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# Backdating.

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# Backdating

By Jeffrey L. Kwall and Stuart Duhl\*

*Backdating is a much misunderstood and largely unexplored subject. It involves a wide range of conduct, some of which is an integral part of everyday law practice. To the layperson, backdating connotes wrongdoing. The propriety of backdating, however, depends upon its purpose and effect. Every lawyer should be capable of distinguishing legitimate backdating from improper backdating. Unfortunately, the dividing line is often far from clear.*

*Little guidance exists on backdating, notwithstanding its pervasiveness, the complexity of determining its propriety, and the serious consequences of a misjudgment. An in-depth examination of the day-to-day backdating issues that most business lawyers face cannot be found in the literature. This Article begins to fill that void.*

*This Article explains the different meanings of backdating, explores the reasons why it is difficult to distinguish legitimate backdating from improper backdating, examines the impact of disclosure on the propriety of backdating, and develops an analytical approach to assist business lawyers in wrestling with the difficult situations most will confront in their daily practices. By illuminating the subject, it is hoped that this Article will begin a much-needed dialogue about backdating.*

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## INTRODUCTION

Backdating describes a broad scope of conduct ranging from blatant fraud to the common practice of executing a document sometime after the event evidenced by the document occurs. Backdating is not right or wrong per se; rather, its propriety depends upon its purpose and effect. Whether a given instance of backdating is legitimate or improper is a complex, multi-faceted question that frequently plagues lawyers.

Almost all business lawyers deal with situations where documents might be backdated. Some lawyers address these situations by carefully evaluating the legal, ethical, and moral issues each case presents; others respond to these situations in a more haphazard fashion. The stakes are high—lawyers who participate in improper backdating can be subject to disciplinary proceedings, civil claims, and even criminal prosecution.

Notwithstanding the pervasiveness and gravity of backdating, the literature is devoid of the much-needed dialogue to guide lawyers, judges, and disciplinary boards through this thicket.<sup>1</sup> Attention has been focused on high profile backdating

1. The issue is touched upon in Sheldon Banoff, *Unwinding or Rescinding a Transaction: Good Tax Planning or Tax Fraud?*, 62 *TAXES* 942, 980 (1984). None of the leading professional responsibility casebooks devote much, if any, attention to backdating. See, e.g., STEPHEN GILLERS, *REGULATION OF LAWYERS: PROBLEMS OF LAW AND ETHICS* 401–02 (7th ed. 2005); GEOFFREY C. HAZARD, JR., SUSAN P. KONIAK, ROGER C. CRAMTON & GEORGE M. COHEN, *THE LAW AND ETHICS OF LAWYERING* (4th ed. 2005); THOMAS D. MORGAN & RONALD D. ROTUNDA, *PROFESSIONAL RESPONSIBILITY* (9th ed. 2006); DEBORAH L. RHODE & DAVID LUBAN, *LEGAL ETHICS* 537–39 (4th ed. 2004); MORTIMER D. SCHWARTZ, RICHARD C. WYDICK, REX R. PERSCHBACHER & DEBRA

cases, like the recent options backdating scandal involving many large, publicly traded corporations.<sup>2</sup> But no meaningful guidance exists as to the far more common day-to-day backdating questions stemming from clients of all sizes. Every lawyer should be equipped with the necessary tools to evaluate the propriety of these everyday backdating issues.

The goals of this Article are to illuminate the subject of backdating, alert lawyers to the necessity of evaluating every backdating situation with care, and provide an analytical approach to assist lawyers in resolving backdating questions. Part I defines backdating and explains the difference between backdating that fabricates and backdating that memorializes. Part II explains that the line between fabricating and memorializing is often unclear and that, even when that line can be discerned, it does not always separate improper backdating from legitimate backdating. Part III considers whether impropriety can be averted by disclosing backdating. Part IV delineates a set of problems to which the Article's analysis is applied. Finally, Part V provides a series of guidelines intended to help lawyers navigate this minefield.

## I. IS BACKDATING WRONG PER SE?

To the layperson, backdating connotes wrongdoing. It sounds like a bad thing. Backdating is just plain wrong—right?

In fact, backdating is neither right nor wrong, *per se*. Rather, its propriety depends upon its purpose and effect. Backdating can be utilized to perpetrate a fraud or it can be employed in legitimate commercial practice. Part I explores the different meanings of backdating and distinguishes backdating that fabricates from backdating that memorializes.

### A. BACKDATING DEFINED

The meaning of the term “backdate” is far from clear. As one commentator has remarked:

It is difficult to generalize about exactly what backdating really is, since there have been significant variations in fact patterns. Indeed, much of the debate centers on which practices are legitimate and which are not.<sup>3</sup>

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LYN BASSETT, *PROBLEMS IN LEGAL ETHICS* (8th ed. 2007). Even the leading tax ethics books offer very limited coverage. See, e.g., BERNARD WOLFMAN, JAMES P. HOLDEN & KENNETH L. HARRIS, *STANDARDS OF TAX PRACTICE* § 502.2.2, at 414–16 (6th ed. 2004); BERNARD WOLFMAN, DEBORAH H. SCHENCK & DIANE RING, *ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE* 259–60 (4th ed. 2008).

2. Stock options generally allow executives and key employees of publicly traded corporations to buy employer stock at the trading price on the day the option is issued. The options backdating scandal involved dozens of public corporations that backdated options to an earlier date when the company's stock was trading at a lower value thereby allowing the recipients to buy the stock at a bargain price. See generally Victor Fleischer, *Options Backdating, Tax Shelters, and Corporate Culture*, 26 VA. TAX REV. 1031, 1037 (2007); Randall A. Heron & Erik Lie, *Does Backdating Explain the Stock Price Pattern Around Executive Stock Option Grants?*, 83 J. FIN. ECON. 271 (2007); Erik Lie, *On the Timing of CEO Stock Option Awards*, 51 MGMT. SCI. 802 (2005); David I. Walker, *Unpacking Backdating: Economic Analysis and Observations on the Stock Option Scandal*, 87 B.U. L. REV. 561 (2007).

3. Robert W. Wood, *Tax Effects of the Stock Options Backdating Flap*, 115 TAX NOTES 137, 137 (Apr. 9, 2007).

The dictionary is a logical starting point for establishing what backdating really means. And the dictionary is as far as one must go to realize that it is impossible to generalize about the propriety of backdating. Whether backdating is legitimate or improper depends upon the type of backdating involved and its potential effects.

Two principal definitions of the verb “backdate” emerge from the dictionary.<sup>4</sup> One involves the action of assigning an event “to a date prior to that of actual occurrence.”<sup>5</sup> The second involves dating a document “as of a time prior to that of execution.”<sup>6</sup> The propriety of backdating depends largely on which of the two actions has occurred.<sup>7</sup>

To the layperson, the term “backdate” typically connotes an act of fabrication—the action described by the first dictionary definition (i.e., assigning an event “to a date prior to that of actual occurrence”). If an event actually occurred on February 11, 2008, and a lawyer drafted a document stating the event occurred on December 3, 2007, the document fabricates the date of the event. The fabrication might be intended to secure a tax benefit for the lawyer’s client at the expense of the government or an economic benefit from a private party not privy to the truth. Under these circumstances, the backdating facilitates wrongdoing and is clearly improper.<sup>8</sup>

Not all backdating, however, entails a fabrication. As the dictionary reveals, backdating also describes the practice of dating a document prior to the time it is executed.<sup>9</sup> In these circumstances, the document might simply memorialize the prior event. As a matter of law, an event often occurs before the document evidencing the event can be executed.<sup>10</sup> For example, if the event in question involves reaching an agreement, the intent of the parties may control that determination and such intent can be expressed long before the document evidencing the agreement is drafted and executed.<sup>11</sup> When a document memorializes a prior event, the act of dating the document prior to the date of execution is not nefarious. Such dating is truthful because the event in question occurred on the earlier date. Indeed, the document would fabricate the date of the event if it indicated the event occurred on the execution date, rather than the earlier date on which the event actually transpired.<sup>12</sup>

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4. The term “backdate” is defined as “predate,” and the term “predate” as “antedate.” WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY, UNABRIDGED 158, 1785 (1986) (defining “backdate” and “predate” respectively). Several definitions are offered for “antedate.” *Id.* at 91. The definitions set forth in the text accompanying notes 5 and 6 are the most relevant to this discussion.

5. *Id.*

6. *Id.*

7. Both actions could occur in the same situation. Specifically, a document dated prior to the date of execution might also assign an event to a date prior to when the event occurred. For purposes of this Article, the two actions are treated as mutually exclusive.

8. See *infra* Part I.B (discussing backdating that fabricates at the expense of a third party or in violation of a law).

9. See *supra* text accompanying notes 4–7.

10. See *infra* Part I.C (discussing backdating that memorializes).

11. See *infra* Part II.A.1.a (discussing when, as a matter of law, an agreement is reached).

12. In cases where the act of execution causes the relevant event to occur, however, backdating the document would necessarily fabricate the date of the event. See, e.g., *U.S. Projector & Elecs. Corp. v. Comm’r*,

In contrast to backdating that fabricates, backdating that memorializes is an integral part of daily law practice.<sup>13</sup> Business lawyers routinely face situations where a document must be executed after an event has occurred. The remainder of Part I will illustrate the distinction between backdating that fabricates the time of an event and backdating that memorializes a prior event.

## B. BACKDATING THAT FABRICATES

A rich body of case law confirms the impropriety of backdating that fabricates at the expense of a third party or in violation of a law. In the most egregious cases, the backdating fabricates an event that never happened.<sup>14</sup> The same potential for impropriety exists, however, when the event described by the backdated document actually occurred, but subsequent to the date reflected in the document. These cases normally involve situations where the beneficiary of the backdating can reap an undeserved benefit at the expense of the government or some other third party only if the event occurred on the earlier date.<sup>15</sup> The following are but a few examples of the many cases where the time of an event was fabricated to achieve such a benefit:

- To protect real estate from the claim of a client's creditor, an attorney backdated a deed to make it appear that the property had been conveyed to the client's controlled corporation before the creditor's claim arose.<sup>16</sup> The

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28 T.C.M. (CCH) 549, 553–54 (1969) (finding that the act of executing a rescission agreement fixed petitioner's liability to return funds previously received, thus determining the timing of a tax deduction).

13. See Fleischer, *supra* note 2, at 1038 (acknowledging “the innocuous sort of ‘as of’ dating that generations engage in every day as a matter of practical necessity”).

