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CLERK SUPREME COURT

IN THE COURT OF APPEALS OF IOWA

MARTINSON MANUFACTURING CO.,)
Plaintiff-Appellant,)
vs.)
ROBERT W. SEERY,)
Defendant-Appellee.)

Filed December 27, 1983

3-271
2-69095

Appeal from Polk District Court - Luther T. Glanton, Judge.

Plaintiff appeals from the judgment entered on a jury verdict for defendant in this legal malpractice action. AFFIRMED.

Lawrence L. Marcucci and Frederick B. Anderson of Williams, LaMarca, Marcucci & Wiggins, P.C., West Des Moines, for plaintiff-appellant.

Richard G. Langdon, Ross A. Walters, and Kermit B. Anderson of Herrick, Langdon & Langdon, Des Moines, for defendant-appellee.

Heard by Donielson, P.J., and Schlegel and Hayden, JJ.

DONIELSON, P.J.

Plaintiff corporation appeals from the judgment entered on a jury verdict for defendant in this legal malpractice action. Plaintiff asserted that the defendant had negligently handled the tax planning for a corporate acquisition. On appeal, plaintiff asserts that (1) the jury should not have been allowed to interpret section 334(b)(2) of the Internal Revenue Code (for purposes of determining whether defendant complied with it) as that question is allegedly one of law; (2) the court should not have excluded documentary evidence of the amounts defendant billed plaintiff for legal services because the bills indicated the nature of the work undertaken by defendant; (3) a new trial should have been granted as the verdict allegedly was contrary to the evidence; (4) certain testimony by an expert witness was inadmissible, and the prejudice was not cured by striking the answer and admonishing the jury to disregard it; (5) the court erred in holding that the net operating loss carry forward available to plaintiff would have been five years, rather than seven or fifteen; and (6) damages for attorney malpractice properly include fees paid the attorney for allegedly erroneous advice, expenses for accountants hired to provide correct advice, loss of tax savings that would have been achieved had the acquisitions been properly structured, and loss of future profits on the amount paid in taxes that otherwise would have been available for investment. We affirm.

Defendant Robert Seery, a Des Moines attorney, participated in the acquisition by plaintiff corporation of Barnum Industries, an Arizona company. The controlling stockholders of plaintiff also controlled Barnum. In 1975, Barnum was losing money rapidly. A plan was evolved in which Barnum would be merged into plaintiff company, hopefully in such a way as to allow plaintiff to use Barnum's accumulated operating losses as a writeoff against plaintiff's present and future taxes.

Attorney Richard Williams, then lead partner in the firm which included

defendant and a well-known tax attorney, was a major stockholder in both plaintiff and Barnum. Defendant's contention has been that Williams evolved the plan for the tax-saving merger and that defendant merely carried it out. In any event, Williams became severely ill, and defendant took over representation of plaintiff from roughly March of 1976. The first purchase of Barnum stock had been made on September 30, 1975, when plaintiff bought 2-1/2 percent of the outstanding stock. In September of 1976 an additional 2-1/2 percent was purchased. The final decision to proceed with the acquisition was made at a board meeting on October 4, 1976. In mid-October of 1976, 80 percent of Barnum's stock was purchased. Barnum was merged into plaintiff on December 31, 1976.

At the beginning of 1977, plaintiff's accountants raised questions as to whether Barnum's net operating loss could be applied against plaintiff's profits. The accountants were concerned that Barnum might have been insolvent at the time of liquidation, a state of affairs which would prevent use of the net operating loss carry-forward. No formal determination of Barnum's solvency was ever made. Plaintiff subsequently ceased relations with defendant and employed other tax counsel. On the advice of the new tax attorney plaintiff did not claim a net operating loss deduction, but rather claimed an investment loss. Thus, it is uncertain whether plaintiff would in fact have been able to claim that net operating loss. The amount of the net operating loss was approximately $300,000 greater than the net investment loss; however, the utility of such a deduction is limited by the carry-forward for such losses. The length of the applicable period was at issue in this case. If the applicable period was five years, the additional benefit to be derived by plaintiff from having had a net operating loss available rather than the investment loss would have been $27,000. This amount is relatively small because the net investment loss was sufficient to offset nearly all of plaintiff's income for the five years after the acquisition. As a result of the expert advice not to use the net operating loss carry-forward, plaintiff felt it had

lost some benefit of the merger; it therefore instituted this suit against defendant for legal malpractice, alleging that he had failed to properly interpret section 334(b)(2) of the Internal Revenue Code dealing with the basis of property obtained in the complete liquidation of another corporation. Specifically, plaintiff alleged defendant was negligent in four ways: 1) in not informing plaintiff that the plan of acquisition which was adopted would not allow plaintiff the use of Barnum's net operating losses; 2) in not investigating alternative ways of structuring the acquisition so as to allow plaintiff's use of Barnum's losses; 3) in failing to structure the acquisition to preserve plaintiff's use of Barnum's losses; and 4) in failing to inform plaintiff that he was not qualified to give tax advice in the area of corporate acquisitions. Defendant responded that the acquisition was fraudulent and that, in any event, the acquisition plan was developed by Williams and was merely implemented by defendant.

