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SUPREME COURT OF NEW JERSEY
Disciplinary Review Board
Docket No. 97-224

IN THE MATTER OF :
 :
JOHN B.M. FROHLING, :
 :
AN ATTORNEY AT LAW :

Decision

Argued: September 18, 1997

Decided: December 16, 1998

John McGill, III appeared on behalf of the Office of Attorney Ethics.

S.M. Chris Franzblau appeared on behalf of respondent.

This matter was before the Board based on a recommendation for discipline filed by special master Alan M. Bell. The four-count complaint filed by the Office of Attorney Ethics ("OAE") charged respondent with a general violation of RPC 1.15 and a specific violation of RPC 1.15 (b) (failure to safeguard client property and failure to promptly deliver trust funds) and RPC 8.4(c) (conduct involving dishonesty, fraud, deceit or misrepresentation) (count one); RPC 8.4(b) (criminal conduct) and (c) (count two); RPC 8.1(b) (failure to cooperate with disciplinary authorities) (count three); and RPC 1.15(d) (failure to comply with the recordkeeping requirements of R.1:21-6) and RPC 8.1(b) (count four). At the first hearing date the special master granted the OAE's motion to dismiss with prejudice the first count of the complaint because the grievant, a California resident, refused to appear at the hearing. In addition, in its written post-hearing summary and legal argument, the OAE made a motion to dismiss the third count of the complaint for lack of sufficient evidence to prove the allegation. That motion was also granted.

Prior to the hearing, by motion dated December 7, 1994, the OAE sought an order from the special master compelling respondent to sign an authorization for the Internal Revenue Service ("IRS") to release certain documents to the OAE. Respondent objected on the grounds that the information was confidential and that its production would violate his fifth amendment rights. By order dated January 17, 1995, the special master granted the OAE's motion.

After the hearing and by way of its written summation, the OAE made a motion to amend the complaint to allege a violation of RPC 1.15(b) (an attorney shall promptly turn over property in which a third-party has an interest). The OAE based its motion on the recent case of In re Gold, 149 N.J. 23 (1997), where the attorney's failure to keep withholding taxes segregated and intact was determined to be a violation of RPC 1.15(b). The complaint had not charged Gold with a violation of RPC 1.15(b). Respondent "strenuously objected" to the motion, on the basis that he had not had the opportunity to present additional testimony and/or documents to meet the allegation. Contrarily, the OAE maintained that respondent had been afforded an opportunity to present all relevant facts and to litigate the issues at the hearing. The special master, however, was concerned about the propriety of amending the complaint after the close of the hearing, deeming it "unfairly prejudicial" to respondent. Accordingly, the special master denied the OAE's motion.

* * *

Respondent was admitted to the New Jersey bar in 1960. He has no history of discipline. Respondent currently maintains an office in Roseland, Essex County. Until November 1991 respondent's office was located in Newark, Essex County.

Respondent's firm, Frohling and Hanley, was a partnership until January 1992, when it became a professional association. In the special master's words, during the relevant period, "for all intents and purposes, [respondent] was the sole proprietor of the law business".

The facts in this matter are as follows:

Count two of the complaint charged respondent with failure to pay all or part of the federal withholding taxes for the period 1986 through 1991 and New Jersey unemployment compensation taxes for the period January 1, 1985 through September 30, 1987, in violation of RPC 8.4(b) and (c). The complaint alleged that respondent had failed to pay all or part of the federal withholding taxes for the relevant period, resulting in IRS levies of \$505,913.25 against respondent's business accounts. The complaint charged that respondent also violated RPC 8.4(b) and (c) when he misrepresented to his employees and the federal and state tax authorities, through employee W-2 forms, that the taxes had been withheld. The complaint alleged that respondent knowingly diverted the funds for his own use.

The OAE presented one witness to prove respondent's misconduct, an OAE investigative auditor who had reviewed respondent's attorney records.¹ The OAE, however, did not ask the IRS about the precise amount claimed: some funds were paid to the IRS by the bank. The complaint contains a table prepared by the auditor, purporting to represent the liens filed by the IRS. Extensive cross-examination of the auditor revealed that the amounts listed for subsequent liens did not take into account certain payments made by respondent's firm and also included amounts from previously filed liens. The special master deemed the table "unreliable" and "erroneous."