14. See, e.g., *United States v. Wilson*, 118 F.3d 228, 231–32 (4th Cir. 1997) (involving an attorney's effort to conceal a client's assets from the Internal Revenue Service by backdating promissory notes to make it appear that the client was obligated to repay certain unconditionally received amounts); *Quick v. Samp*, 697 N.W.2d 741, 743 (S.D. 2005) (involving a malpractice suit against an attorney who backdated a document to make it appear that a corporation had assigned its rights under a contract to the corporation's sole shareholder because the attorney had erroneously named the shareholder, rather than the corporation, as the plaintiff in a breach of contract lawsuit against a third party); *Medieval Attractions N.V. v. Comm'r*, 72 T.C.M. (CCH) 924, 936–44 (1996) (involving an effort to claim tax deductions by backdating documents to make it appear that intangible property had been transferred to a related party so that payments to the related party could be treated as tax deductible royalties); *In re Boyd*, 430 N.W.2d 663, 663–64 (Minn. 1988) (involving an attorney's effort to avoid the expense and inconvenience of probate by backdating a deed conveying real property from a client's deceased father to the client who forged her father's name on the deed); *State ex rel. Counsel for Discipline of Neb. Sup. Ct. v. Rokahr*, 675 N.W.2d 117, 120–21 (Neb. 2004) (involving an attorney who, after a trust for which the client had served as a trustee terminated, backdated an easement to secure access by the client's children to property previously held in the trust); *Office of Disciplinary Counsel v. Shaffer*, 785 N.E.2d 429, 429–30 (Ohio 2003) (involving an attorney's effort to avoid the expense of guardianship for a client's incapacitated grandmother by backdating a power of attorney to a date prior to the grandmother's stroke—to which the client forged the grandmother's signature).

15. See generally *Moore v. Comm'r*, 93 T.C.M. (CCH) 1275, 1284 (2007) (“[E]ach of the . . . cases petitioners cite in support of their argument that courts uniformly disregard (and may even find fraudulent) backdated documents involves taxpayer efforts to use those documents solely in order to achieve a tax result dependent upon timely action by the taxpayer, where the time to act had already passed.”).

16. *Comm. on Prof'l Ethics & Conduct of the Iowa State Bar Ass'n v. O'Donohoe*, 426 N.W.2d 166, 169 (Iowa 1988) (involving an attorney who was disciplined for making a false statement of fact on a document filed for public record, thereby misleading opposing counsel and the general public).

backdating attempted to accelerate the transfer of the real estate by the debtor to deprive the creditor of a recovery.<sup>17</sup>

- To accelerate revenue to an earlier period on a company's financial statements, the company backdated invoices to make it appear that the revenue occurred in the earlier period.<sup>18</sup> The backdating made the company look more profitable and could have induced the purchasers of the company's stock to pay an inflated price.<sup>19</sup>
- To avoid liability under an employee health benefit plan, the president of a corporation amended the company's self-insurance plan to exclude coverage for motorcycle accidents and backdated the amendment to a date before an employee's motorcycle accident had occurred.<sup>20</sup> The backdating attempted to exclude from coverage a claim that had arisen prior to the amendment.<sup>21</sup>
- To enjoy tax-free treatment on the sale of real estate contingent on the identification of replacement property within forty-five days of the sale, documents were backdated to treat the replacement property as having been identified within the forty-five day period.<sup>22</sup> The backdating attempted to accelerate the identification date to support favorable tax treatment to which the seller was not entitled.<sup>23</sup>
- To maintain the qualification of certain employee benefit plans, an attorney backdated documents making it appear certain plan amendments were completed in a timely manner.<sup>24</sup> The backdating attempted to accelerate the amendments to avoid disqualification of the plan with the attendant adverse tax consequences.<sup>25</sup>
- In many cases, attorneys have backdated documents to make it appear that their clients' investments in property generating tax deductions were made at an earlier time.<sup>26</sup> In each of these cases, the backdating attempted

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17. *See id.* at 167.

18. *U.C. Castings Co. v. Knight*, 754 F.2d 1363, 1370-71 (7th Cir. 1985) (finding that the "jury could have found that one of the motives for the [backdating] practice was continuously to record income from the future and thus to increase profits shown so that when Universal should be offered for sale, its profits record would appear better than it really was").

19. *See id.*

20. *Confer v. Custom Eng'g Co.*, 952 F.2d 41, 42-43 (3d Cir. 1991) (involving backdating that occurred after a corporation learned it was liable for coverage because both an oral modification and a subsequent written modification were insufficient to change the terms of the plan).

21. *Id.*

22. *Dobrich v. Comm'r*, No. 98-70693, 1999 WL 650572, at \*2-3 (9th Cir. Aug. 25, 1999) (involving a taxpayer's attempt to defer gain on the sale of real estate pursuant to Internal Revenue Code section 1031).

23. *Id.*

24. *Berger v. United States*, 87 F.3d 60, 61-62 (2d Cir. 1996) (involving an employee benefits attorney who filed documents indicating his clients' pension plans were amended in a timely manner where the plans were actually amended after the deadline thereby causing the affected plans to lose qualified status for some years).

25. *See id.*

26. *See, e.g., United States v. Solomon*, 825 F.2d 1292, 1295 (9th Cir. 1987) (involving the backdating of tax shelter documents to precede the date on which the law was changed); *United States v. Drape*, 668 F.2d 22, 24-25 (1st Cir. 1982) (involving a taxpayer whose attorney, in 1977, backdated the

to accelerate the investment date to enable the clients to claim tax deductions to which they were not entitled.

All of the foregoing cases illustrate backdating that fabricated the time at which an event occurred to secure benefits to which the parties were not entitled. Such conduct is clearly wrongful. Consequently, attorneys who engage in or accommodate this conduct may be subject to disciplinary action, civil liability, and criminal prosecution.

### C. BACKDATING THAT MEMORIALIZES

When a document is drafted and executed after an event occurs but accurately reflects the earlier date on which the event actually transpired, the backdating is not a fabrication. Rather, the backdated document simply memorializes the earlier event.<sup>27</sup> The act of memorializing is sometimes not even regarded as backdating.<sup>28</sup>

The legitimacy of memorializing emerges from some simple examples. Assume a lender issues a \$5,000 check to a borrower on March 1, 2009, at which time the borrower agrees to repay the \$5,000 with 5 percent interest in one year. The parties also agree that the borrower will execute a promissory note incorporating their arrangement. Sometime thereafter, the promissory note is drafted and the borrower executes the note. Quite clearly, the loan occurs on March 1 and the promissory note should bear that date even though the note is prepared and executed at a later time.

As another example of backdating that memorializes, consider a corporate action that requires the approval of the corporation's board of directors.<sup>29</sup> Assume

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taxpayer's investment in a coal mining tax shelter to December 15, 1976, to generate deductions for the taxpayer's 1976 tax return); *Popkin v. Comm'r*, 56 T.C.M. (CCH) 294, 295-96 (1988) (involving a taxpayer who entered into leases, providing for the payment of advance royalties, that were backdated to precede the date the income tax regulations were amended to disallow the deduction of advance royalties), *aff'd*, 899 F.2d 21 (11th Cir. 1990); *Fried v. Comm'r*, 57 T.C.M. (CCH) 1300 (1989) (involving another party in *Popkin* case), *aff'd*, 954 F.2d 730 (11th Cir. 1992); *In re Spear*, 774 P.2d 1335, 1338 (Ariz. 1989) (involving an attorney/CPA who advised his client to purchase property in November 1983 from a partnership and then backdated the contract of sale to March 31, 1983, so the client could claim additional depreciation deductions); *Fla. Bar v. Adler*, 505 So. 2d 1334, 1335 (Fla. 1987) (involving an attorney who backdated a tax shelter investment to avoid a change in the tax law (enactment of the "at-risk" rules) that caused non-recourse obligations to no longer provide tax deductions for investors); *Comm. on Prof'l Ethics & Conduct of the Iowa State Bar Ass'n v. Bauerle*, 460 N.W.2d 452, 452-53 (Iowa 1990) (involving an attorney who was instructed by a client in 1982 to backdate a partnership agreement to January 1, 1981, to enable the client to claim additional depreciation deductions).

27. Parties accused of fraudulently backdating documents often defend themselves by claiming that the backdating merely memorializes a prior event. *See, e.g., Medieval Attractions N.V. v. Comm'r*, 72 T.C.M. (CCH) 924, 959 (1996) ("Petitioners attempt to justify backdating as a common practice to memorialize agreements."); *Herman v. Zatzkis*, 632 So. 2d 302, 303-04 (La. Ct. App. 1993) (involving a divorce case in which the husband (Ralph) attempted to increase retroactively the fee paid to his attorney-brother with a backdated letter where "Ralph and his attorneys contend[ed] that the letter represents only a written memorialization of what had always been the oral fee arrangement between Ralph and his brother").

28. *See infra* text accompanying notes 134-37.

29. Various corporate actions require approval of the board of directors. *See, e.g., MODEL BUS. CORP. ACT* § 8.01 (2005).



the corporation's directors convene a meeting in the presence of the corporation's attorney at which time the directors verbally approve certain corporate actions.<sup>30</sup> The minutes of the meeting might be drafted and executed weeks after the actual meeting. Nevertheless, the minutes should normally reflect the date of the meeting because that was the day the action was taken.

Courts have recognized the legitimacy of memorializing a prior act. For example, the Seventh Circuit articulated the clear distinction between backdating that fabricates to perpetrate a fraud and backdating that memorializes a prior event in *United States v. Micke*.<sup>31</sup> There, the defendant, who claimed deductions stemming from a tax shelter investment on his 1982 tax return, asserted that documents executed in January 1983 memorialized an investment made in December 1982.<sup>32</sup> Although the court affirmed a criminal fraud conviction, it explained that the backdating would have been legitimate had an agreement actually been reached in 1982:

The sole issue at trial was whether the deal had been agreed on in December or subsequently in January. If the former, the backdating was legitimate and the returns were not fraudulent; if the latter, the backdating and the returns were fraudulent.<sup>33</sup>

The Tax Court has gone so far as to treat backdating intended to memorialize a prior agreement as evidencing the existence of that agreement. In *Baird v. Commissioner*,<sup>34</sup> a taxpayer entered into a preliminary agreement to purchase property on August 29, 1970, and the deed was also dated August 29, 1970.<sup>35</sup> The deed was not executed until October 28, 1970, however, and was not recorded until November 17, 1970.<sup>36</sup> The taxpayer claimed ownership was transferred on the August 29 date stated on the deed.<sup>37</sup> By contrast, the Internal Revenue Service claimed that ownership was not transferred until the deed was recorded on November 17.<sup>38</sup>

The *Baird* court agreed with the taxpayer that ownership was transferred when the preliminary agreement was reached on August 29, stating: "It is understandable that all the details and the formal documents would require some time for preparation."<sup>39</sup> Moreover, the court determined that the backdating served as evidence of the taxpayer's intent to transfer the property on the earlier date: "The fact that the formal documents were all backdated to August 29, 1970, also supports the

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30. In the case of a closely held corporation, director approval will normally be effectuated by unanimous consent, rather than a meeting. See, e.g., *id.* § 8.21(a) (providing that "action . . . by the board of directors may be taken without a meeting if each director signs a consent describing the action").