The case was tried to a jury. Among other things, the court submitted to the jury the question of whether section 334(b)(2) was properly complied with. The jury returned a verdict for defendant. The trial court overruled plaintiff's motion for new trial; in doing so, it held as a matter of law that defendant's interpretation of section 334(b)(2) was correct. This appeal followed.

Before considering plaintiff's arguments on appeal, it may be helpful to look more closely at the relevant statute. Plaintiff's lawsuit is predicated on the claim that it was given erroneous legal advice by defendant in its attempt to acquire Barnum so as to allow it to use the rather substantial net operating losses incurred by Barnum to offset plaintiff's profits, thus reducing plaintiff's tax obligations. In order for plaintiff to be able to use Barnum's losses against plaintiff's profits, it was necessary, for technical reasons which we need not explicate here, to avoid the application of section 334(b)(2) of the Internal Revenue Code (26 U.S.C.A.

§ 334(b)(2) (1978)). At all times relevant to this lawsuit,[1] section 334(b)(2) provided as follows:

> **Exception.** If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), and if—
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> (A) the distribution is pursuant to a plan of liquidation adopted not more than 2 years after the date of the transaction described in subparagraph (B) (or, in the case of a series of transactions, the date of the last such transaction); and
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> (B) stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), was acquired by the distributee by purchase (as defined in paragraph (3)) during a 12-month period beginning with the earlier of—
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> (i) the date of the first acquisition by purchase of such stock, or
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> (ii) if any of such stock was acquired in an acquisition which is a purchase within the meaning of the second sentence of paragraph (3), the date on which the distributee is first considered under section 318(a) as owning stock owned by the corporation from which such acquisition was made,
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> then the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made. For purposes of the preceding sentence, under regulations prescribed by the Secretary, proper adjustment in the adjusted basis of any stock shall be made for any distribution made to the distributee with respect to such stock before the adoption of the plan of liquidation, for any money received, for any liabilities assumed or subject to which the property was received, and for other items.

In this case, section 334(b)(2)(B) is particularly relevant. That subsection makes section 334(b)(2) applicable when the acquiring corporation (here, plaintiff) has purchased at least 80 percent of the stock of the acquired corporation (here,

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[1] Section 334(b) was completely revised by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 224(b), 96 Stat. 488.

Barnum) within a certain twelve-month period. Therefore, since plaintiff sought to avoid the applicability of section 334(b)(2) in order to be able to use Barnum's losses, it was necessary to structure plaintiff's acquisition of Barnum so that 80 percent of Barnum's stock was not purchased within that twelve-month period. With this background in mind, we now proceed to a consideration of plaintiff's contentions.

I.

Plaintiff first claims that the trial court erred in submitting to the jury the question whether plaintiff's acquisition of Barnum was structured so that it avoided the application of section 334(b)(2). Plaintiff contends that the applicability of the statute was a legal issue to be decided by the court instead of the jury. We may assume that plaintiff is correct in asserting that the trial court should have decided this issue; however, plaintiff is not entitled to reversal if no prejudice resulted from submission of the legal question to the jury because, for example, the jury reached the correct result. 5A C.J.S. Appeal & Error § 1760 (1958); Gompert v. Frost, 188 Iowa 1039, 1046, 177 N.W. 71, 73 (1920). The jury's verdict in favor of defendant necessarily implies that the jury found that the acquisition of Barnum stock was structured so as not to come within the provisions of section 334(b)(2)—the result desired by plaintiff. We believe the jury decided this question correctly; consequently, the court committed no reversible error in submitting the statutory question to the jury.

