THE STATE OF SOUTH CAROLINA
In The Supreme Court

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SC SUPREME COURT

APPEAL FROM CHARLESTON COUNTY
In The Court of Common Pleas

The Honorable Roger M. Young
Case No. 2011-CP-400

Unpublished Opinion No. 2015-UP-491
Filed October 14, 2015

Appellate Case No. 2016-000065

Jacquelin S. Bennett, Genevieve S. Felder and Kathleen S. Turner, individually, as Co-Trustees and beneficiaries of the Marital Trust and the Qualified Terminable Interest Trust created by the Thomas Stevenson Will, and Jacquelin S. Bennett, and Kathleen S. Turner, as Co-Personal Representatives on behalf of the Estate of Jacquelin K. Stevenson,

Appellants,

v.

T. Heyward Carter, Jr.; Evans, Carter; Kunes & Bennett, P.A.; Dixon-Hughes f/k/a Pratt-Thomas Gumb & Co., P.A.; and Lynne L. Kerrison,

Defendants,

Of Whom

Dixon-Hughes f/k/a Pratt-Thomas Gumb & Co., P.A.; and Lynne L. Kerrison are

Petitioners.

PETITIONERS' REPLY TO RESPONDENTS' RETURN TO PETITION FOR WRIT OF CERTIORARI

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February 29, 2016
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INDEX

TABLE OF CASES AND AUTHORITIES

CASES

STATUTES

TREATISES

REGULATIONS

ARGUMENT

I. PLAINTIFFS ACKNOWLEDGE THAT THEY SEEK TO RECOVER FROM DEFENDANTS BASED ON ALLEGATIONS THAT DEFENDANTS SHOULD HAVE TOLD PLAINTIFFS OF THE TRUSTEES' DEFALCATIONS.

The Return to the Petition for a Writ of Certiorari confirms that, absent review and correction by this Court, the Court of Appeals' decision will impose on certified public accountants an unprecedented and undefined duty to warn non-clients that their interests will be adversely affected by the wrongful acts of the accountants' clients. Left uncorrected, the decision will have significant and far-reaching adverse effects for accountants and the clients who entrust them with their confidential information.

At bottom, this case always has been founded on the allegation that Defendants, upon learning of the relevant transactions, should have done more to stop the trustees' defalcations than advise their client, Jacquelin K. Stevenson. See Bennett v. Carter, No. 2015-UP-491, p. 5 (S.C. Ct. App. Oct. 14, 2015) (faulting Defendant Kerrison for taking "no further action" to stop the defalcations after notifying the attorney of her client, Mrs. Stevenson, who was the sole lifetime beneficiary under the trusts). For the reasons stated in the Petition for a Writ of Certiorari, imposition of such a duty is contrary to applicable state and federal law that criminalize such disclosures. Yet in the Return to the Petition for a Writ of Certiorari, Plaintiffs confirm that their sole remaining claim, for aiding and abetting a breach of fiduciary duty, still rests on that faulty foundation. Plaintiffs repeatedly reference transactions that occurred after the death of Mrs. Stevenson's bookkeeper, when Defendants had physical custody of a trust checkbook for a period of time (although never had check-signing authority). See, e.g., Return to the Petition for a Writ of Certiorari, p. 8. But Plaintiffs acknowledge that their claim is in no way limited to

those transactions. See Return to the Petition for a Writ of Certiorari, p. 8 (stating that Plaintiffs' theory of recovery includes the allegation that Defendants "fail[ed] to disclose" the trustees' transactions to Plaintiffs).

Indeed, the Return to the Petition for a Writ of Certiorari makes it abundantly clear that Plaintiffs seek to recover from Defendants on grounds that include the allegation that Defendants should have told Plaintiffs, who were not clients, of the trustees' transactions. See Return to the Petition for a Writ of Certiorari, p. 1 (complaining that Defendants "kept the thefts secret"); see Return to the Petition for a Writ of Certiorari, p. 2 (objecting that upon learning of the trustees' action, Defendants "did nothing to stop it"); see Return to the Petition for a Writ of Certiorari, p. 3 (stating that Mrs. Stevenson's attorney acknowledged that Plaintiffs "needed to be told of the illegal withdrawals"); and see Return to the Petition for a Writ of Certiorari, p. 5 (arguing that federal law authorized Defendants to disclose the trustees' defalcations to Plaintiffs).