31. 859 F.2d 473 (7th Cir. 1988).

32. *Id.* at 475-76.

33. *Id.* at 478.

34. 68 T.C. 115 (1977).

35. *Id.* at 119-21.

36. *Id.* at 120, 124.

37. *Id.* at 124.

38. *Id.*

39. *Id.* at 127-28.

conclusion that the parties intended the transaction to be closed as of that date."<sup>40</sup> The *Baird* court effectively concluded that the backdating merely memorialized a prior event; in other words, the event in question (the transfer of ownership) had occurred on the date reflected by the backdated document.<sup>41</sup>

The Internal Revenue Service has also acknowledged the legitimacy of memorializing a prior event.<sup>42</sup> In fact, the Internal Revenue Service recently affirmatively argued that a backdated document memorialized a prior event in *Moore v. Commissioner*.<sup>43</sup> That case involved a dispute as to whether a majority member of a limited liability company transferred a 10 percent interest to a minority member in 1997 or in 2000. The document conveying the membership interest was dated January 1, 1997, but was not executed until July of 2000.<sup>44</sup> Neither member apparently paid tax on the income attributable to the disputed 10 percent interest during the years at issue.<sup>45</sup> The Commissioner attempted to tax the minority member claiming that the transfer occurred on the January 1, 1997, date stated on the document:

[The Commissioner] argues that the... agreement was the means of "formalizing" [the majority member's] transfer of 10-percent membership interests in the LLC to [the minority members] effective January 1, 1997.... He argues that the... agreement was not "backdated", i.e., it "was not a document... [attempting] to change the past or... to misrepresent the past", but, rather, "was... created to formalize informal transactions that had occurred in the past".<sup>46</sup>

In agreeing with the Commissioner, the court concluded that the purpose of the agreement was "to reduce to writing a prior oral understanding among the parties."<sup>47</sup> Thus, the backdated document merely memorialized the earlier event because the transfer of the membership interest had occurred on the date reflected by the backdated document.

Part I suggests that a clear line exists between backdating that fabricates and backdating that memorializes. If a document is dated prior to the occurrence of

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40. *Id.* at 128.

41. Note that the Internal Revenue Service bore the burden of proof in *Baird* because the issue of ownership was raised late in the proceedings. *See id.* at 124. It is uncertain whether the court would have found that ownership was transferred on the earlier date if the taxpayer had borne the burden of proof.

42. *See* Crystal Tandon, *ABA Tax Section Meeting: Fraud Referral Program Paying Off, IRS Official Says*, 111 *Tax Notes* 777, 777 (May 15, 2006) ("Asked about whether backdated documents in themselves raise scrutiny, [IRS Criminal Investigation Division Chief Nancy] Jardini said that legitimate memorialization of a transaction after the fact is not CI's concern.")

43. *See* *Moore v. Comm'r*, 93 T.C.M. (CCH) 1275, 1283 (2007).

44. *Id.* at 1282.

45. The court inferred that the majority member (Dr. Joffe) did not report the income from the disputed 10 percent membership interest because "[p]etitioners' failure to question Dr. Joffe with respect to his returns or require him to produce those returns raises an inference that they would reflect Dr. Joffe's belief that he, in fact, possessed a 68-percent membership interest [rather than a 78 percent interest] as of January 1, 1997." *Id.* at 1285.

46. *Id.* at 1283.

47. *Id.*

an event, the backdating fabricates and the potential for impropriety exists. By contrast, if the document is executed after an event occurred but accurately reflects the date of the event, the backdating merely memorializes and thereby reflects the truth. Sounds simple—but maybe not. Part II will explore why it is not always so easy to distinguish legitimate backdating from improper backdating.

## II. WHY IS IT DIFFICULT TO DISTINGUISH LEGITIMATE BACKDATING FROM IMPROPER BACKDATING?

Determining whether a given instance of backdating is legitimate or improper can be complicated for three reasons. First, the line between fabricating and memorializing becomes unclear when ambiguous law governs the timing of an event or uncertain facts surround the event. Second, establishing that a given instance of backdating is a fabrication is not always determinative of its impropriety; such backdating can be innocuous when it does not compromise the rights of a third party or violate any law. Third, establishing that backdating memorializes does not necessarily establish its legitimacy; backdating that memorializes can mislead a tribunal and thereby expose a lawyer to sanctions. Part II explores the complexities associated with distinguishing legitimate backdating from improper backdating.

### A. WHETHER BACKDATING FABRICATES OR MEMORIALIZES IS NOT ALWAYS CLEAR

It is easy to determine whether backdating fabricates or memorializes if one knows with certainty when the event in question occurred. If the event occurred *on* the date stated in the document, the backdating memorializes; if the event occurred *subsequent to* the date stated in the document, the backdating fabricates.<sup>48</sup> The time at which a given event occurs can be uncertain, however, when the law governing the event is ambiguous or the facts are unclear.

#### 1. Ambiguous Law Might Govern the Time of an Event

Although backdating issues can arise in a variety of contexts, two of the most common instances involve commercial agreements and property transfers. Whether backdating fabricates or memorializes in these situations depends upon (1) when an agreement is reached and (2) when a transfer of ownership occurs. The legal standards governing these events are difficult to apply and often yield unpredictable results.

##### a. *When Does an Agreement Occur?*

The question of when, as a matter of law, a contract arises is often uncertain. Generally, an agreement will evolve over time through a series of negotiations that

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48. If the event occurred *prior to* the date stated in the document, a fabrication would also exist. That situation involves postdating, a subject beyond the scope of this Article.

may be oral and/or involve the exchange of writings.<sup>49</sup> When such negotiations culminate in an agreement, the precise date on which the agreement is reached may not be apparent.

The inability to discern the date on which an agreement is reached does not preclude the existence of a contract.<sup>50</sup> Yet, when a document encapsulating the agreement is backdated to the date the parties believe their agreement was achieved, it might be difficult to determine whether the backdating fabricates or memorializes. If the agreement occurred on the earlier date, the backdating memorializes; if an agreement was not reached until a later date, the backdating fabricates.

Identifying the date on which an agreement is reached is further complicated when the parties reach a tangible preliminary agreement before arriving at a final agreement. In these situations, it is often unclear as to whether the preliminary agreement constitutes a step in the negotiation process or instead represents an agreement that is subsequently being formalized.<sup>51</sup> If the preliminary agreement is merely part of the negotiation process, backdating the final agreement to the date of the preliminary agreement is a fabrication. By contrast, if the preliminary agreement constitutes a contract, the final agreement merely memorializes that contract. Not surprisingly, courts have reached different conclusions about the significance of preliminary agreements in factually similar cases.<sup>52</sup>

The presence of a contingency can also cloud the legal issue of when an agreement exists. A contingency might be seen as precluding a contract from arising (historically referred to as a “condition precedent”<sup>53</sup>) or, alternatively, as allowing a contract to exist but threatening its continuation (historically referred to as a “condition subsequent”<sup>54</sup>). Accordingly, when a document is backdated to a time

49. RESTATEMENT (SECOND) OF CONTRACTS § 27 cmt. a (1981) (“Parties . . . often . . . before the final writing is made . . . agree upon all of the terms which they plan to incorporate therein. This they may do orally or by exchange of several writings.”).

50. U.C.C. § 2-204(2) (2002) (“An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.”).

51. RESTATEMENT (SECOND) OF CONTRACTS § 27 (1981) (“Manifestations of assent that are in themselves sufficient to conclude a contract will not be prevented from so operating by the fact that the parties also manifest an intention to prepare and adopt a written memorial thereof; but the circumstances may show that the agreements are preliminary negotiations.”).

52. Compare *Finley v. Atl. Richfield Co.*, No. 95-7055, 1996 WL 80380, at \*2 (10th Cir. 1996) (involving a preliminary letter agreement treated as effective—even though the final settlement agreement differed in many ways—because “[t]he Settlement Principles reflected in the final document . . . remained unchanged. Additional terms were collateral or immaterial matters which did not affect the formation of a contract.”), with *Debreceni v. Outlet Co.*, 784 F.2d 13, 18–19 (1st Cir. 1986) (involving a preliminary agreement that was expressly subject to the execution of definitive documents where the court stated, “Even if we were [willing] to accept [the claim that the later, definitive agreement is] retroactively binding [between the parties to the contract], we are unwilling to go a step further and hold that parties to a contract can make it retroactively binding to the detriment of third persons not party to the contract.”).

53. Compare 13 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS §§ 38:4, 38:7 (4th ed. 2000 & Supp. 2007) (focusing on a condition precedent to the existence of contract), with *City of Haverhill v. George Brox, Inc.*, 716 N.E.2d 138 (Mass. App. Ct. 1999) (focusing on a condition precedent to liability under an existing contract).

54. See 13 WILLISTON & LORD, *supra* note 53, § 38.10, at 413 (noting that conditions subsequent are generally only subsequent in form and tend to be conditions precedent to the duty of immediate performance).

before the contingency is resolved, the backdating is a fabrication if the contingency represents a condition precedent. In this situation, no contract would have existed at the earlier time. By contrast, if the contingency represents a condition subsequent, the backdated document simply memorializes a prior event. In these circumstances, the event in question, arriving at a contract, previously occurred. Unfortunately, the distinction between a condition precedent and a condition subsequent is far from clear. As one venerable commentator has remarked, “[E]ven the best of courts sometimes exhibit confusion in determining whether a condition is subsequent or precedent.”<sup>55</sup> For all of the foregoing reasons, the law governing a backdated agreement can create confusion as to whether the backdating fabricates or memorializes.

*b. When Is Ownership Transferred?*

Backdating also commonly occurs in connection with the conveyance of property. Whether such backdating fabricates or memorializes depends upon when the transfer of ownership occurs. The principles of law governing the transfer of property ownership can be difficult to apply and may lead to uncertain results.

