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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: RICHARD B. LOWE III Justice

PART 56

Sidney B. Silverman

-v-

Gregory E. Keller et al

INDEX NO. 601913/04

MOTION DATE 5/19/05

MOTION SEQ. NO. 002

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

The decision closing out motion sequence 002 in this action is amended to include the attached memorandum decision.

Dated: 8/1/05

RICHARD B. LOWE III J.S.C.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

----------X

SIDNEY B. SILVERMAN,

Plaintiff,

Index No.: 601913/04

-against-

GREGORY E. KELLER, JOHN F. HARNES,
JOAN T. HARNES, and H. ADAM PRUSSIN;

Defendants.

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RICHARD B. LOWE, III, J.

This is an application for an order compelling plaintiff Sidney B. Silverman ("Silverman") to produce the complete tax returns and financial records of the former law firm of Silverman, Harnes, Harnes, Prussin and Keller ("SHHPK").

BACKGROUND

Defendants, Joan T. Harnes ("Joan Harnes"), John F. Harnes ("John Harnes"), Gregory E. Keller ("Keller"), and plaintiff Silverman were all members of SHHPK. Joan Harnes and plaintiff Silverman founded the original firm of "Silverman and Harnes," which in the mid 1990's became SHHPK. The underlying dispute involves claims by the plaintiff, and counterclaims by the defendants, for fees earned on cases accepted by SHHPK before it was dissolved. The defendants' counterclaim centers around disputed claims of partnership, with the defendants claiming they were equity partners of SHHPK, while the plaintiff opposes those allegations.

Provident Cases

In the underlying action, plaintiff Silverman filed a complaint against the defendants to recover part of the fees awarded in two cases known as the Provident cases. In 1997, Silverman, and another lawyer Lawson F. Bernstein ("Bernstein"), was hired as counsel in a class action, by a policy holder of the Provident Mutual Insurance Company. There was an agreement to split equally any fees awarded in the Provident cases between Bernstein and SHHPK (hereinafter "original agreement"). Bernstein died sometime in 1998. Subsequently, when John Harnes and Keller left SHHPK at the end of 1999 to form a new firm, Harnes Keller LLP ("HK"), they took the Provident cases with them. Keller assumed full responsibility for the Provident actions, under a new agreement with Silverman to split fees equally between themselves.

In 2001, one of the Provident cases settled and Silverman and Keller split the fees equally. Silverman then proceeded to remit half of his share to the Bernstein heirs. The Bernstein heirs objected and filed a Federal suit against Silverman, John Harnes, Keller, SHHPK and HK, for 50% of the total fee awarded, pursuant to the original agreement (hereinafter "Bernstein dispute"). Silverman settled that suit.

The main contention of the complaint in the present case is that Silverman is entitled to part of the Provident fees that Keller retained. Silverman alleges that there exists an email agreement between him and Keller whereby Keller agreed to pay him an extra $100,000, (if the second Provident case paid a fee), for settling with the Bernstein heirs.

Plum Creek Cases

Defendants, Joan Harnes, John Harnes, and Keller, counter-sued Silverman alleging

that they are entitled to fees awarded to SHHPK in the Plum Creek Cases as well as any other profits plaintiff might have concealed. The Plum Creek fee was awarded in 1999 but was actually paid out in 2002. The defendants claim that they are entitled to fees from the Plum Creek cases, as they had worked on the case and the fee was awarded while they had an alleged partnership interest in the firm.

Current Application

In the current application, the defendants want to compel the plaintiff to produce the complete partnership tax returns and financial records for the law firm of SHHPK. Defendants allege that the partnership tax returns are necessary to establish that they were partners of the firm in the relevant years, and also to ascertain damages based on their alleged entitlement to fees received by SHHPK for the Plum Creek cases.

Both the plaintiff and the defendants agree that Joan Harnes was a partner of SHHPK from 1971 to 1992, and that she gave up her 33% partnership interest in 1992. However, plaintiff admits that in 1998 he gave all the defendants, (including Joan Harnes who had allegedly given up her percentage interest), a share in the profits of SHHPK ("1998 Bonus Plan"). Silverman claims that this "1998 Bonus Plan" did not automatically continue into future years, and was conditioned on defendants making contributions to the firm's revenue at least equal to their shares. Plaintiff Silverman further alleges that none of the defendants were ever equity partners in SHHPK, and that they were treated as employees for tax and profit sharing purposes.