Below, Defendants address the legal arguments that Plaintiffs raise in the Return to the Petition for a Writ of Certiorari. But as an initial matter, it is important to fully grasp the extraordinary and radical nature of Plaintiffs' claim, as confirmed in their Return to the Petition for a Writ of Certiorari. If this Court does not review and correct the decision of the Court of Appeals, accounting professionals in this state will incur civil liability if they do not warn non-clients that their interests might be adversely affected by the actions of the accountants' clients. This Court should issue a writ of certiorari and should affirm that no such duty exists. Alternatively, if this Court believes it is appropriate to impose such a duty on accounting professionals, this Court should issue a writ of certiorari so that it might delineate the scope of this duty and give CPAs some guidance on when disclosure of

confidential client information is compelled and when it is forbidden. Absent such direction, the decision of the Court of Appeals is certain to sow confusion and uncertainty in an area where public policy favors clarity and certainty. See S.C. Code Ann. § 40-2-5 ("It is the policy of this State ... that the conduct of persons licensed as having special competence in accountancy be regulated in all aspects of their professional work."). Because the decision of the Court of Appeals contains no substantive discussion of these conflicting duties, and in fact fails even to acknowledge their existence, accounting professionals will be left to speculate on the particulars of this newly found duty, on pain of civil or criminal liability, if this Court does not issue a writ of certiorari to review and correct the errors of law in the Court of Appeals' decision.

II. FEDERAL LAW BARRED DEFENDANTS FROM DISCLOSING THE TRUSTEES' TRANSACTIONS TO PLAINTIFFS.

Federal law makes it a crime for a tax return preparer to disclose tax return information in the circumstances presented here. In arguing to the contrary, Plaintiffs incorrectly state that (A) this case does not arise out of tax preparation services, (B) 26 U.S.C. § 7216 does not preempt the "state common law duties of an accountant," and (C) the "related-taxpayers" exception contained in federal regulations authorized Defendants to tell Plaintiffs of the trustees' defalcations. Each incorrect statement is discussed in turn.

A. This Case Arises Out of Tax Preparation Services.

This case presents the paradigm example of a tax engagement in which federal law makes it a crime for a tax return preparer to disclose tax return information to third parties. This Court should issue a writ of certiorari to review and correct the Court of Appeals' decision because it conflicts with, and so is preempted by, 26 U.S.C. § 7216 and related regulations.

Plaintiffs complain that Defendants did not tell them about the trustees' defalcations and argue that such a disclosure would not be governed by 26 U.S.C. § 7216. In fact, this case presents the classic situation in which a CPA must keep tax return information confidential or face criminal prosecution. Ms. Kerrison first learned of the transactions when she reviewed documents provided to her by Mrs. Stevenson's bookkeeper, Pat Neapolitan, for the purpose of preparing the tax return of Mrs. Stevenson. (R. p. 912, July 13, 2011 Dep. Of Lynne Kerrison, p. 30, Lines 6-11). Records provided to Ms. Kerrison by Ms. Neapolitan for the preparation of Mrs. Stevenson's tax returns clearly are tax return information. See 26 C.F.R. § 301.7216-1(b)(3) ("Definitions") (broadly defining "tax return information" to include any information "which is furnished in any form or manner for, or in connection with, the preparation of a tax return of the taxpayer."). As such, Ms. Kerrison could not make that information known to any third party in any manner absent express authority in federal statute or regulation. See 26 C.F.R. § 301.7216-1(b)(5) ("Definitions") (broadly defining "disclosure" to mean "the act of making tax return information known to any person in any manner whatever"). Contrary to Plaintiffs' argument, this case arises out of tax preparation services and so is subject to the comprehensive regulatory scheme created by 26 U.S.C. § 7216 and related regulations.