At first blush, the legal standard governing the point at which ownership is transferred seems reasonably clear.<sup>56</sup> As a matter of property law, ownership of real estate is transferred when the deed is executed and delivered.<sup>57</sup> Rather than focusing on property law, however, backdating cases typically involve the question of when ownership is transferred for purposes of the tax law.<sup>58</sup> These cases generally involve the efforts of purchasers to claim deductions associated with property ownership from the earliest possible date.<sup>59</sup> Although the transfer of legal title is relevant to the transfer of ownership for tax purposes, courts have often found that ownership of real property was transferred before the deed was delivered.<sup>60</sup>

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55. *Id.* at 414 (noting that the terminology has been abandoned for the most part); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 224 reporter's note (1982) (introducing the more contemporary distinction between express and implied conditions).

56. In certain cases, the standard and its application are clear. *See, e.g., United States v. Solomon*, 825 F.2d 1292, 1295–96 (9th Cir. 1987) (finding that because “patents could be assigned only in writing,” defendant's claim that parties had entered into an oral agreement was irrelevant).

57. *See* EDWARD H. RABIN, ROBERTA ROSENTHAL K WALL & JEFFREY L. K WALL, FUNDAMENTALS OF MODERN PROPERTY LAW 901–18 (5th ed. 2006). The issue of when ownership is transferred can be complex even under property law because of the passage of equitable title at the time of the agreement of sale. Under the doctrine of equitable conversion, when the purchaser and seller enter into a contract for the sale of land, the purchaser becomes the equitable owner of the land and the seller retains legal title until closing occurs. *Id.* at 1127–47.

58. The determination of tax ownership has generated significant litigation. Richard E. Marsh, *Tax Ownership of Real Estate*, 39 TAX LAW. 563, 564–65 (1986). These cases are not limited to real property. *See, e.g., H.J. Heinz Co. v. United States*, 76 Fed. Cl. 570 (2007) (stock ownership); *Georgiou v. Comm'r*, 70 T.C.M. (CCH) 1341 (1995) (stock ownership).

59. *See supra* note 26 and text accompanying notes 34–41. When income, rather than a deduction, is at issue, the purchaser can be expected to argue that ownership was transferred at a later date. *See, e.g., Moore v. Comm'r*, 93 T.C.M. (CCH) 1275, 1282 (2007).

60. *See, e.g., Comm'r v. Union Pac. R.R. Co.*, 86 F.2d 637, 638–39 (2d Cir. 1936); *Baird v. Comm'r*, 68 T.C. 115, 119–28 (1977); *Pomeroy v. Comm'r*, 54 T.C. 1716, 1724–26 (1970).

In determining when ownership of property is transferred for tax purposes, the courts consider a variety of factors. These factors include the transfer of possession, the transfer of the economic benefits and burdens of ownership, the satisfaction of conditions precedent, the existence of uncertainty regarding the property, and the payment of the purchase price.<sup>61</sup> Each of these factors presents additional complexity; for example, the transfer of possession does not necessarily occur at a single moment in time; the benefits and burdens analysis utilizes a variety of factors that can be weighed differently by different tribunals;<sup>62</sup> and the existence of conditions precedent requires distinguishing meaningful conditions from insubstantial ones.<sup>63</sup> The inconsistency with which courts apply these factors further complicates the determination of ownership.<sup>64</sup> As one commentator recently remarked, "In sum, the law of tax ownership is vast, remarkably fragmented, and thoroughly confused."<sup>65</sup> Hence, one must pinpoint an event when the law establishing that event "is a patchwork of rules that appear to lack a unifying principle."<sup>66</sup>

This section was not intended to offer a comprehensive analysis of the legal standards for determining when a specific event occurs. Its purpose is simply to highlight the ambiguity surrounding certain common legal standards that must be applied to make this determination. Regardless of how carefully a lawyer might analyze the law in these areas, uncertainty will often exist as to when the event in question actually occurred. When the timing of the event is unclear, determining whether the backdating fabricates or memorializes is no longer a simple matter.

## 2. Relevant Facts May Be Uncertain

Even when the relevant law is clear, the timing of an event will depend upon the particular facts and circumstances. Unfortunately, ambiguous facts frequently make it difficult to discern the precise time an event occurs. Often, traces of evidence will exist suggesting an event occurred prior to the time of formal documentation. If this evidence is sufficient to establish a fact, backdating the document memorializes the event. If the evidence is insufficient, however, the backdating might fabricate the time of the event. Factual uncertainty can result from ambiguous records, limits on one's ability to recollect past observations, and reliance on the observations of others.

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61. See Alex Raskolnikov, *Contextual Analysis of Tax Ownership*, 85 B.U. L. Rev. 431, 460–65 (2005). See also Banoff, *supra* note 1, at 980 ("[O]ne should consider backdating a document only where the dating is consistent with the parties' intent. In such case, it is, of course, necessary for the parties to allocate the benefits, and suffer the burdens, of ownership as of that earlier date, i.e., give economic effect to the earlier date.")

62. Burdens of ownership include the risk of loss and liability for real estate taxes while benefits usually include the right to use the property, the profits from that use, and any appreciation in the value of the property. See Marsh, *supra* note 58, at 575.

63. See Raskolnikov, *supra* note 61, at 463–64 (discussing that when "a meaningful condition precedent has not been fulfilled, the contract . . . will remain executory," while "an insubstantial condition will not delay the sale").

64. *Id.* at 434, 514–16.

65. *Id.* at 515.

66. *Id.* at 432.

a. *Ambiguous Records*

Case law reveals that an ambiguous record can create uncertainty as to whether an event actually occurred before it was documented. For example, in *In re Jagiela*,<sup>67</sup> an attorney drafted an agreement in September and October 1990 to share proceeds of a settlement judgment.<sup>68</sup> The agreement was executed in October 1990 but backdated to August 18, 1988.<sup>69</sup> The backdated agreement was based on an amalgamation of at least five documents drafted prior to August 18, 1988, and the attorney claimed the agreement “merely memorialized a prior oral agreement between the signatories made on or before August 18, 1988.”<sup>70</sup>

The *Jagiela* court found as follows: “It appears from the record that the back-dated agreement may well have memorialized a prior oral agreement, at least to some extent.”<sup>71</sup> The court nevertheless concluded the event did not occur on the earlier date and the attorney’s actions warranted discipline.<sup>72</sup> Although *Jagiela*’s course of conduct appeared egregious,<sup>73</sup> the court’s acknowledgment that the agreement “may well have” memorialized a prior oral agreement<sup>74</sup> illustrates how conflicting evidence can create uncertainty as to the actual time of a specific event.<sup>75</sup>

b. *Limits on One’s Ability to Recollect*

The complexity presented by factual uncertainty is even more problematic than case law suggests. The cases reflect a static picture—the court has sifted through oral testimony and documents and created a snapshot of an event that may or may not be accurate. The accuracy of those findings is far from clear because no “omniscient observer” exists who witnesses all events and can relate the details of each event with perfect accuracy. Thus, it is necessary to rely upon human observation to establish when events occur.

Countless studies reveal that human recollection even by the most forthright individual under the best possible circumstances is far from accurate.<sup>76</sup> Distortions

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67. 517 N.W.2d 333 (Minn. 1994).

68. *Id.* at 334.

69. *Id.* at 334–35.

70. *Id.*

71. *Id.* at 335.

72. *Id.* at 336.

73. *Id.* at 334 (indicating *Jagiela* falsely stated in a brief and in pleadings that the agreement had been executed in 1988, rather than 1990).

74. *Id.* at 335.

75. See also *Pittsburgh Realty Inv. Trust v. Comm’r*, 67 T.C. 260, 280–81 (1976). This case involved a factual question as to whether a corporate liquidation occurred on September 30, 1968—resulting in no tax liability—or on October 4, 1968—resulting in a significant tax liability. *Id.* at 278–79. Ultimately, the court determined that the liquidation occurred on the later date, notwithstanding the existence of documents suggesting the liquidation occurred on the earlier date. *Id.* at 280. These documents included the deed conveying the corporation’s property to its shareholders, the closing sheet, the IRS Form 966, and the articles of dissolution filed with the state. *Id.*

76. Daniel L. Schacter, Kenneth A. Norman & Wilma Koutstaal, *The Cognitive Neuroscience of Constructive Memory*, 49 ANN. REV. OF PSYCHOL. 289, 290 (1998) (noting that since 1932 psychological studies have indicated that memory is not an exact reproduction of events, rather it is a constructive process that can be distorted).

in memory range from slight modifications of the actual event to the construction of memories of events that never occurred.<sup>77</sup> Both internal sources and external influences at the time of encoding and retrieval of memories affect the accuracy of recollection.<sup>78</sup> For instance, providing subsequent suggestions or new information can completely distort someone's original memory.<sup>79</sup> Considering that ideal circumstances rarely exist and that even a person with the best of intentions will likely resolve uncertainties in his or her favor in at least some cases,<sup>80</sup> the prospect of discerning an accurate set of "facts" is often dim.

*c. Reliance on the Recollections of Others*

In many situations, a lawyer must deal with facts that the lawyer does not observe firsthand. Rather, the lawyer must rely on the recollections or statements of others. Such reliance poses a whole host of problems requiring difficult judgments to be made.

A lawyer is likely to have a unique relationship with each client. The lawyer might have a long history with some clients, dealing with them on a continuing basis and observing them in both business and social situations. Other clients will likely be newer, dealt with infrequently, and only in a professional capacity. If a history of interactions exists, the lawyer might be in a better position to judge the integrity of the client; however, an attorney's ability to ascertain the veracity of any client's words in a given case is likely to be limited.

Assume that a lawyer meets with a client on January 15, 2009, at which time the client indicates he purchased an interest in a partnership on December 15, 2008. If the purchase actually occurred on December 15, assume the client would be entitled to claim a significant amount of tax deductions on the client's 2008 tax return. The client asks the lawyer to prepare documents dated December 15, 2008, evidencing the investment. The client and the seller of the investment will then execute the documents. What should the lawyer do?

Quite clearly, the lawyer should not prepare the documents unless the lawyer can confirm that the purchase actually occurred on December 15. By preparing the documents, the lawyer can be regarded as having made the judgment that the client's statement is true.<sup>81</sup> If the lawyer misjudges the client's veracity, he or she could be subject to severe sanctions, including criminal prosecution, for participating in a fraudulent transaction. In attempting to evaluate the claims of the

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77. See Giuliana Mazzoni & Manila Vannucci, *Hindsight Bias, The Misinformation Effect, and False Autobiographical Memories*, 25 SOC. COGNITION 203, 208–09 (2007).

78. See Valerie F. Reyna, Robyn Holliday & Tammy Marche, *Explaining the Development of False Memories*, 22 DEVELOPMENTAL REV. 436, 441–42 (2002). See also Mazzoni & Vannucci, *supra* note 77, at 211 (stating that factors such as familiarity, plausibility, and memorability of an event as well as social variables can cause people to have biased recollections and false memories).