"It is a well-established principle of statutory construction that absent clear evidence of a contrary legislative intention, a statute should be interpreted according to its plain language." United States v. Apfelbaum, 445 U.S. 115, 121, 100 S. Ct. 948, 952, 63 L. Ed. 2d 250, 257 (1980); see also State v. Sharkey, 311 N.W.2d 68, 72 (Iowa 1981). In this case, we believe it is clear that the acquisition of the Barnum stock was arranged such that it did not meet the twelve-month requirement of section 334(b)(2). Subsection B of that statute provides that at

least 80 percent of the stock must be acquired "during a 12-month period beginning with the earlier of—(i) the date of the first acquisition by purchase of such stock, or (ii) [the alternative date is not relevant in this case] . . . ." 26 U.S.C.A. § 334(b)(2)(B) (emphasis added). In other words, section 334(b)(2) does not apply in this case if plaintiff did not acquire at least 80 percent of Barnum stock within twelve months of the date of plaintiff's first acquisition of any amount of that stock. It is not disputed that the first purchase took place on September 30, 1975, when plaintiff acquired 2-1/2 percent of the stock. The next purchase did not take place until September of 1976, when another 2-1/2 percent of Barnum stock was acquired. Finally, in mid-October of 1976, plaintiff acquired 80 percent soon after which Barnum merged with plaintiff and was then liquidated. Thus, the "date of the first acquisition" of Barnum stock was September 30, 1975. The twelve-month period beginning with that date expired on September 30, 1976, by which time plaintiff had acquired a total of only 5 percent of Barnum stock. It is clear, therefore, that the twelve-month provision of section 334(b)(2)(B) was not satisfied in this case and that, in conformity with plaintiff's desire, the entire acquisition did not fall within the purview of section 334(b)(2). The fact that 80 percent was acquired at one time in October of 1976 does not bring this transaction within the statute since the relevant twelve-month period ended on September 30, 1976.

Plaintiff contends that Treas. Reg. 1.334-1(c) brings this case under the statute. That regulation reads in part as follows:

> In general, section 334(b)(2) will be applicable to a distribution in complete liquidation of a subsidiary corporation if the parent corporation purchased, within the meaning of section 334(b)(3) and during a period of not more than twelve months, 80 percent or more of the stock (other than nonvoting stock which is limited and preferred as to dividends) of the subsidiary corporation and then adopted a plan of liquidation (on or after June 22, 1954) not more than two years after the date on which the stock ownership requirement was met. (emphasis added)

Plaintiff focuses on the underlined portion of this regulation in claiming that an 80-percent acquisition within any twelve-month period will suffice to bring the transaction under section 334(b)(2). This argument, however, ignores the history of that statute and regulation. Prior to 1966, section 334(b)(2)(B) applied if 80 percent of the stock of the acquired company was purchased "during a period of not more than 12 months"; the statute did not make any provision as to when the twelve-month period was to begin. It was under this version of the statute that Treas. Reg. 1.334-1(c) was adopted. See T.D. 6500, 25 Fed. Reg. 11,633. Section 334(b)(2) itself, however, was amended by the Foreign Investors Tax Act of 1966 (Pub. L. 89-809, § 202(b), 80 Stat. 1576) which deleted the general clause "during a period of not more than 12 months" and replaced it with the specific language, referred to above, of subparagraphs (i) and (ii) of section 334(b)(2)(B)—the provisions for the determination of the date on which the twelve-month period begins to run. These specific provisions were in the statute at all times relevant to this lawsuit, but the portions of the regulation relied on by plaintiff were not and have not yet been amended to conform to the 1966 statutory amendment. Therefore, we are not inclined to give much weight to that portion of Treas. Reg. 1-334.1(c) relied on so heavily by plaintiff. "Administrative regulations are not absolute rules of law and should not be followed when they conflict with the design of the statute or exceed the administrative authority granted." Usery v. Kennecott Copper Corporation, 577 F.2d 1113, 1118 (10th Cir. 1977). This principle is especially appropriate where, as here, the statute on which the regulation was originally founded has been substantially changed but the regulation has not been amended to reflect that change.

In conclusion, we believe the jury correctly found that the timing of the plan developed for plaintiff's acquisition of Barnum's stock did not fall within the provisions of section 334(b)(2). Consequently, any error that the trial court may have committed in submitting the statutory question to the jury was harmless

since the correct result was reached in any event.

II.