Plaintiffs claim that Defendants subsequently learned of additional defalcations in the course of a non-tax engagement. See Return to the Petition for a Writ of Certiorari, p. 4. This would not permit Defendants to disclose the tax return information described above. Nor could Defendants disclose subsequent and additional defalcations to non-clients without violating the statutory duty of confidentiality imposed by the General

Assembly. See S.C. Code Ann. § 40-2-190(A). Plaintiffs' argument that Defendants' citation to S.C. Code Ann. § 40-2-190(A) represents an issue raised for the first time on appeal is without merit. Defendants have consistently contended that requiring a CPA to disclose confidential client information conflicts with a CPA's obligation to keep such information confidential, and the statute provides additional grounds for this court to issue a writ of certiorari. Tellingly, Plaintiffs make no substantive argument that Defendants could have disclosed the trustees' defalcations to Plaintiffs without violating S.C. Code Ann. § 40-2-190(A). Rather, Plaintiffs argue that the statute does not permit a CPA "to actively participate in a client's breach of fiduciary duty." Return to the Petition for a Writ of Certiorari, p. 6. If Plaintiffs located authority that supports their contention that Defendants could have disclosed trustee defalcations to non-clients without violating S.C. Code Ann. § 40-2-190(A), Plaintiffs no doubt would have included such authority in their Return to the Petition for a Writ of Certiorari. Their failure to do so should be read as a tacit admission that a CPA cannot simultaneously comply with the duty of confidentiality under S.C. Code Ann. § 40-2-190(A) and the duty to warn non-clients of a client's wrongful acts adopted by the Court of Appeals.

This Court should issue a writ of certiorari to review and correct the Court of Appeals' decision because requiring a tax professional to tell a non-client of wrongful acts by the professional's client conflicts with, and so is preempted by, 26 U.S.C. § 7216 and related regulations, as well as S.C. Code Ann. § 40-2-190(A).

B. 26 U.S.C. § 7216 Preempts the State Common Law Duties of an Accountant.

This Court should issue a writ of certiorari to review and correct the Court of Appeals' decision because it erroneously imposes on a CPA a duty of disclosure to non-

clients that is in direct conflict with federal law that criminalizes such disclosure. Put simply, a tax professional cannot comply with the state common law duty of disclosure recognized by the Court of Appeals and the duty of confidentiality imposed by 26 U.S.C. § 7216. In such circumstances, federal law preempts the contrary state law provision. Priester v. Cromer, 401 S.C. 38, 43, 736 S.E.2d 249, 252 (2012) (citation omitted).

Plaintiffs argue that "[i]t is clear from the language of the statute (26 U.S.C. § 7216) that it was not meant to occupy the field so as to displace state common law duties of an accountant." Return to the Petition for a Writ of Certiorari, p. 5. Plaintiffs fail to identify the clear statutory language to which they refer. In fact, 26 U.S.C. § 7216 contains no such language. To the contrary, the plain language of the statute and related regulations make clear federal authorities' intent to create a comprehensive regulatory scheme governing disclosure of tax return information in every instance: a tax professional is unambiguously forbidden to disclose tax return information to third parties unless a federal statute or regulation expressly authorizes the disclosure. See 26 U.S.C. § 7216; 26 C.F.R. § 301.7216-2(a). It is for that purpose that federal authorities adopted the broadest definitions imaginable of "tax return information" and "disclosure," bringing within the scope of this regulatory framework every instance in which a preparer might make known to a third party any information furnished for the purpose of preparing a return.

Plaintiffs' argument that 26 U.S.C. § 7216 does not preempt the common law duty recognized in the Court of Appeals' decision is without merit.

C. The "Related-Taxpayer" Exception Did Not Permit Defendants to Tell Plaintiffs of the Trustees' Defalcations.

Plaintiffs incorrectly claim that the "related-taxpayers" exception authorized Defendants to disclose the trustees' defalcations to Plaintiffs. On its very face, the regulation has no application in the circumstances presented here.