Defendants deny the allegation that they were not equity partners of SHHPK. They acknowledge that John Harnes and Keller left SHHPK around the end of 1999 to form their

own firm Harnes Keller LLP ("HK"), and also admit that Joan Harnes left SHHPK in 2000 to join HK. As evidence that Joan Harnes had a partnership interest in SHHPK defendants point to an affidavit by the plaintiff to the New York City Tax Appeals Tribunal, dated November 30, 1999, stating that "Joan T. Harnes and I are and were the only partners in the law firm of Silverman, Harnes & Harnes and its successor firms."[1] Defendants also provide the K1 forms provided for Joan Harnes by SHHPK for all the relevant years. With regard to John Harnes and Keller, defendants furnish as evidence the copy of a letter by the plaintiff, dated May 16, 2000, that refers to Keller as a partner and to John Harnes as a former partner.

Plaintiff, alleging that none of the defendants were equity partners, provides:

1. An affidavit by John Harnes, about the firm Silverman, Harnes & Harnes, made to the New York City Tax Appeals Tribunal on October 7, 1999, stating: "I have, and had, no interest in the partnership or share in its profits; I have made no contribution to the firm's capital either by cash or otherwise and have had no control over the management of the firm."[2]

2. W2's for defendants Keller and John Harnes for the years 1995 to 1999, issued by SHHPK.

3. A Confidential Mediation Memorandum of Law, submitted by Keller, John Harnes

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[1] The appeal before the Tax Tribunal addressed the issue of whether John Harnes was a partner since he was issued both employee and partnership tax forms by SHHPK in 1995-96. The defendants in the present action, provide an affidavit by an accountant for SHHPK, who admits it was his mistake that led to John Harnes being issued both a W2 and a 1099 Form in 1995. The accountant affirms that John Harnes should have been issued only a form W2 as he was an employee not a partner or an independent contractor. The court notes that while the determination of the Tax Tribunal does not allow the court to decide partnership issues for the years 1999 and 2000, the affidavit by Silverman, dated November 1999, makes a claim that encompasses all years up to that date.

[2] *Supra* note 1.

and HK, to the United States District Court for the Southern District of New York in December 2001, in relation to the Bernstein dispute[3], that states in part that "Keller and Harnes in fact were not equity partners in the law firm of . . . [SHHPK], nor were they individual partners with . . . Silverman."

4. Forms K1 of defendant Joan Harnes, for the years 1990, 1999 and 2000, putting forward her percentage of profit sharing and loss sharing in SHHPK at 33.33%, 0.0000000% and 0.0000000% respectively, showing the change in her percentage interest over the years.

In opposition, defendants contend that the stated 0.0000000% profit sharing on Joan Harnes' Forms K1 is fallacious, as Silverman's own Form K1 for the year 1998 sets forth his percentage of profit and loss sharing at 0.0000000%. Defendants also assert that plaintiff has made the tax returns relevant to the action by alleging that defendants were treated as employees for tax purposes.

Procedural Issues So Far

The underlying action has involved repeated violations by the defendants of both, the court's Orders, and the Rules of the Commercial Division Justices. Plaintiff suggests that the defense disregarded the PC order because despite knowing that the discovery cut-off date was May 15, 2005, the defendants waited until the eve of the deadline (May 11, 2005), to make the motion to compel production of the complete tax returns. Plaintiff asserts that the defendants made no application to the court regarding the firm's tax returns prior to a status conference in May 2005. While the defendant's original document request did contain a request for all tax

[3] Dispute over whether the Bernstein heirs are entitled to 50% of all fees awarded in the Provident cases pursuant to the original agreement between Silverman and Bernstein.

returns, plaintiff had objected to the request on the grounds that it was over broad. Defendant argues that the original request for tax returns was not over broad, as the returns are relevant to both the issue of partnership and to the determination of damages in their counter suit based on the Plum Creek cases. A Scheduling Order in February 2005, based on the recommendation of a Special Master, led to the production of SHHPK's tax returns in redacted form.

Plaintiff also points out that the defendants have canceled, or failed to appear, for their own scheduled depositions a number of times. Additionally, dependants have failed to take Silverman's deposition before the close of discovery and the court has ruled that defendants' have waived the right to take plaintiff's deposition. Defendants have also, on multiple times, delayed their responses to plaintiff's document requests and interrogatories without asking for extensions from the court.

