client, or anything of value related to the lawyer's representation of the client, from one other than the client unless:
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> (a) the client gives informed consent;
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> (b) there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship; and
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> (c) the client's confidential information is protected as required by Rule 1.6.

18. We have held that a lawyer may accept a referral fee from a nonlegal service provider provided that the referring attorney is not benefitting financially from the underlying transaction and complies with Rule 1.8(f), or, if the referring attorney is involved in the underlying related transaction, the attorney (a) advises the client of the arrangement and (b) credits the client with the referral fee obtained. *See* N.Y. State 845 (2010); *see also* N.Y. State 667 (1994); N.Y. State

626 (1992); N.Y. State 576 (1986); N.Y. State 461 (1977). Recently in N.Y. State 1086 ¶¶ 15-16 (2016) we again visited the question of referral fees from a third-party service provider. In that case, we stated that the attorney may not accept the referral fee from a third-party investment firm as the money to be invested arose from the engagement in which the lawyer represented the client. In contrast, in N.Y. State 981 ¶¶ 4-5 (2013), we said that a referral fee was not prohibited when the service is not related to the lawyer's legal services and the lawyer makes no recommendation to use the service, which is not the case here.

CONCLUSION

19. A lawyer who forms an R&D tax credit firm may not pay referral fees to other lawyers unless the lawyer or his law firm could pay such referral fees under Rule 1.5(g) or Rule 7.2, which does not appear to be the case here because, among other things, the payment would be a referral and not in proportion to the work done and the referring lawyers would not be assuming joint responsibility for the matter. Assuming that referring business to an R&D tax credit company constitutes the practice of law when conducted by a lawyer, the lawyer may not do so as an employee of a business owned by a non-lawyer. If the lawyer is not employed by the tax credit business, a lawyer who is not involved in the transaction may receive a referral fee from such business if the lawyer obtains informed consent from the client and satisfies the other conditions of Rule 1.8(f). If the lawyer is involved in the underlying transaction, then the lawyer would need to advise the client of the arrangement and credit the client with the referral fee obtained.

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