Regulations adopted by the Internal Revenue Service create several discrete exceptions to the general rule barring disclosure under 26 U.S.C. § 7216. For instance, a tax professional may disclose tax return information pursuant to the order of a state or federal court. 26 C.F.R. § 301.7216-2(f)(1). Plaintiffs contend that the "related-taxpayers" regulation authorized Defendants to tell Plaintiffs of the trustees' defalcations because the definition of "related taxpayer" includes a "trust or estate and beneficiary." Return to the Petition for a Writ of Certiorari, p. 5, citing 26 C.F.R. § 301.7216-2(e)(1)-(2). The argument is defeated by the plain language of the regulation. The exception applies only when one taxpayer provides tax return information to a tax professional, who then uses the information to prepare the tax return of a second, related taxpayer. It does not permit disclosure of information, nor its use, for any other purpose. The regulation says:

> **(e) Disclosure or use of information in the case of related taxpayers. (1)** In preparing a tax return of a second taxpayer, a tax return preparer may use, and may disclose to the second taxpayer in the form in which it appears on the return, any tax return information that the tax return preparer obtained from a first taxpayer if—
>
> > **(i)** The second taxpayer is related to the first taxpayer within the meaning of paragraph (e)(2) of this section;
> >
> > **(ii)** The first taxpayer's tax interest in the information is not adverse to the second taxpayer's tax interest in the information; and
> >
> > **(iii)** The first taxpayer has not expressly prohibited the disclosure or use.

> **(2)** For purposes of paragraph (e)(1)(i) of this section, a taxpayer is related to another taxpayer if they have any one of the following relationships: Husband and wife, child and parent, grandchild and grandparent, partner and partnership, trust or estate and beneficiary, trust or estate and fiduciary, corporation and shareholder, or members of a controlled group of corporations as defined in section 1563.

26 C.F.R. § 301.7216-2. Even when the related-taxpayer exception applies, its application is remarkably narrow, as the tax professional may only disclose to the second taxpayer the information obtained from the first taxpayer "in the form in which it appears on the return." Id. Ms. Neapolitan provided information regarding the trustees' transactions to Defendants for the purpose of preparing the tax return of Mrs. Stevenson, the sole lifetime beneficiary under both trusts. There is no evidence that Defendants used that information to prepare tax returns for Plaintiffs, and absent such evidence the related-taxpayer regulation is inapplicable.

For all of the above reasons, federal law barred Defendants from telling Plaintiffs of the trustees' defalcations and this Court should issue a writ of certiorari to correct the errors of law in the Court of Appeals' decision.

III. PERMITTING PLAINTIFFS TO ASSERT A CLAIM FOR AIDING AND ABETTING A BREACH OF FIDUCIARY DUTY AGAINST DEFENDANTS IN THESE CIRCUMSTANCES WOULD DRAMATICALLY EXPAND ACCOUNTANTS' LIABILITY TO THIRD PARTIES.

It is settled law in South Carolina that an accountant has no duty to disclose client information to non-clients. See, e.g., ML-Lee Acquisition Fund, L.P. v. Deloitte & Touche, 327 S.C. 238, 489 S.E.2d 470 (1997) (reversing the Court of Appeals' ruling that a CPA who audited the financial statements of a company owed a duty to disclose to a non-client investor that the company was overstating its inventory). Yet the Return to the Petition for a Writ of Certiorari makes clear that the sum and substance of Plaintiffs' sole

remaining claim, for aiding and abetting a breach of fiduciary duty, is that Defendants, upon learning of the relevant transactions, should have done more to stop the trustees' defalcations than advise Defendants' client, Jacquelin K. Stevenson. Plaintiffs expressly complain that Defendants did not disclose the transactions to Plaintiffs. ML-Lee is a dead letter if a Plaintiff can avoid its holding by alleging that a CPA aided and abetted a breach of fiduciary duty by failing to disclose client information to non-clients to whom Defendants owed no duty of care. See ML-Lee, 327 S.C. at 241, 489 S.E.2d at 471, n. 3 (1997) (adopting § 552 of the Restatement (2d) of Torts to govern accountant liability to third parties and noting that § 552 "imposes no duty to disclose information.").

The Court of Appeals decision dramatically departs from this Court's precedents delineating CPA liability to non-clients by providing for liability where a CPA does not warn a non-client of wrongful acts committed by a client of the CPA. This Court should issue a writ of certiorari to correct the errors of law in the Court of Appeals decision.

IV. ANY CLAIM FOR AIDING AND ABETTING A BREACH OF FIDUCIARY DUTY IS BASED ON THEORIES OF FRAUD AND DECEIT COMMITTED BY THE STEVENSON BROTHERS, AND THEREFORE DID NOT SURVIVE THE DEATH OF JACQUELIN STEVENSON.