DISCUSSION

Because of their confidential and private nature, disclosure of tax returns is generally not favored without a strong showing of necessity (see *Nanbar Realty Corp. v Pater Realty Co.*, 242 AD2d 208, 209 (1st Dept 1997) (failing to state why partnership K1 forms were insufficient as proof of partnership led to the reversal of an order to produce the returns); *Roth v American Colonial Ins. Co.*, 159 AD2d 370, 370 (1st Dept 1990) (denying production of personal tax returns because they were not necessary or material to the case)). The party seeking the disclosure is required to make a "showing that the information contained in . . . [the] tax returns is indispensable to th[e] litigation and unavailable from other sources" (*Briton v Knott Hotels Corp.*, 111 AD2d 62, 63 (1st Dept 1985)).

Relevancy of the Tax Returns to the Defendants' Plum Creek Claim

Defendants argue that they are entitled to the complete tax returns of SHHPK because the returns are relevant to their Plum Creek claim. They allege that the statement by the plaintiff in a pre-trial memo, stating that defendants were not entitled to the "Plum Creek" fee because the firm had losses in other cases, made SHHPK's income and losses an issue in the case. Moreover, the plaintiff by claiming that the defendants were treated as employees for tax purposes made the firm's tax returns relevant to the countersuit based on the Plum Creek cases. Consequently, the defendants' claim they are entitled to the complete tax and financial records of the partnership.

"It is well settled that discovery of fiscal matters in an action for an accounting may not be obtained unless and until plaintiff has established a right to an accounting. This principle has been specifically applied in cases of disputed partnerships . . . " (*LSY International, Inc. v Kerzner*, 140 AD2d 256, 256 (1st Dept 1988) (dismissing an order that granted inspection of various sales invoices and financial statements in a suit seeking a declaration of a partnership)). To enlist the aid of an court in obtaining financial records in an accounting, a party is first required to show the existence of a partnership (*Adam v Cutner & Rathkopf*, 238 AD2d 234, 241 (1st Dept 1997)).

It should also be noted that where a party alleges a claim on the percentage of net profits, a demand to produce tax returns and financial statements should not be granted unless the right to the profits has been established (*Goldman v Salzberg*, 45 AD2d 680, 680 (1st Dept 1974)). Accordingly, it follows that the defendants don't have a right to access the financial and tax statements of SHHPK, despite their relevancy to damages under the Plum Creek

action, unless defendants' establish a rightful claim on those profits first.

Relevancy of the Tax Returns to the Partnership Issue

New York Courts have required the production of redacted tax returns where the existence of a partnership is at issue, and there are no financial statements or other documents reflecting on the issue (*Rosenfeld v Kaplan*, 245 AD2d 176, 176 (1st Dept 1997) (involving a partnership claim where plaintiff alleged that no other financial documents reflecting on the issue existed)). The income tax returns, including the Form K1, reflecting deductions for partnership expenses "may be the sole source of positive evidence of the partnership's existence" (*id.*). (*See also Gould v Sullivan*, 54 NYS.2d 430, 431 (NYS Supr. Spec. Term 1945) (granting plaintiff, who claimed a partnership existed, access to certain portions of defendant's income tax returns, where defendant claimed to have no knowledge as to the contents of his tax returns), *aff'd.*, 269 AD 736, 736 (1st Dept 1945)).

Thus, the law requires production of redacted tax returns as proof of a partnership, where there are no other financial documents or no available means by which a party can establish that the partnership existed. In the present case, plaintiff has made available all partnership and compensation agreements, subject to them being viewed in his home office. Plaintiff has also produced all redacted tax returns and K1 forms in his possession and has twice made himself available for deposition. While the plaintiff has complied with the law as it stands, there is merit to the defendants' argument that the percentage of profit sharing as determined by the K1 forms is not determinative of actual partnership interest. This is because Silverman's own 1998 Form K1 shows his percent interest at 0.0%.

Pursuant to the Uniform Partnership Act, which has been adopted in New York, all partners should have free and complete access to the books, papers, and affairs of the partnership at all reasonable times (NY CLS Partn Art. 4 §41 (2005)). (*See, e.g., Sanderson v Cooke*, 256 NY 73, 78 (1931) (holding partnership books should be kept open for inspection by general partners even after dissolution of partnership)). However, it is to be noted that, New York Courts distinguish between income partners and equity partners (with a ownership interest), stating that income partners are not entitled to an accounting (*Mazur v Greenberg*, 110 AD2d 605, 606 (1st Dept 1985), *aff'd*, 66 NY2d 927 (1985)).

