

## 2014 NY Slip Op 50517(U)

CHANG YI CHEN, Plaintiff,

v.

ZHEN HUANG, ESQ. A/K/A JACKIE HUANG, ESQ., Defendant.

3847/12.

Supreme Court, Kings County.

Decided March 31, 2014.

DAVID I. SCHMIDT, J.

Upon the foregoing papers, defendant Zhen Huang, Esq. moves for an order, pursuant to CPLR 3212, granting her summary judgment dismissing the complaint.

Defendants motion is granted only to the extent that plaintiffs causes of action based on breach of contract and on breach of fiduciary duty are dismissed. Defendants motion is otherwise denied.

Plaintiff Chang Yi Chen alleges that defendant Zhen Huang, Esq., failed properly effectuate a real estate transaction intended to be structured as a "like-kind exchange" under Internal Revenue Code (26 USC) § 1031 in order to defer payment of capital gains taxes on the transaction. Plaintiff alleges that he approached defendant, who held herself out as an attorney who specialized in real estate transactions, for advice regarding the tax consequences of selling property he owned in order to purchase another property. Defendant allegedly informed plaintiff that he could avoid paying capital gains taxes on the sale and purchase of a new property by way of a section 1031 transfer. Plaintiff thereafter retained defendant to represent him in the sale and purchase of properties through a section 1031 exchange.

On May 28, 2009 plaintiff entered into an agreement to purchase a property (Purchase Property) and on June 15, 2009, reached an agreement to sell the property he owned (Sale Property). Plaintiff alleges that these properties qualified as "like kind property" for purposes of a section 1031 exchange. The closing for the Sale Property occurred on September 1, 2009, and defendant held the proceeds of this sale in escrow until September 2, 2009, when she transferred these proceeds back to plaintiff. At a closing held on November 1, 2009, plaintiff used these sale proceeds to purchase the Purchase Property. Although plaintiff believed that these actions were sufficient to qualify for section 1031 tax treatment, the United States and New York State tax authorities thereafter issued tax warrants notifying plaintiff of deficiencies and penalties because the property transfers did not qualify for section 1031 treatment. According to plaintiff, the transfer did not qualify for such treatment because the proceeds from the sale of the Sale Property were held by defendant in escrow and then released directly to plaintiff in contravention of section 1031's requirement that such proceeds be held by a "qualified intermediary."

Plaintiff has since commenced this action, alleging causes of action for breach of contract, breach of fiduciary duty and legal malpractice based on defendants alleged failure to insure that the transactions qualified for section 1031 treatment. Defendant now moves for summary judgment dismissing the complaint on the ground that, regardless of whether defendant committed malpractice in failing to effectuate a section 1031 exchange, plaintiff has not alleged any compensable damages. In this respect, defendant, pointing to the complaint, asserts that "plaintiff only seeks to recover the tax liabilities he incurred from the sale of the 57th Street property" (Memorandum of Law at 6). According to defendant, such damages are not recoverable because a section 1031 exchange only defers the payment of capital gains tax until the replacement property is sold, and that as such, plaintiff may not recover the capital gains tax he was required to pay since such a recovery would constitute a windfall. In addition, as plaintiff has not sold the Purchase Property, a determination of the capital gains taxes he will owe with respect to the sale of the property would be unduly speculative.

For the purpose of this motion, defendant does not dispute plaintiffs central allegation that the sale transactions were structured in a way that would have qualified for the deferral of the payment of capital gains taxes but for defendants release of the proceeds relating to the sale property directly to plaintiff in contravention of the requirement that plaintiff could not receive such proceeds actually or constructively in order to take advantage of the section 1031 exchange (see Urged States v Okun, Fed Appx 364, 366 n1 [4th Cir 2011], cert denied US , 132 Sct 1953 [2012]; see also Endless Ocean, LLC, v Twomey, Latham, Shea, Kelly, Dubin & Quartararo, 113 AD3d 587, 588-589 [2d Dept 2014]; Wo Yee Hing Realty Corp. v Stem, 99 AD3d 58, 64 [1st Dept 2012]).<sup>1</sup> The courts determination thus turns on whether plaintiff has a legal basis for obtaining damages from defendant.