¹ This matter arose when the auditor learned of the notices of levy against the firm's business accounts during an investigation in connection with the first count of the complaint. As noted above, that count of the complaint has been dismissed.

In the alternative, the OAE relied on an admission, contained in respondent's answer to the complaint, that withholding taxes had not been timely forwarded to the federal and state taxing authorities, although respondent had taken exception to the amount owed to the federal government. The OAE also relied on the firm's quarterly federal tax returns (Form 941) (exhibit C-VV). For the quarters ending June, September and December 1990 and March, June, September and December 1991, the quarterly returns showed a balance due (after crediting reflected payments) of \$143,317.28. This figure represented the revised amount the OAE claimed to be due to the IRS for federal withholding taxes for the relevant period.²

Respondent contended that the amount cited by the OAE was incorrect. Respondent admitted, however, that there were times when the firm did not have sufficient funds to pay the withholding taxes on time. Respondent was aware of the notice of levy on his accounts. He argued that the amount owed was disputed, although he never supplied specific information about the nature of the dispute.³ Respondent did not call as a witness the accountant who was working on resolving the IRS dispute for the firm. Instead, the parties entered into a stipulation consisting of two paragraphs from the accountant's report, which was read into the record. The report itself is not in evidence. The stipulation states as follows:

I am presently working on a problem for Frohling & Hanley with regard to a payroll tax underpayment to the quarters ended June 30, 1991, through December 31, 1991, and December 31, 1990, which to my knowledge, are the only quarters in

² In its brief to the Board, the OAE deemed the amount to be, as of May 8, 1996, at least \$108,672. The correct figure is not easily ascertainable from this record. In any event, the particular dollar amount in question is not relevant to the allegation that respondent failed to timely pay withholding taxes over to the government.

³ Respondent testified that, "since 1989 or 1988, we had been in continual dialogue with the IRS" and that an installment payment program had been negotiated.

which taxes remain unpaid.

We have submitted a formal Offer and Compromise (OAC) on this matter pursuant to Section 7122 of the Internal Revenue Code of 1986, as amended (the 'Code'), and are currently working with the assigned Collection Agent toward its acceptance.

Respondent admitted that, when the taxes were not timely paid, there was insufficient money to do so or the individuals responsible for making the payment had failed to do so. The stipulated portion of the accountant's report acknowledges that there was an underpayment and that the taxes remained unpaid as of May 1996.

There is no dispute that funds are owed to the State of New Jersey. The OAE introduced into evidence a certified certificate of debt issued by the State of New Jersey against respondent's law firm for unemployment compensation taxes due for the period October 1, 1982 through March 31, 1984, in the amount of \$11,235.42. Respondent stated in his answer that state taxes were withheld from his employees and that "at times certain of them were not timely forwarded." Although there was a question of whether a higher amount, \$21,292.73, as alleged in the complaint, was owed, respondent did not dispute the indebtedness represented by the certificate of debt.

The OAE submitted into evidence a number of checks showing that, while the taxes were owed and disputed, respondent's law firm spent large sums of money on, among other things, entertaining clients and making political contributions. The OAE maintained that those funds should have been used to pay the taxes.

* * *

Count Four of the complaint charged respondent with failure to produce certain documents in connection with a demand audit by the OAE, in violation of RPC 1.15(d) and RPC 8.1(b).

Notice of a demand audit was served on respondent on January 7, 1992. At respondent's request, the audit was adjourned to February 10, 1992, at which time he appeared without the requested documentation. Respondent contended that his records had been lost or stolen. The OAE did not dispute that assertion.

According to respondent, he had relocated his office in 1991. The new office was not ready and his practice was conducted from a temporary office from November 1991 through January 1992, when the new office was completed. Respondent's associate was asked to help find the documents requested by the OAE. Her efforts were hindered by the two moves. Although several cartons of records were compiled in reply to the OAE's request, some of the information could not be located. The associate was unsuccessful in reconstructing some of the quarterly reconciliations, because of the missing records.