Partnership Claims of John Harnes and Gregory Keller

While defendants John Harnes and Keller claim they were equity partners, there is no factual basis for this suggestion. The affidavit by John Harnes, to the New York City Tax Appeals Tribunal, dated October 1999, where he clearly states that he was never a partner at SHHPK, and W2 forms issued by SHHPK for John Harnes, are evidence that he was treated as a salaried employee. Defendant Keller likewise fails to meet the burden of proving to the court that he was a partner of SHHPK, and entitled to its tax returns. He fails to submit to the court any K1 forms which suggest profit and loss sharing. Furthermore, the W2 forms issued by SHHPK in his name clearly suggest he was a salaried employee.

The general rule is that employers are required to file W2 forms for wages paid to each employee. John Harnes and Keller received W2's for every year, from 1995 until 1999, when they left SHHPK. Additionally, neither of these defendants submitted to the court any K1 forms that suggest partnership profit and loss sharing. There is no inference of a partnership where a share of the profits is received as payment of wages to an employee (NY CLS Partn

Art.2 §11). Thus, the court finds that John Harnes and Keller were considered employees of SHHPK and any share of profits received by them was as payment of wages. Accordingly, their claims to records of the partnership are without merit.

Partnership Claim of Joan Harnes

Defendant Joan Harnes was provided Forms K1 in her name issued by the SHHPK for all the relevant years. These forms show her to be a general partner. Plaintiff asserts that Joan Harnes gave up all interest in the partnership in 1992 and points to her K1 forms which show her profit sharing interest to be 0.0% in the following years. Silverman argues that unless defendant can prove herself to be an equity partner she is not entitled to an accounting.

Under the Uniform Partnership Act, any partner has the right to a formal accounting as to partnership affairs "whenever other circumstances render it just and reasonable" (NY CLS Partn Art. 4 § 44). The right to an account of her interest shall accrue to any partner against the surviving partner continuing the business at the date of dissolution, in the absence of agreement to the contrary (*id.* at Art. 6 § 74). Furthermore, the Partnership Act states that "the receipt by a person of a share of the profits of a business is prima facie evidence that she is a partner in the business," as long as the profits were not received in payment as: debt, wages, rent, annuities to the spouse of a deceased partner, interest on loans, or, consideration for the sale of the good-will of a business or other property (*id.* at Art. 2 § 11).

However, New York distinguishes between partners who are compensated by a fixed percentage of net income and have no other financial involvement with the firm, and partners who possess an ownership interest in the firm (*Mazur* 110 AD2d at 606 (denying the action

for an accounting to a partner who had joined the firm as an associate and was given a share in the firm's profits, but had no interest in the firm's capital account)). (*See also Lynn v Corcoran*, No. 11425/92, 1994 WL 123519 *1, *2 (Sup. Ct. Nassau County Feb. 17 1994) (holding the demarcation line between equity and income partners was blurred, where there was no written partnership agreement, but the party's name appeared on the partnership title, he indemnified outgoing partners, and assumed responsibility for overhead on the partnership's lease), *aff'd*, 219 AD2d 698, 699 (2d Dept 1995)).

Here, there is no evidence of a decisive partnership agreement, and Joan Harnes who was a founding partner continued to get partnership K1 forms even after giving up her 33.33% interest in 1992. In addition, Silverman, who acknowledges himself as an equity partner, also put 0.0%, on his 1998 K1, as his percentage of profit sharing[4]. That suggests that the defendant Joan Harnes' status cannot be determined just by examining her K1 forms (*cf. Nanbar*, 242 AD2d 208, 209 (failing to state why K1 forms are insufficient proof of a partnership, does not support production of tax returns)).

Consequently, in the present case it is not clear that defendant Joan Harnes was regarded as only an "income partner" at SHHPK. However, while there may be issues about the partnership status of Joan Harnes, the law is clear that all other avenues have to be exhausted before tax returns are produced in discovery (*see Roth*, 159 AD2d 370 ("Unless there is a strong showing of necessity, the production of tax returns, because of their confidential and private nature, is not favored."); *Nanbar*, 242 AD2d at 209).

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[4] (*See* Complaint, Ex. C (Interoffice Memorandum)).

The defendants here, as a result of their own failure to depose the plaintiff on time, have waived the right to depose him. Thus, they have not made a strong showing of necessity that the partnership issue cannot be resolved without production of the complete tax returns. Even if the court were inclined to grant Joan Harnes the right to access the tax returns because of the lack of clarity of her status as a partner, the act would amount to rewarding the defendants for their inefficiencies in handling discovery.

CONCLUSION

Accordingly, for all the fore going reasons, it is hereby

ORDERED that the defendants motion to compel production of the complete tax returns of the firm is denied.

This constitutes the decision and order of the court.

DATED: August 1, 2005

ENTER:

J.S.C.

RICHARD B. LOWE III