"Damages in a legal malpractice case are designed to make the injured client whole" (Rodoff v Shayne, Dachs, Stanisci, Corker & Sauer, 8 NY3d 438, 443 [2007], quoting Campagnola v Mulholland, Minion & Roe, 76 NY2d 38, 42 [1990]). Generally, the same compensatory damages rules applicable in contract cases apply to damages allowed in legal malpractice cases (Campagnola, 76 NY2d at 42). Such damages are not intended to provide a party with a windfall (*id.* at 45). However, in light of the unique fiduciary and ethical obligations of attorneys, public policy, at times, requires that traditional contract rules of damages be applied in a different manner in cases involving legal malpractice (*id.* at 43-44).

Here, defendant correctly asserts that taxes paid are generally not recoverable as damages under New York law (see Menard M. Gertler, M.D., P.C. v Sol Masch & Co., 40 AD3d 282, 283 [1st Dept 2007]; Alpert v Shea Gould Climenko & Casey, 160 AD2d 67, 71-72 [1st Dept 1990]; see also Lama Holding Co. v Smith Bamey, 88 NY2d 413, 422-423 [1996]). This is because tax liability results from a taxable event and allowing recovery for the payment of such tax would therefore constitute a windfall for a plaintiff (see Alpert, 160 AD2d at 71-72; Apple Bank for Say. v PricewaterhouseCoopers, LLP, 23 Misc 3d 1126 [A], 2009 NY Slip Op 50948 \* 6 [U] [Sup Ct, New York County 2009], modified on other grounds 70 AD3d 438 [1st Dept 2010]; see also, Lama Holding Co., 88 NY2d at 423; Gaslow v KPMG LLP, 19 AD3d 264, 265 [1st Dept 2005], /v dismissed 5 NY3d 849 [2005]). In addition, damages that are uncertain or unduly speculative may not be recovered in New York (Ashland Mgt. Inc. v Janien, 82 NY2d 395, 403 [1993]; Farrar v Brooklyn Union Gas Co., 73 NY2d 802, 804 [1988]; see also Solin v Domino, 501 Fed Appx 19, 22 [2d Cir 2012]).

In conjunction, these principles preclude plaintiff from recovering as damages the amount he paid to the IRS as capital gains taxes, at least on the facts here, where plaintiff has not sold the replacement property. In this regard, in a properly completed section 1031 exchange, the basis from the property sold becomes the basis for the replacement property, and the recognition of any gain or loss is deferred until the replacement property is sold in a sale that does not involve a section 1031 exchange (see Ocmulgee Fields, Inc. v C.I.R., 613 F3d 1360, 1364-1365 [11th Cir 2011]). The tax consequences of such a deferral depend on many factors, including any change in the capital gains tax rate, IRS rules for determining capital gains, market forces affecting the value of the property, and plaintiffs ability to offset the gain against the losses (see generally Internal Revenue Code [USC] § 1001; Internal Revenue Code [USC] subtitle A, Chapter 1, subchapter P; IRS, Topic 409 - Capital Gains & Losses, <http://www.irs.gov/taxtopics/tc409.html> [last reviewed or updated Feb. 27, 2014, accessed March 28, 2014]). As plaintiff has not sold the Purchase Property, any determination at this time that his capital gains liability would be less at the time of a future sale of the Purchase Property than he was actually required to pay involves future changeable events, and is thus inherently speculative (see Farrar, 73 NY2d at 804; Solin, 501 Fed Appx at 22; see also Ashland Mgt. Inc., 82 NY2d at 403; see also Menard M. Gertler M.D. P.C., 40 AD3d at 283; Alpert, 160 AD2d at 71-72).<sup>141</sup>