The special master heard testimony from respondent, his associate and his bookkeeper about the firm's efforts to get the missing documents from the bank. The record also contains documentary evidence in the form of an affidavit and letters sent to the bank, demonstrating the firm's efforts to comply with the OAE's requests. The bank did not supply the missing documents. During the same time period, although the OAE obtained the records from the bank by way of a subpoena, the OAE did not so inform respondent, who continued to try to get them from the bank. The firm employed several accounting firms that attempted unsuccessfully to complete the reconciliations. Although some reconciliations were performed and sent to the OAE auditor, as of the ethics hearing not all those requested had been turned over.

The OAE alleged that respondent failed to supply the requested reconciliations and to account for trust funds, relying on In re Barker, 115 N.J. 30 (1989) (an attorney has a non-delegable duty to safeguard client trust funds). There are no allegations of misappropriation in this matter.

* * *

The special master determined that respondent's law firm owes federal withholding taxes in an unspecified amount and state unemployment compensation taxes of at least \$11,235.42. The special master noted that, although respondent disputed the amount of his debt to the federal government, he acknowledged that some tax payment was owed. Respondent did not challenge the indebtedness to the State of New Jersey. Therefore, the question before the special master was whether "the owing of withholding taxes to the Federal Government (the precise amount of which is unproven and disputed) or to the State of New Jersey, (the amount of which does not appear to be in dispute), comprise[s] a violation of RPC 8.4, entitled Misconduct." After analyzing the language of RPC 8.4(b) and (c), the rules charged in the complaint, the special master found that the proofs did not sustain a finding of a criminal act [RPC 8.4(b)]. The Special master noted that the OAE had apparently recognized (1) that the conduct in question did not rise to the level of a crime and (2) that neither federal nor state authorities had charged respondent with a crime.

With regard to the alleged violation of RPC 8.4(c), the special master set forth the arguments made by each side. The OAE contended that respondent was the person in the firm who was obligated to see that taxes were paid, a fact undisputed by respondent. The OAE also cited Begier v. IRS, 496 U.S. 53 (1990), for the proposition that federal taxes withheld constitute a special fund

held in trust for the United States.⁴ See 22 U.S.C.A. section 7501(a). Respondent, however, presented an expert witness who testified that, if the employer fails to pay withholding taxes, the employee suffers no loss. The expert also testified that he knew of no rule requiring an employer to place withholding taxes in a separate or segregated account. Furthermore, he testified that it was not a breach of a fiduciary duty to fail to pay withholding taxes for an employee, noting that the employer is personally liable for the payment to the IRS.

The special master agreed with the expert's testimony that the employees suffered no harm from the employer's failure to pay withholding taxes. The special master disagreed, however, with the expert's view on the employer's duty regarding federal taxes withheld. The special master determined that "the taxes withheld from one's employees are, in fact, treated as funds held in trust such that an attorney/employer has a fiduciary obligation to keep them separate and intact and remit same to the governmental authorities." citing People v. Franks, 866 P.2d 1375 (1994) and In re Gold, 149 N.J. 23 (1997).⁵

The special master remarked that, although respondent owed money to the IRS for withholding taxes, "he continued during that time period to conduct his practice as if said funds were not owed, wining and dining clients and prospective clients of his bond practice at his golf club and in Atlantic City." Although the special master recognized that, arguably, respondent's practice

⁴ Begier involved a bankruptcy where the taxpayer had written a check to pay taxes. Once paid from the account, the funds were segregated. The trustee in bankruptcy sought to avoid the payment of the taxes. The U.S. Supreme Court held that the funds were not recoverable.

⁵ In Franks, a Colorado attorney pleaded guilty to one count of failure to pay income tax withheld from employees. The Court found that the conduct involved an element of dishonesty or misrepresentation, although the attorney had disclaimed any intentional wrongdoing. The attorney, who was also found guilty of neglect of a client matter, was suspended for one year and one day.

would have suffered if those expenses had not been incurred, "Respondent willfully chose to continue to do business as usual, despite owing to the IRS and the State of New Jersey sums of money for withholding taxes." In the special master's view, failure to pay withholding taxes, in light of Franks and Gold, is a violation of RPC 8.4(c), even if the act is unintentional. Therefore, the special master concluded, despite the lack of clear and convincing evidence that respondent's dereliction was intentional, he was "compelled" to find that respondent had violated RPC 8.4(c) by failing to pay withholding taxes for his firm's employees.