79. Mazzoni & Vannucci, *supra* note 77, at 205.

80. See Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 REV. OF GEN. PSYCHOL. 175, 178 (1998).

81. In an analogous situation, a lawyer who prepares a will for a testator of uncertain ability can be regarded as having made the judgment that the testator is competent.



client, the lawyer should examine the cancelled check evidencing the investment, learn the identity of all parties present at the December 15 meeting, confirm that all such parties can verify the purchase terms that were agreed upon at that meeting, and secure any additional evidence demonstrating that an investment was actually made on December 15.

Depending upon the lawyer, dramatic variations will likely exist regarding how deeply the lawyer will dig for evidence, how closely the lawyer will examine the evidence, and how much uncertainty, if any, the lawyer will tolerate to be willing to draft the documents. Lawyers will likely rely heavily on past history with the client in judging whether the client's story is true and the extent to which extrinsic evidence should be sought. If the matter involves a new client and no past opportunities to evaluate the client's forthrightness exist, most lawyers will likely reject the request to draft the documents, unless strong independent evidence exists corroborating the client's story. It will probably be much more difficult for the lawyer to reject the request of an existing client, particularly when a history of interactions exists that bolsters the lawyer's confidence that the client is telling the truth.<sup>82</sup> Even when such a history exists, however, the lawyer must recognize the limits on his or her ability to assess the client's veracity in any given case.

There is no clear answer as to what the lawyer should do in this situation.<sup>83</sup> If the client's story is in fact true, the lawyer can draft the necessary documents to memorialize the transaction. In most cases, however, some degree of uncertainty will exist as to whether the story is true and as to how a tribunal would resolve the question.

Regardless of how carefully the lawyer assesses the facts, if the lawyer erroneously concludes that the client is telling the truth, the lawyer must be prepared to pay a heavy price for having participated in a fabrication that defrauded the government. Because these situations are very dangerous, the prudent lawyer will refrain from participating when any doubt exists about the truthfulness of the client's story. Ambiguous facts frequently make it difficult for the lawyer to know precisely when an event occurred, thereby compromising the attorney's ability to evaluate whether backdating fabricates or memorializes.

## B. BACKDATING THAT FABRICATES CAN BE INNOCUOUS

Even when it can be determined that backdating fabricates rather than memorializes, uncertainty still might exist as to the propriety of the backdating. Whether

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82. Most lawyers will likely be concerned about the loss of future business from an existing client whose credibility is being questioned.

83. See 31 C.F.R. § 10.37 (2008) (Circular 230) (stating a practitioner should not give tax advice that "unreasonably relies upon representations . . . of the taxpayer or any other person [and] does not consider all relevant facts that the practitioner knows or should know"); *id.* § 10.33 (listing best practices, which include "evaluating the reasonableness of any assumptions or representations"). *But see* Louis Mezzullo, *College of Tax Counsel Criticizes Sweep of Circular 230 Amendments*, 2005 LEXIS TNT 111-18 (June 10, 2005) (criticizing section 10.37 of the Circular 230 Regulations as "vague in its application" and opining that "[p]ractitioners should not be required to independently verify that the facts and statements provided by a client are correct if they appear to be reasonable").

backdating that fabricates is wrongful depends upon the purpose and effect of the backdating. In most cases, such backdating is improper because it is utilized to deceive a third party to extract an undeserved benefit.<sup>84</sup> In other cases, however, such backdating might be utilized to implement an economic arrangement between two consenting parties where no intent exists to harm a third party, no third party's rights are adversely affected by the backdating, and no law is violated. In the latter cases, the backdating can be innocuous.

As a matter of law, the parties to an agreement can make their agreement effective on whatever date they wish, provided no third party rights are compromised by the action.<sup>85</sup> Hence, if a prospective employee who is to commence employment in March persuades her employer to pay her what she would have earned had she been employed since January, the parties may agree to that result by backdating their agreement to January 1 as long as no third party rights are compromised and no law is violated. Similarly, a landlord holding property in high demand might negotiate an agreement with a prospective tenant whereby, pursuant to a lease negotiated in March, the tenant agrees to pay the landlord the rents that would have been due for January and February had the lease begun in January. Here again, the parties might implement their agreement by backdating the lease provided no third party's rights are compromised and no law is violated.<sup>86</sup>

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84. See *supra* Part I.B (illustrating when backdating that fabricates is improper).

85. See 2 WILLISTON & LORD, *supra* note 53, § 6:61, at 895 (“[I]t seems clear that, where the parties themselves agree that a contract between them should be given effect as of a specified date, *absent the intervention of third-party rights*, there is no sound reason why that agreement should not be given effect.” (emphasis added)). Courts often acknowledge and follow this rule. See, e.g., *Viacom Int'l Inc. v. Tandem Prods. Inc.*, 368 F. Supp. 1264, 1270 (S.D.N.Y. 1974) (stating, “as a general rule[,] when a written contract provides it shall be effective ‘as of’ an earlier date, it generally is retroactive to the earlier date”), *aff'd*, 526 F.2d 593 (2d Cir. 1975); *Du Frene v. Kaiser Steel Corp.*, 231 Cal. App. 2d 452, 458 (Dist. Ct. App. 1964) (finding that an agreement applied to an accident occurring on November 6, where the agreement stated it was “approved and accepted” as of November 4, even though it was dated November 15 and presented for signature on November 22); *Am. Cyanamid Co. v. Ring*, 286 S.E.2d 1, 3 (Ga. 1982) (stating that “the effective date of a contract is not the date of execution where the contract expressly states that its terms are to take effect at an earlier date”); *Buffalo Police Benevolent Ass'n v. Buffalo*, 114 Misc. 2d 1091, 1092–93 (Erie Co. Ct. 1982) (treating a collective bargaining agreement as effective on its stated effective date of July 1, 1980, notwithstanding the court's acknowledgment that execution did not occur until February 10, 1982, and that the “parties were without an agreement from July 1, 1980, to February 10, 1982”). *Cf.*, e.g., *Pittsburgh Realty Inv. Trust v. Comm'r*, 67 T.C. 260, 280 (1976) (stating that “[i]n a business context, where both parties to a transaction are agreed, the custom of backdating documents or dating them ‘as of’ a prior date may be acceptable”); *SEC v. Solucorp Indus. Ltd.*, 197 F. Supp. 2d 4, 11 (S.D.N.Y. 2002) (stating that “[w]e do not dispute that certain contracts may be legitimately backdated”). The Supreme Court has tacitly approved of a dating pattern appearing to involve a fabrication. See *Comm'r v. Phila. Transp. Co.*, 174 F.2d 255, 256 (3d Cir. 1949), *aff'd per curiam*, 338 U.S. 883 (1949). This case involved a corporation that did not come into existence until January 1, 1940, but issued bonds dated January 1, 1939, bearing interest from that date. *Id.* at 255. The court acknowledged this dating occurred “for reasons best known to management,” sanctioned the corporation's deduction of the 1939 interest in 1940, and determined that the corporation was satisfying its own obligation, not that of another party. *Id.* at 256.

86. Retroactivity is a two-edged sword, however. If retroactivity harms the parties involved, courts have been willing to enforce the harm. See, e.g., *Am. Cyanamid Co.*, 286 S.E.2d at 2–3 (involving an indemnification agreement that was executed on July 15, 1975, but was held to be effective “as of July 1, 1975”—the effective date stated in the agreement. This caused American Cyanamid to be held liable for the death of an employee five days before the agreement was executed.); *Diamond Int'l*

Although the recent options backdating scandal clearly involved wrongdoing, litigation related to that scandal illustrates how backdating that fabricates can be innocuous. The scandal stemmed from the backdating of options issued by certain publicly traded corporations to a date when each company's stock was trading at a lower price.<sup>87</sup> By allowing the recipient of the option to purchase shares at the trading price on the earlier date, an economic benefit was conferred on the recipient.<sup>88</sup> For example, assume that a company issues an option to purchase 1,000 shares of stock to an employee on December 15 when the market value of the employer's stock is \$100 per share. Further assume that the option permits the employee to purchase the shares at a price of \$70 per share and is backdated six months to June 15 when the market value of the stock was actually \$70. In effect, the employee enjoys a potential \$30,000 benefit by virtue of being allowed to purchase stock with a value of \$100,000 at a price of \$70,000.<sup>89</sup>

As a general matter, no prohibition exists on the form of an employee's compensation and nothing precludes the parties from utilizing a fiction to quantify the desired level of compensation.<sup>90</sup> Presenting that fiction as fact to third parties, however, is clearly improper when doing so adversely impacts the rights of a third party or violates a law.<sup>91</sup> The backdating of options was improper because the action was reported to regulatory authorities as if the options had actually been issued on the earlier date, thereby violating accounting rules, securities laws, and tax laws.<sup>92</sup> But, as a federal district court recently clarified:

The practice of backdating a stock option occurs when persons responsible for the timing, pricing and/or approval of a stock option grant retroactively set the exercise price for the option based on a date other than the date on which the option was actually granted. . . . However, *the practice is not improper, in and of itself*, provided it is: 1) fully disclosed to necessary parties, including securities and tax authorities, corporate directors and shareholders; [93] 2) properly accounted for under Generally Accepted Accounting Principles ("GAAP") in the company's financial disclosures to shareholders, the SEC and other regulatory agencies; 3) correctly taxed at both the company and grantee levels; and 4) permitted under the company's by-laws and/or shareholder-approved stock option plans.<sup>94</sup>

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Corp. v. Glad, 330 N.W.2d 526, 526–27 (S.D. 1983) (involving a partnership agreement restated in October 1978 to convert Glad's status from a limited partner to a general partner retroactive to March 1978, pursuant to which Glad was held responsible for a claim that arose in September 1978 when he was a limited partner).

87. See *supra* note 2.

88. By treating the options as having been awarded on an earlier date when the stock price was lower, the options are "in the money" on the date they are actually received. See Fleischer, *supra* note 2, at 1036–39; Walker, *supra* note 2, at 570–73.

89. [ $\$100 \text{ per share value} \times 1,000 \text{ shares}$ ] - [ $\$70 \text{ per share price} \times 1,000 \text{ shares}$ ] = \$30,000.

90. The statement in the text assumes that no relationship exists between employer and employee that might activate regulatory rules restricting their arrangement.