Plaintiffs' claim for aiding and abetting a breach of fiduciary duty is based on theories of fraud and deceit and so the claim abated on the death of Mrs. Stevenson.

Plaintiffs seek to distinguish this Court's holding in Ferguson on the grounds that Defendants are alleged to have aided and abetted the Stevenson Brothers in breaching *statutory* duties. Return to the Petition for Writ of Certiorari, p. 9, citing S.C. Code § 62-7-802(a). Ferguson cannot be distinguished on those grounds, as the cause of action in that case also involved an alleged statutory violation. See Ferguson v. Charleston Lincoln Mercury, Inc., 349 S.C. 558, 564, 564 S.E.2d 94, 97 (2002) ("Although Mr. Ferguson's

cause of action arose directly under the Dealers Act, his action was based upon a theory of fraud and deceit."). Plaintiffs' argument that their claim is not based on theories of fraud and deceit because they allege violation of statutory duties ignores this Court's clear holding in Ferguson. Regardless of how a plaintiff characterizes an action, where the claim in substance is based on a theory of fraud and deceit, the claim is exempt from the general survival statute. Plaintiffs' claim for aiding and abetting a breach of fiduciary duty is based on theories of fraud and deceit committed by the Stevenson Brothers. See, e.g., Return to the Petition for Writ of Certiorari, p. 1 (stating that the Stevenson Brothers "began stealing money, disguised as loans"). Such a claim is clearly based on theories of fraud and deceit and therefore did not survive the death of Mrs. Stevenson.

Finally, Plaintiffs incorrectly claim that the state of mind of Mrs. Stevenson is not relevant to this claim. Return to the Petition for Writ of Certiorari, p. 10, n. 9. The state of mind of Mrs. Stevenson is critically important where Plaintiffs not only allege that the Stevenson Brothers deceived their mother, but that Defendant Kerrison also "hid the facts from Mrs. Stevenson." Reply Brief of Appellants, p. 8. Defendants did not deceive Mrs. Stevenson. See Bennett v. Carter, No. 2015-UP-491, p. 5 (S.C. Ct. App. Oct. 14, 2015) (Defendant Kerrison gave effective notice to her client, Mrs. Stevenson, by fully disclosing the trustee transactions to the attorney for Mrs. Stevenson while Mrs. Stevenson remained competent). However, Plaintiffs may seek to prove that Ms. Kerrison deceived Mrs. Stevenson, who was the sole lifetime income beneficiary of both trusts and held a power of appointment for one of the trusts. In that event, evidence regarding the state of mind of Mrs. Stevenson would be unavailable, including the extent of her knowledge about these transactions and whether she ratified or even authorized the transactions. See Faircloth v.

Finesod, 938 F.2d 513, 517 (4th Cir. 1991) (in adopting the general survival statute, the South Carolina General Assembly "could rationally conclude that the difficulty and potential unfairness of proving the state of mind of a dead party to a fraudulent transaction justified excepting fraud from the survival statute.").

Plaintiffs' claim for aiding and abetting a breach of fiduciary duty is based on theories of fraud and deceit and so the claim abated on the death of Mrs. Stevenson. This Court should issue a writ of certiorari to review and correct the errors of law in the decision of the Court of Appeals.

CONCLUSION

The Court of Appeals erred in conflict with federal law and prior decisions of this Court for the reasons stated above and in the Petition for a Writ of Certiorari and Memorandum of Law and Authorities. Absent review and correction by this Court, the Court of Appeals' decision will have significant and far-reaching adverse effects for accountants, as well as for the clients who entrust them with their confidential information. Defendants ask this Court to grant their Petition for Writ of Certiorari to review the Court of Appeals' order reversing the trial court's grant of summary judgment in favor of Defendants on Plaintiffs' claim for aiding and abetting breach of fiduciary duty, and grant such other relief to which Defendants may be entitled.

Respectfully submitted,

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PROOF OF SERVICE

I certify that on this 29th day of February 2016, I have served on the Appellants' counsel a copy of the attached Reply Brief to Petition for Writ of Certiorari by causing a copy of the same to be placed in the U.S. Mail, first-class postage paid, addressed to:

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