With regard to count four of the complaint, the special master did not find respondent guilty of misconduct in connection with the production of the requested records, calling his efforts to try to obtain the bank records "diligent and reasonable under the circumstances." The special master considered that respondent was unable to subpoena his own bank records without instituting an action. The special master noted that respondent's bookkeeper, whom he deemed "quite credible," testified that the required journals had been kept and quarterly reconciliations had been prepared.⁶ Accordingly, the special master dismissed the allegations of violations of RPC 1.15(d) and RPC 8.1(b).

As to the appropriate quantum of discipline, the special master noted the OAE's reliance on In re Esposito, 96 N.J. 122 (1984) and In re Gold, *supra*, 149 N.J. 23 (1997), to urge a finding that respondent was under a fiduciary obligation to pay withholding taxes to the government. In Esposito, an attorney pleaded guilty to violating federal law by failing to pay income and social security taxes on behalf of employees. His actions were not marked by any attempt at personal gain. The Court found his criminal conviction to be conclusive evidence of a disciplinary violation. The

⁶As noted earlier, respondent claimed that they had been lost or stolen.

attorney was suspended for six months. Here, however, there was no criminal proceeding against respondent.

The OAE cited Gold “for the proposition that an unintentional violation of an attorney’s fiduciary obligation to properly remit withholding taxes to the governmental authorities and failure to keep said taxes segregated and intact warrants a six month [sic] suspension.” The Court adopted the Board’s decision, which warned that, in the future, similar misconduct would be met with stern discipline. As the special master pointed out, however, Gold was not decided until October 17, 1996; the misconduct here occurred before Gold, in 1990 and 1991. The special master determined that a suspension of one month was appropriate, stating that

[w]hile I have some nagging doubts about the Respondent’s credibility and there was no proof of the legitimacy of the dispute with the IRS, the OAE did not challenge its legitimacy. If attorneys who have not been convicted of a crime and who are involved in some type of dispute with the IRS over amounts due are now found to have breached their ethical obligations by not paying withholding taxes to governmental authorities within a timely manner, fair warning should be given before imposing severe sanctions. In my view, fundamental fairness mandates this lesser form of discipline.

* * *

Upon a de novo review of the record, the Board is satisfied that the conclusion of the special master that respondent was guilty of unethical conduct in connection with the payroll taxes is fully supported by clear and convincing evidence .

The special master properly dismissed count four of the complaint. The OAE did not dispute respondent’s contention that the records needed to complete the required reconciliations had been maintained, but had been lost or stolen. Respondent, as well as several members of his staff, introduced evidence, both testimonial and documentary, about their efforts to obtain the missing

records from the bank. The OAE did not disagree that such efforts had been made. Similarly, the OAE did not disagree respondent's contention that he had attempted to have several accounting firms complete the reconciliations, to no avail. It is not known what more respondent should have done to obtain the required bank records to complete the reconciliations, particularly in light of the fact that the OAE had the bank records, but never offered them to respondent. Therefore, the Board concurred with the special master's dismissal of violations of RPC 1.15(d) and RPC 8.1(b).

With regard to count two and the reliance on Gold – that an attorney's failure to keep taxes segregated and intact violates RPC 1.15(b) – both sides in this matter filed briefs with the Board. Essentially, the OAE urged the Board to find that respondent's conduct was intentional, in that he knowingly failed to pay all or part of the state and/or federal withholding taxes and that he misrepresented to the tax authorities and to his employees that the taxes had been collected and withheld. Respondent, in turn, argued that no finding of a violation of RPC 8.4(c) could be made because the essential elements of dishonesty, fraud, deceit and misrepresentation had not been established. Respondent argued further that Franks can be distinguished from this case because it involved criminal conduct, a factor not present here. With regard to the special master's reliance on Gold, respondent pointed out that the misconduct found in that case was the breach of a fiduciary obligation, a charge not made against him. Therefore, respondent added, Gold cannot be used as precedent for a finding of misconduct in this matter. This argument misses the mark, however. Although the complaint did not charge a violation of RPC 1.15(b) in Gold, the Board and the Court found support for a finding of a violation of that rule. Gold, therefore, serves as precedent for a finding of a violation of RPC 1.15(b). In addition, the complaint states that respondent withheld payroll taxes, "but failed to hold those funds in trust. . . ." Accordingly, respondent had notice of