91. See *supra* Part I.B (illustrating when backdating that fabricates is improper).

92. See Walker, *supra* note 2, at 567–70.

93. See *infra* Part III for a discussion of the relevance of disclosure to the propriety of backdating.

94. *In re Computer Sciences Corp.*, No. CV 06-05288, 2007 WL 1321715, at \*2 (C.D. Cal. Mar. 26, 2007) (emphasis added). See Fleischer, *supra* note 2, at 1034 n.7 (acknowledging that options

In essence, as long as an economic arrangement based on a fiction does not adversely impact the rights of third parties or violate any law, the use of a fiction to implement the economic goals of the parties can be innocuous.

The foregoing analysis reveals that backdating that fabricates can be innocuous only if the backdating has neither a bad purpose nor a bad effect. In most cases, it should be clear whether a bad purpose exists. If the backdating is utilized to deceive a third party in order to extract an undeserved benefit, the purpose is bad and the action is clearly improper.<sup>95</sup> Alternatively, if the backdating is utilized to implement the economic interests of the parties to the arrangement with no intent to harm a third party, the purpose is not objectionable. Nevertheless, the backdating would still be improper if it adversely affected the rights of a third party or violated a law.

Determining whether the rights of third parties might be adversely affected by backdating can be extremely difficult for several reasons. First, in some cases, it will be difficult, if not impossible, to identify the universe of private rights that might be adversely impacted by the backdating. At a minimum, the interests of owners, investors, creditors, and employees must be considered. Second, in addition to private rights, the interests of all levels of government must be considered. Finally, even if all relevant private and public third parties can be identified, it can still be difficult to assess whether the backdating has an improper effect. For example, if the federal, state, or local taxation of one or more of the parties to the backdating is impacted by the fabrication, it might be difficult to assess whether the backdating results in illegal tax evasion.<sup>96</sup> Consequently, although backdating that fabricates can theoretically be innocuous, it will often be difficult for the attorney to make this judgment.

Backdating that fabricates the date of an event might sometimes be the simplest way for the parties to implement an economic arrangement and minimize the resulting legal fees. In these situations, the client might exert pressure on the lawyer to utilize a fabricated date. It is critical, however, for the lawyer to realize that the absence of any bad intent on the part of the parties does not render the backdating innocuous. Unless the lawyer is confident that the fabricated date violates no law and does not adversely impact the rights of any third party, the lawyer should not succumb to the temptation posed by ease and economy.

When evaluating whether backdating that fabricates might adversely impact the rights of third parties, the lawyer should assume that every backdated document will be discovered by any interested third party. Regardless of how remote that prospect might seem, a future controversy can always arise and cause a backdated document to surface. Hence, a lawyer should not participate in such backdating unless the lawyer is prepared to defend the document in a truthful and forthright manner.

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backdating would be "perfectly acceptable" under the conditions set forth by the *In re Computer Sciences Corp.* court, though "I have yet to hear about any companies that followed this path").

95. See *supra* Part I.B (illustrating when backdating that fabricates is improper).

96. In this regard, all types of taxes must be considered, including income taxes, transfer taxes, and property taxes.

In sum, backdating that fabricates can be innocuous if the backdating has neither a bad purpose nor a bad effect. Before concluding the backdating is innocuous, the attorney must be extremely careful to assess whether the rights of any third party might be adversely impacted, or any law is violated, by the backdating. An attorney who fails to anticipate a harm that materializes could suffer severe consequences by participating in the backdating.

### C. BACKDATING THAT MEMORIALIZES CAN BE PROBLEMATIC

In contrast to backdating that fabricates, backdating that memorializes is normally regarded as a legitimate practice. Often, it is not feasible to document an event contemporaneously with its occurrence. Rather, the event will be documented at a later time and the document will be backdated to the date the event actually occurred. Though this action may seem appropriate, the act of memorializing can expose a lawyer to sanctions if it supports the inference that the document was executed when the event occurred, rather than at a later time.

A classic example of problematic memorializing emerges from *In re Stern*.<sup>97</sup> In *Stern*, an Illinois lawyer was censured for backdating a document that accurately reflected the date the event had occurred. Pursuant to a 1981 divorce, Stern was required to maintain health insurance for his ex-wife and children.<sup>98</sup> On December 7, 1982, Stern procured a new health insurance policy that the insurance agent indicated would be effective immediately.<sup>99</sup> As such, Stern permitted the old policy to lapse.<sup>100</sup> When Stern's ex-wife learned that the old policy had lapsed, she petitioned the court to find Stern in contempt for failing to maintain insurance.<sup>101</sup> On January 10, 1983, Stern learned that the agent who sold Stern the new policy had been mistaken about its effective date and that a lapse in coverage had occurred.<sup>102</sup>

On January 11, 1983, the date on which Stern was to appear before the court, Stern allegedly told the insurance agent to prepare a letter on the agent's stationery accurately stating that the agent had told Stern the new policy was effective on December 7.<sup>103</sup> The January 11 letter was backdated to December 15.<sup>104</sup> The agent brought the letter to court and showed it to Stern and Stern's attorney.<sup>105</sup> Stern's attorney showed the letter to Mrs. Stern's attorney who examined the insurance agent about the letter.<sup>106</sup> The agent initially falsely testified that he had written the letter on December 15 but then admitted that the letter had been backdated.<sup>107</sup>

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97. 529 N.E.2d 562 (Ill. 1988).

98. *Id.* at 563.

99. *Id.*

100. *Id.*

101. *Id.* at 563–64.

102. *Id.* at 564.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

The Review Board of the Illinois Attorney Registration and Disciplinary Commission found that Stern's conduct violated disciplinary rules prohibiting "conduct involving dishonesty, fraud, deceit or misrepresentation," "knowingly mak[ing] a false statement of law or fact," and conduct "which tends to defeat the administration of justice or to bring the courts or the legal profession into disrepute."<sup>108</sup>

The *Stern* court agreed with the review board that Stern had violated disciplinary rules even though the letter in question merely memorialized a prior event. The court stated, "While the actual contents of the letter were true, an element of dishonesty and deceitfulness exists because of the false date the letter bore."<sup>109</sup> Moreover, the court rejected Stern's argument that the evidence failed to establish an improper motive for the backdating. Rather, the court held that intent can be inferred from surrounding circumstances.<sup>110</sup> Specifically, the court reasoned that the letter must have been created to strengthen Stern's case because he directed that it be created and that it be brought to the court.<sup>111</sup>

The *Stern* case demonstrates that attorney disciplinary rules prohibiting dishonesty and deceit can potentially be violated even in the absence of any intent to do harm. The attorney disciplinary codes of most jurisdictions have rules similar to the Illinois rule applied in *Stern* that prohibit conduct involving "dishonesty, fraud, deceit or misrepresentation."<sup>112</sup> These rules do not generally address the lawyer's mental state.<sup>113</sup> The cases where attorneys have violated these rules typically involve blatant misconduct with respect to which the attorneys' intent and

108. *Id.* (internal quotation marks omitted). Each of these disciplinary rules has been codified in substantial part by the Model Rules of Professional Conduct and the Model Code of Professional Responsibility, one or the other of which has been adopted by most states. See AM. BAR ASS'N & BUREAU OF NAT'L AFFAIRS, ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT § 1:3 (2008). Model Rule 8.4(c) and its corollary DR 1-102(A)(4) prohibit attorneys from engaging in "conduct involving dishonesty, fraud, deceit or misrepresentation." *Id.* § 101:401. Model Rule 3.3(a)(1) and its corollary DR 7-102(A)(5) prohibit attorneys from "knowingly mak[ing] a false statement of fact or law [to a tribunal]." *Id.* § 61:301. Model Rule 8.4(d) and its corollary DR 1-102(A)(5) prohibit attorneys from engaging in "conduct that is prejudicial to the administration of justice." *Id.* § 101:501.

109. *Stern*, 529 N.E.2d at 564-65.

110. *Id.* at 565.

111. *Id.* at 564-65.

112. See, e.g., MODEL RULES OF PROF'L CONDUCT R. 8.4(c) (2006). Model Rule 8.4(c) has been adopted by each of the forty-seven states that have adopted the Model Rules of Professional Conduct, and a similar rule is employed by the minority of states that have adopted the Model Code of Professional Responsibility. See ABA & BUREAU OF NAT'L AFFAIRS, *supra* note 108, §§ 1:3, 101:401.

113. The Model Rules of Professional Conduct define "fraud" as "conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive." MODEL RULES OF PROF'L CONDUCT R. 1.0(d) (2006). States that have adopted the Model Rules similarly require that the attorney have a "purpose to deceive" to sustain a fraud charge. See, e.g., ARIZ. RULES OF PROF'L CONDUCT 1.0(d); ILL. RULES OF PROF'L CONDUCT, Terminology; PA. RULES OF PROF'L CONDUCT 1.0(d). The Model Rules shed no light on the requisite mental state for dishonesty, deceit, or misrepresentation, and the law varies from state to state. Compare *Florida Bar v. Fredericks*, 731 So. 2d 1249, 1252 (Fla. 1999) ("In order to find that an attorney acted with dishonesty, misrepresentation, deceit or fraud, the Bar must show the necessary element of intent."), with *Parsee v. Statewide Grievance Comm.*, No. CV88-0348079, 1993 WL 137568, at \*3 (Conn. Super. Ct. 1993) (stating that "[t]here is no requirement under rule 8.4(c) that the prohibited misrepresentation be intentional. . . ; in general, legal liability for misrepresentations rests on false statements made either intentionally or negligently" (emphasis added)).

improper motive are evident.<sup>114</sup> Nevertheless, a violation of the rule might be established without direct proof of bad motive or intent.<sup>115</sup>

Although *Stern* suggests that backdating that merely memorializes a past event can cause a lawyer to be sanctioned for dishonest conduct, this threat should materialize only if the backdated document becomes the subject of legal proceedings.<sup>116</sup> In the vast majority of situations, documents that memorialize events will never be seen by anyone other than the parties executing those documents and their advisors. Nevertheless, the possibility of a future controversy always exists and, therefore, *any* backdated document might someday appear before a court.<sup>117</sup> The lawyer therefore must always be prepared to defend every backdated document in a truthful and forthright fashion.