On the other hand, plaintiff may be entitled to recover the amounts paid to the IRS as interest and penalties. Interest imposed by the IRS based on a failure to pay a tax generally may not be recovered as damages because the interest represents a payment to the IRS for the taxpayer's use of the money while the taxpayer was not entitled to the use of the money (see Shalam v KPMG LLP, 43 AD3d 752 754 [1st Dept 2007]; Alpert, 160 AD2d at 72). Here, however, plaintiff, but for defendants alleged malpractice, would have been entitled to the

use of this money during the time for which IRS imposed interest. As such, plaintiff suffered a loss as the result of the IRS's imposition of interest and plaintiffs recovery of damages for such a loss would not constitute a windfall (see Jamie Towers Hous. Co. v William B. Lucas, Inc., 296 AD2d 359, 359-360 [1st Dept 2002]; Ronson v Talesnick, 33 F Supp2d 347, 355 rDNJ 19991; see also Liebowitz v Kolodny, 24 AD3d 733, 733 [2d Dept 2005]; Apple Bank for Say., 2009 NY Slip Op 50948 \* 6-7). For the essentially the same reasons, any penalty imposed by the IRS may be recovered as damages. '§'

Accordingly, defendant has failed to demonstrate her initial summary judgment burden of demonstrating, as a matter of law, that plaintiff cannot recover damages. As such, this portion of defendants motion must be denied regardless of the sufficiency of plaintiffs opposition papers (see Winegrad v New York Univ. Med. Ctr., 64 NY2d 851, 853 [1985]). The court further notes that the motion turns almost entirely on the pleadings and that the only evidentiary fact before the court is plaintiffs admission that he has not sold the Purchase Property. Thus, to the extent that this motion, couched as a motion for summary judgment, should more appropriately be addressed as a motion to dismiss for failing to state a cause of action pursuant to CPLR 3211 (a) (7) (see Light v Light, 64 AD3d 633, 634 [2d Dept 2009]), the motion is denied because plaintiff has adequately pleaded that he suffered some cognizable damage as the result of the alleged malpractice (see Kocak v Ewert, 280 AD2d 335, 336 [1st Dept 2001]).

Defendant, however, is entitled to dismissal the breach of contract and breach of fiduciary duty causes of action as duplicative of the legal malpractice cause of action because they arose from the same facts as the malpractice cause of action and do not plead allege any distinct damages (see Palmieri v Biagianni, 108 AD3d 604, 608 [2d Dept 2013]; Keness v Feldman Kramer & Monoco, P.L., 105 AD3d 812, 813-814 [2d Dept 2013]).

This constitutes the decision and order of the court.

al This recitation of plaintiff claims is, unless otherwise noted, is drawn from the factual allegations made in the complaint, as verified by plaintiffs attorney.

[2]. In this respect, defendant has submitted a notice to admit served on plaintiff in which defendant requested plaintiff to admit that he was still the owner of the Purchase Property. Plaintiff is deemed to have admitted this statement in light of his failure to respond to the notice to admit within 20 days (CPLR 3123). In any event, counsel for plaintiff, in his affirmation in opposition to the motion, essentially admits that plaintiff still owns the Purchase Property (Yu-Xi Liu, Affirmation in Opposition, 111115 and 16).

f3\_1 Although counsel for defendant, in his memorandum of law in support of the motion, asserts that defendant denies the allegations of wrongdoing alleged in the complaint, he does not dispute plaintiffs factual or legal claims of malpractice for purposes of the motion.

[41 If plaintiff sells the Purchase Property before the final determination of damages, he may have a claim for damages relating to taxes he paid to the extent that he can show that he would have paid less taxes at the time of such sale than he was forced to pay because the section 1031 exchange was improper.

f\_5\_1 The court also notes that, while plaintiff may not recover the amount paid as capital gains tax, he may be entitled to some recovery for the loss of use of this money from the time he paid the IRS until damages are determined in this action, if not some future date. As the purpose of a section 1031 exchange is to allow a taxpayer to defer payment of the capital gains tax and allow the taxpayer to retain the use of the money, some recovery for the loss of use this money may constitute the kind of consequential damages for which recovery is allowed (see Ashland, 82 NY2d at 405-406; see also Biotronik A.G. v Conor Medsystems Ireland, Ltd., NY3d , 2014 NY Slip Op 02101 [2014]). Plaintiff may also be entitled to recover any attorneys fees he paid to defendant (see Campagnola, 76 NY2d at 44). As the parties have not specifically addressed these issues, the court makes no final determination regarding whether plaintiff may recover such damages.

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