a potential finding in this regard. In light of the foregoing, the Board finds that respondent's conduct in using funds that could have been withheld to pay payroll taxes violated RPC 1.15(b). Respondent did not prorate the funds he had available to him, as required by law. Instead, he used those funds for, in the special master's words, "winning and dining" clients. In this fashion, respondent breached his duty to pay over payroll taxes to the government. Moreover, respondent violated RPC 8.4(c) when he presented his employees with W-2 forms indicating that a certain sum had been taken from their gross pay and had been or would be paid over to the government. Whether respondent's employees suffered any adverse consequences from respondent's dereliction is irrelevant. The impropriety lay in his misrepresentation to the employees and to the government that certain sums had been set aside for the payment of taxes. For this misconduct the Board unanimously determined to impose a reprimand. The Board found respondent's ethics infractions not as serious as those committed by the attorney in In re Olitsky, 149 N.J. 27 (1997) (attorney suspended for three months for recordkeeping deficiencies and commingling of personal and client funds to avoid IRS lien for failure to pay payroll taxes).

* * *

One final point warrants mention. One of the central issues in this case was whether respondent was obligated to keep the withholding taxes in trust for the government. Respondent's expert's report, exhibit C-000, stated as follows:

Typically, the tax withheld from employees is spoken of as being held 'in trust' for the United States. That is, it is not supposed to be used for other purposes, particularly not for paying other creditors. The position of the Service and the courts is that if the responsible officer is not able to pay the full amount of the wages or

salaries due and also pay the taxes withheld, he should pay only a portion of the salaries due and pay the appropriate percentage of what he has paid to the government as withheld tax.

Admittedly, as noted above, Respondent did not timely pay over to the Service income taxes withheld from employees' compensation under [Internal Revenue Code] section 6672(a). . . . Under section 7501, 'Whenever any person is required to collect or withhold any . . . tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a 'special fund in trust for the United States.'

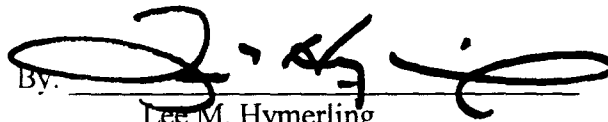
Respondent argued that he was not required to segregate the withholding taxes and keep them intact. According to the OAE, "[a]lthough the funds collected for withholding taxes are not required to be segregated from the employer's general funds unless special and limited circumstances apply, the amounts collected must be held intact for remittance to the government and are not for the employer's personal or other business use." Substantial questions have been raised in this matter about an attorney's obligation to set such funds aside and, if so, where. In light of the lack of guidance in this regard, the Board determined to refer this question to the Professional Responsibility Rules Committee.

The Board further determined that respondent be required to reimburse the Disciplinary Oversight Committee for administrative costs.

Dated:

12/16/97

By:



Lee M. Hymerling
Chair
Disciplinary Review Board

SUPREME COURT OF NEW JERSEY

**DISCIPLINARY REVIEW BOARD
VOTING RECORD**

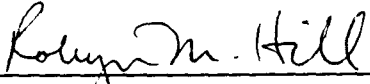
**In the Matter of John B. M. Frohling
Docket No. DRB 97-224**

Argued: September 18, 1997

Decided: December 16, 1997

Disposition: Reprimand

Members	Disbar	Suspension	Reprimand	Admonition	Dismiss	Disqualified	Did not Participate
Hymerling			x				
Zazzali			x				
Brody			x				
Cole			x				
Lolla			x				
Maudsley			x				
Peterson			x				
Schwartz			x				
Thompson			x				
Total:			9				


Robyn M. Hill
Chief Counsel

1/6/98