Courts are likely to have little tolerance for any backdated document that can potentially mislead and adversely impact the integrity of the court's fact-finding function. The lawyer who drafts such a document must therefore ensure that the document does not support the inference that it was executed on the date of the event when it was actually executed on a later date. Thus, whenever a document is intended to memorialize an event, the lawyer should have the foresight to make adequate disclosure of the backdating to deter any inference that the document was executed on the date of the event.<sup>118</sup>

Part II has demonstrated that it is often difficult to determine the propriety of backdating. In many cases, it will be unclear whether backdating fabricates or memorializes because complex law and ambiguous facts can cloud the time that the event actually occurred. Moreover, when backdating in fact fabricates the date of an event, the backdating might be innocuous if it neither adversely affects the rights of any third party nor violates any law. By contrast, backdating that in fact

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114. See, e.g., Fla. Bar v. Adler, 505 So. 2d 1334, 1335 (Fla. 1987) (disciplining attorney for backdating documents to precede a change in the law that eliminated certain tax deductions). See also *In re Brown*, 766 N.E.2d 363, 364 (Ind. 2002) (disciplining an attorney for forging his client's signature on a check and stealing a portion of his client's settlement); *In re Perrini*, 662 N.Y.S.2d 445, 448 (App. Div. 1997) (disciplining attorney for backdating letter submitted to bankruptcy court because he failed to file timely proof of claim); *In re Graham*, 503 N.W.2d 476, 477 (Minn. 1993) (disciplining attorney for submitting backdated documents to the bankruptcy court to conceal his assets from creditors).

115. Even in Illinois, the jurisdiction where *Stern* was decided, some confusion exists about the standard. See *In re Howard*, No. 96 CH 531, 1998 WL 772167, at \*8 (Review Bd. of the Ill. Attorney Registration & Disciplinary Comm'n June 4, 1998) ("[While Rule 8.4(a)(4)'s statement] that 'a lawyer shall not engage in dishonesty, fraud, deceit or misrepresentation' . . . appears to be aimed at intentional acts of deception, our review of relevant cases provides no clearcut statement as to the requirements of the rule. Some cases have premised a violation of Rule 8.4(a)(4) on a finding of dishonest motive. Conversely, this Board has stated that 'a violation of Rule 8.4(a)(4) can be found even without proof that anyone was actually deceived' and 'malice is not an element the [a]dministrator must prove.'" (citations omitted)).

116. The American Bar Association has suggested that an attorney be admonished for submitting false statements to a court that cause little or no harm or adverse consequences to a party. AM. BAR ASS'N, ABA STANDARDS FOR IMPOSING LAWYER SANCTIONS, Standard 6.14 (1992).

117. For example, a party who originally consented to the arrangement might have second thoughts resulting in a dispute that causes the backdating to surface. See, e.g., *Moore v. Comm'r*, 93 T.C.M. (CCH) 1275, 1284-85 (2007) (discussing dispute between members of LLC as to when a transfer of membership interests occurred).

118. The mechanics of disclosure are explored in Part III.

memorializes an event can be problematic if it supports the inference that the document was executed on the earlier date of the event. Part III will examine whether disclosure can eliminate the uncertainties that impact the propriety of backdating.

### III. DOES DISCLOSING BACKDATING PROTECT AGAINST IMPROPRIETY?

As discussed in Part II, backdating, even in its most benign form, can potentially mislead a court or some other third party into believing a document was executed on an earlier date. To mitigate this possibility, backdating should always be disclosed. Part III examines the impact of disclosure and analyzes two disclosure methods; namely, identifying the date the document was executed and utilizing “as of” dating.

#### A. THE IMPACT OF DISCLOSURE

When a document memorializes an earlier event and, therefore, is backdated to the date of the event, the document might mislead a court or government agency into believing it was executed on the date the event occurred.<sup>119</sup> This possibility should generally be foreclosed, however, when the backdated document reveals on its face that it was executed after the stated date of the event. Hence, disclosure should normally solve any potential problem posed by backdating that memorializes a prior event.

When a backdated document fabricates the time of an event but is not intended to harm a third party, the backdating is nevertheless improper if a third party's rights are in fact compromised or a law is violated.<sup>120</sup> If such backdating is disclosed, any third party with access to the document will have notice of the backdating. Such notice should, at least in some cases, mitigate the possibility of harm.<sup>121</sup> In addition, the act of disclosing the backdating belies any intent to deceive because parties who intend to deceive would normally be expected to rely on subterfuge.<sup>122</sup> Hence, it is also beneficial to disclose this form of backdating.

119. See *supra* Part II.C (discussing how backdating that memorializes can be problematic). See, e.g., *Herman v. Zatzkis*, 632 So. 2d 302, 304 (La. Ct. App. 1993) (“[The parties] contend that the letter represents only a written memorialization of what had always been the oral fee arrangement. . . . They argue that the court should not ascribe bad faith and fraud to the failure to disclose the fact that the letter was backdated. . . . The date on the letter was a material issue and we find that there was an affirmative duty to disclose whether asked or not.”); *In re Jagiela*, 517 N.W.2d 333, 335 (Minn. 1994) (“It appears from the record that the back-dated agreement may well have memorialized a prior oral agreement, at least to some extent. The back-dated agreement, however, was given to opposing counsel . . . , submitted to the . . . court, and testified to by various parties. . . . [The attorney] did not inform the court or opposing counsel of the back-dating of the agreement. Thus, there is clear and convincing evidence of [the attorney]’s misconduct with regard to the agreement.”).

120. See *supra* Part II.B (discussing backdating that fabricates).

121. See *supra* text accompanying notes 90–94.

122. Cf., e.g., *Cipparone v. Comm’r*, 49 T.C.M. (CCH) 1492, 1498 (1985) (“Any conduct, the likely effect of which would be to mislead or conceal, is indicative of fraud.”); *The Curious Capitalist*, blog.com/curious\_capitalist/2007/03/actually\_holman\_stockoption\_ba.html (Mar. 7, 2007, 15:49 EST)



Disclosure will not ensure the propriety of such backdating, however, because a third party could still be harmed by the backdating, or the backdating could violate a law, even when it is disclosed.<sup>123</sup>

## B. HOW DISCLOSURE MIGHT BE MADE

Backdating might be disclosed by identifying the date on which the backdated document was executed. Alternatively, disclosure might be made by dating the document “as of” an earlier date. This section will discuss these two forms of disclosure.

### 1. Identifying the Date of Execution

The most straightforward way of disclosing that a document was backdated would be for the document to identify the date on which it was executed. By disclosing the execution date, no one privy to the document could possibly believe the document was executed on an earlier date. The execution date, however, is often irrelevant to the timing of the event in question and disclosing that date can create unnecessary confusion about when the event governed by the document actually occurred.

As previously discussed, events often occur as a matter of law prior to the date on which the document evidencing the event is executed.<sup>124</sup> In many cases, the actual date of the event will be unclear or the parties might have different views of that date. Nevertheless, the parties must agree on an effective date so that they have the same expectations about all terms of the arrangement that are dependent upon that effective date. Regardless of whether the actual date of the event is known or the parties establish an agreed upon effective date, it is unlikely that these dates will coincide with the date of execution. When the dates do not coincide, the execution date is irrelevant to the event governed by the document.

Identifying an irrelevant execution date can create needless confusion as to when the event in question actually occurred. For example, in *Sweetman v. Strescon Industries, Inc.*,<sup>125</sup> a contract stated it was “made this 22nd day of April 1976.”<sup>126</sup> The contract was not executed, however, until June 22, 1976, and that date apparently appeared after the signature.<sup>127</sup> The issue before the court was whether

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(“Actually, Holman, Stock-Option Backdating Is Never Ok”) (“Backdating is, by its very definition, *not* disclosing what you’re doing.” (emphasis in original)).

123. Backdating utilized to deceive a third party is per se improper and disclosure will not mitigate the wrongdoing. In fact, the purported disclosure of such backdating might actually reflect an effort to impede authorities from ascertaining the truth. See *infra* notes 138–46 and accompanying text.

124. See *supra* Part II.A.1 (exploring how a contract can exist and ownership of property can be transferred before corresponding documents are executed).

125. 389 A.2d 1319 (Del. Super. Ct. 1978).

126. *Id.* at 1321 (internal quotation marks omitted).

127. *Id.* After discussing the April 22 effective date, the court states that “a later date does appear following the signature.” *Id.* at 1322. That “later date” was presumably the June 22 execution date but this is not clear.

an indemnification clause in the contract applied to an accident that occurred between those two dates (on May 25, 1976).<sup>128</sup> The court stated:

The presence of two different dates creates an ambiguity which opens the matter to evidentiary proof that the date appearing at the beginning of the agreement should not control the inception of rights and liability thereunder.<sup>129</sup>

Hence, disclosing the date of execution in an agreement intended by the parties to be operative on an earlier date could jeopardize the parties' objectives.<sup>130</sup> At a minimum, it can create a legal issue that could be costly and time consuming to resolve.<sup>131</sup>

## 2. Utilizing "As Of" Dating

Identifying the execution date on a backdated document is not the only way of revealing that the document was executed subsequent to the date of the underlying event. Some other mechanism might be utilized to show that the document was backdated. As long as the document conveys on its face that it was executed subsequent to the document date, the risk that a third party will be misled should be minimized even if the specific date of execution is not identified.

Rather than identifying the date of execution, a common drafting practice for disclosing backdating is to qualify the date stated in the document with an "as of" or "effective as of" modifier.<sup>132</sup> For example, rather than categorically stating an event occurred "on July 14, 2009," the backdated document might state that the event occurred "as of July 14, 2009." "As of" dating highlights the document was executed after the event occurred without creating potential confusion as to the actual or effective date of an arrangement.<sup>133</sup>

128. *Id.* at 1321.

129. *Id.* at 1322.

130. See also *Am. Cyanamid Co. v. Ring*, 286 S.E.2d 1, 2-3 (Ga. 1982) (involving a contract dated "as of July 1, 1975" where one party inserted the July 15, 1975, execution date next to his signature, resulting in the trial court determining that "the two dates on the contract created an ambiguity which was appropriate for the jury to resolve"); *Suffolk Constr. Co. v. Lanco Scaffolding Co.*, 716 N.E.2d 130, 133 (Mass. App. Ct. 1999) (affirming in dicta that the appearance of multiple dates "might create ambiguity or confusion as to a different effective date for the contract" even though only one date appeared in the contract at issue).

131. The research for this Article revealed only three backdating cases where the date of execution was disclosed. See *Pittsburgh Realty Inv. Trust v. Comm'r*, 67 T.C. 260, 268 (1976) (involving a stock purchase agreement disclosing the execution date as follows: "10-4-68 (as of 9-30-68)"); *Sweetman*, 389 A.2d at 1321 (involving a contract stating it was "made this 22nd day of April 1976" and that it was executed on June 22, 1976); *Am. Cyanamid Co.*, 286 S.E.2d at 2 (involving a contract dated "as of July 1, 1975" where one party inserted the July 15, 1975, execution date next to his signature). The absence of cases involving disclosure of the date of execution could mean either that the practice rarely occurs or that litigation rarely occurs when the date of execution is identified.