Next, plaintiff argues that the trial court erred in excluding evidence of defendant's billings to plaintiff which described the work done by defendant on the Barnum acquisition. The trial court has considerable discretion in deciding to exclude evidence due to the danger of unfair prejudice; we will not interfere with the court's decision absent a showing of abuse of that discretion. Henkel v. R & S Bottling Co., 323 N.W.2d 185, 193 (Iowa 1982). We see no reason to disturb the court's decision to exclude those exhibits. The billings were ruled inadmissible after defendant's objection because, in addition to a description of the work performed by defendant, they also contained the amounts charged for those services which the court ruled were irrelevant. Plaintiff made no effort to excise the dollar amounts from the exhibits which would have rendered them admissible. In addition, the information sought from these exhibits, i.e. the nature of defendant's work for plaintiff, was presented to the jury in other forms; specifically, defendant's time slips and his own testimony which was supplemented by referring to the challenged exhibits themselves. Under these circumstances, plaintiff was not prejudiced by the court's exclusion of this evidence.

III.

Plaintiff also contends that the trial court erred in not granting its motion for a new trial because the jury's verdict in defendant's favor was allegedly contrary to the evidence. We disagree. Plaintiff claims that its undisputed expert testimony demonstrates that defendant was negligent in not properly scheduling the acquisition of Barnum stock and in failing to determine the question of Barnum's solvency—both of which were critical factors in plaintiff's ability to use Barnum's net operating losses. Plaintiff is arguing in effect that it was entitled to a directed verdict on the question of liability. We believe, however, that defendant presented sufficient evidence to generate jury questions on these issues.

Initially, we note that plaintiff's allegations of defendant's negligence are very possibly premature. Plaintiff never attempted to use Barnum's losses against its own profits; instead, it claimed investment losses on the advice of other counsel. Thus, plaintiff was never assured by the I.R.S. that the Barnum losses could not be used; plaintiff's allegations of defendant's negligence are mere speculation at this point. Had the I.R.S. specifically ruled against plaintiff on this issue, the legal malpractice claim would be on firmer ground. In any event, both defendant and his expert witness testified that the acquisition was properly timed so as to avoid application of section 334(b)(2) of the Internal Revenue Code; we have already stated our agreement with this conclusion in Division I of this opinion. There was also evidence presented that solvency involves more than looking at a corporation's balance sheet and that Barnum in fact had a number of intangible assets such as good will, patent and licensing rights, and a possible judgment in a lawsuit in which Barnum was plaintiff. Questions of negligence are usually to be left to the jury's determination; they may be decided as matters of law only in exceptional cases. Iowa R. App. P. 14(f)(10). This case is not one of those exceptions. There was sufficient evidence presented to present factual questions on defendant's liability; we cannot say that the jury's verdict is contrary to the evidence.

IV.

We finally consider plaintiff's claim that it was entitled to a new trial after allegedly improper testimony was given by Walter Brown, defendant's expert witness. Brown was asked if he had an opinion as to whether defendant acted reasonably in implementing the Barnum acquisition plan. He responded as follows:

> In order to answer that question, I would have to go into some background material on this, if I may. My discovery deposition was taken a week ago yesterday. At that time, I didn't realize I would be asked any questions in this area, because I didn't realize that counsel had put this area on my—what I was an expert to testify about.

> I told counsel for the plaintiffs at their deposition I did not contemplate doing that. In fact, I really hadn't given it any appreciable amount of thought. At that time, I answered numerous questions put to me about "would you do this, would you do that," which pertained to what I thought my level—my answers pertained to what I thought my level of conduct should be.
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> Since that deposition, I have been giving this quite a bit of thought.

Plaintiff's attorney objected on the ground that Brown had testified at the earlier deposition that he had no opinion on the reasonableness of defendant's actions. The trial court sustained the objection.

Plaintiff nevertheless argues that it was "unalterably prejudiced" by the question and partial answer given and that it is entitled to a new trial. This argument is completely without merit. First, Brown did not get to answer the question asked of him; i.e. whether defendant's conduct was reasonable. The jury therefore had no idea whether Brown thought defendant's actions were reasonable. In any event, the trial court sustained plaintiff's objection, struck the partial answer which had been given by Brown, and admonished the jury to pay no attention to that answer. Finally, Brown had previously testified without objection that defendant's implementation of the Barnum acquisition plan satisfied all of the relevant requirements of the Internal Revenue Code in light of plaintiff's objectives. Under these circumstances, plaintiff cannot seriously claim undue prejudice. There is no error.

V.

Plaintiff raises a number of issues relating to the measure and elements of damages. Since we have already determined adversely to plaintiff the issues relating to liability, we need not consider any damages issues; when a defense verdict is returned or upheld, any error in the submission of damages issues is harmless. Galbraith v. George, 217 N.W.2d 598, 603 (Iowa 1974). We find no

reason to disturb the verdict and judgment in defendant's favor. We therefore affirm.

AFFIRMED.