132. This technique might also be utilized when it is difficult or impossible to gather all parties together to execute a document at one time. Geographic differences or strained relationships might make it impractical for everyone to convene in one place. Hence, a document might be executed in counterparts at different times and places. In these circumstances, the "as of" date can establish a specific time for the event.

133. To guard against any inference that the "as of" date reflects the execution date, a clause could be added stating: "The date on this document shall not be construed to imply that the document was executed on that date."

“As of” dating utilized in good faith should minimize the risk that a backdated document could mislead a third party. In light of the “as of” language, a third party should not be surprised that the document was executed subsequent to the “as of” date. The “as of” language normally belies any intent to hide the backdating and effectively invites any third party to whom the actual date of execution might possibly be relevant to inquire about that date. If the attorney is asked when the document was executed, he or she should of course disclose that date.

Tribunals have confirmed that “as of” dating belies any attempt to mislead—indeed, courts have gone so far as to regard the convention to be inconsistent with backdating. For example, in *In re Blazina*,<sup>134</sup> the hearing board stated:

[I]t was considered by us, and weighed in favor of the Respondent that the amendments [to a partnership agreement] each say they are entered into “as of” a specific date and are signed “as of” that same date. As a result, if an amendment were typed up some time after the decision was made, the Respondent in fact did not backdate the document. The document would be backdated if . . . , the document stated “I have hereunto set my hand and seal this 14th day of September 1990” when in fact it was signed on a later date. That was not done on the documents at issue in the complaint.<sup>135</sup>

Similarly, in *Moore v. Commissioner*,<sup>136</sup> the court stated as follows:

“[B]ackdating” generally involves an effort to make it appear that the document in question was executed on a date prior to its actual execution date; i.e., there is an effort to mislead the reader. That is not true of the . . . agreement [at issue], where the “effective as of” phrase makes clear that the intended effective date differs from the execution date.<sup>137</sup>

Hence, “as of” dating often serves as an optimal way of disclosing backdating.

Like any other drafting technique, “as of” dating can be employed to achieve illegitimate ends. If the time of an event is fabricated to reap an undeserved benefit by compromising the rights of a third party or violating a law, utilizing “as of” dating might serve to camouflage impropriety, rather than disclose conduct believed to be legitimate. In this situation, “as of” dating does not mitigate the wrongdoing.

For example, in *United States v. Delaney*,<sup>138</sup> a Philadelphia tax lawyer was indicted for allegedly creating documents in 1998 dated “as of January 1, 1996” in which it appeared that certain partners in a tax shelter were liable for partnership debts.<sup>139</sup> The apparent objective of the alleged backdating was to enable the partners to deduct approximately \$15 million of the partnership’s 1996, 1997, and

134. No. 93 CH 202, 1999 WL 802836 (Ill. Attorney Registration & Disciplinary Comm’n Feb. 25, 1999).

135. *Id.* at \*10.

136. 93 T.C.M. (CCH) 1275 (2007) (discussed *supra* at text accompanying notes 42–47).

137. *Id.* at 1283–84.

138. No. 2:02-cr-00134-BMS (E.D. Pa. filed Mar. 5, 2002).

139. Amended Indictment at 4, *United States v. Delaney*, No. 2:02-cr-00134-BMS (E.D. Pa. Mar. 29, 2005) [hereinafter “Amended Indictment”].

1998 losses on their personal tax returns.<sup>140</sup> The indictment stated that the lawyer “knew no such agreement had ever been reached” in 1996.<sup>141</sup> If this allegation was true,<sup>142</sup> the backdated document evidenced an event that never occurred and supported a violation of the tax laws.<sup>143</sup>

The press reporting of the Delaney case demonstrates significant misunderstanding about “as of” dating and disclosure. One source reported the following:

Local tax lawyers... expressed mixed feelings about filing a criminal indictment... based solely on the “as of” documents, saying it is a common practice. “The point of using the ‘as of’ language in an agreement is to say that the parties intended the agreement to be effective as of the date in question, even though it was, in all likelihood, executed on a later date,” a tax partner at a large Center City firm said. “While it is both unethical and illegal to tell the IRS that a document was signed before the date it actually was signed, it is not clear that giving the IRS a document dated ‘as of’ a particular date should be viewed as a representation that the agreement was actually signed on that date. . . .” Another tax partner at a large firm said that standing alone, he does not believe that submitting an “as of” document to the IRS constitutes an indictable offense, but it is clearly not good practice. “Though it’s not the same as back-dating, there is an issue as to whether you are defrauding the government by implying through the document that it had been signed at a certain point,” the tax partner said.<sup>144</sup>

The lawyers quoted above seem to miss the fundamental point that “as of” dating is neither a legitimate nor illegitimate drafting technique per se.<sup>145</sup> Rather, it is the ends to which the technique is employed that determine its propriety. Unless the indicted lawyer could have disproved the alleged facts, the backdating supported tax fraud. Hence, this would appear to have been a case where the fabrication was used for a “bad” purpose. Backdating of this type is improper regardless of whether or how it might be disclosed. The problem has nothing to do with “as of” dating—the same problem would exist if the actual date of execution had been identified. When backdating is utilized to deceive a third party or violate a law, it is clearly improper and disclosure of any form will not mitigate the wrongdoing.<sup>146</sup>

140. See *id.* at 3. See also I.R.C. § 704(d) (2000) (limiting partner’s deduction of partnership losses to partner’s basis in partnership interest); *id.* § 752(a) (allowing partner to augment basis in partnership interest for partnership liabilities with respect to which partner bears a risk of loss).

141. Amended Indictment, *supra* note 139, at 5.

142. The evidence supporting the government’s view included the following: “In or about April 1998, defendant [lawyer] advised one of the . . . partners that he would keep the false guarantees dated ‘as of August 25, 1995’ hidden in his desk drawer and not provide them to [one of the limited partners].” *Id.* at 7.

143. The attorney pled guilty and was sentenced to six months of imprisonment and three years of supervised release. Criminal Docket Report at nos. 20, 34, *United States v. Delaney*, No. 2:02-cr-00134-BMS (E.D. Pa. filed Mar. 5, 2002).

144. Jeff Blumenthal, *Tax Bar Debates Merits of Jacobs Indictment*, LEGAL INTELLIGENCER, Mar. 7, 2002, at 1.

145. The quoted lawyers might not have been aware of the fact that the Delaney case apparently involved the alleged fabrication of an event that never occurred. Their comments seem to be contemplating the use of “as of” dating in situations intended to memorialize a prior event.

146. See also *Melnick v. Comm’r*, 91 T.C.M. (CCH) 741, 748 (2006) (involving a transaction where the documents suggested a “willingness to manipulate the relevant chronology in a way that does not

In sum, backdating should always be disclosed. Disclosure normally minimizes the risk that a third party will be misled into believing the document was executed on an earlier date. However, when backdating is utilized to mislead a third party, adversely affects the rights of a third party, or violates a law, disclosure will not cure the impropriety.

#### IV. PROBLEMS

To aid the reader in employing the analyses set forth in this Article, Part IV relates a series of hypothetical problems involving backdating. These fact patterns offer the opportunity to apply the principles previously discussed to concrete illustrations. A short discussion follows the facts of each problem.

##### PROBLEM 1

*Facts:* Employer and Employee verbally agree to an employment arrangement on January 15, 2009. A written agreement is subsequently drafted. The written agreement is dated "as of" January 15, 2009, and is executed by the parties on January 30. The agreement is governed by the law of State X which establishes that a contract arose on January 15, 2009.

*Discussion:* The written agreement memorializes an event that occurred on January 15, 2009. The fact that the written agreement was drafted and executed after January 15 is irrelevant to the timing of the event. Nevertheless, the "as of" reference should deter any third party from inferring that the document was executed on January 15.

##### PROBLEM 2

*Facts:* Same as Problem 1, but the agreement is governed by the law of State Y. Under State Y law, the contract arose on January 30, 2009, the date the agreement was executed.

*Discussion:* The written agreement fabricates the date of the event. Thus, the backdating is improper unless it was not intended to harm a third party, does not adversely affect the rights of any third party, and does not violate any law.

##### PROBLEM 3

*Facts:* The personnel policies of Employer state that anyone employed on January 1 who works for a full calendar year is eligible for a bonus. On January 15, 2009, Employer and Employee agree to an employment arrangement pursuant to which Employee is to be compensated at a level that would include the 2009 bonus Employee would have received had his employment commenced on

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enhance the credibility of petitioner's evidence" where the court found that "[t]he 'effective as of' dating and backdating of relevant documents impede our review of the substance of the transactions... and lead us to conclude that the chronology reflected by those documents is not credible").

January 1. Employer could legitimately have conferred this economic benefit by increasing Employee's salary or by creating a new bonus plan. Instead, Employer backdates the employment contract to January 1 to allow Employee to receive a bonus for 2009 under the existing plan. Employer does not intend to harm a third party by this action.

*Discussion:* The employment agreement fabricates the date of the event (i.e., the commencement of Employee's employment). Although Employer could have legitimately conferred the benefit in other ways and did not intend to harm a third party, the backdating is improper unless no third party's rights are adversely affected and no law is violated.

#### PROBLEM 4

*Facts:* Same as Problem 3, however, Employer's bonus plan covers ten other employees and requires that any amount set aside for bonuses shall be divided equally among all covered employees at year-end.

*Discussion:* The agreement fabricates the commencement date of Employee's employment. The rights of third parties are compromised by the backdating because participation by Employee means that the other participants will get a lesser share of the amount set aside for bonuses (i.e., each of the other participants will receive 1/11 of the bonus money if Employee is included and 1/10 of the bonus money if Employee is not included). As such, the backdating is improper.

#### PROBLEM 5

*Facts:* Sole Shareholder of Closely Held Corporation ("CHC") would like Key Executive to come to work for CHC. CHC is a C corporation for federal tax purposes.<sup>147</sup> To attract Key Executive, Sole Shareholder agrees on January 1, 2009, to give her 10 percent of his CHC stock. On that same date, Key Executive and CHC enter into an employment agreement which makes no reference to the CHC stock. In December, it is discovered that the paperwork to transfer 10 percent of Sole Shareholder's shares to Key Executive was never completed. The paperwork is completed on December 31, 2009, and the transfer documents are dated "as of" January 1, 2009.

*Discussion:* If, as a matter of law, Sole Shareholder's January 1, 2009, agreement to transfer 10 percent of her stock to Key Executive caused Key Executive to become the owner of the shares on that date, the December paperwork merely memorializes the transfer. By contrast, if the transfer of ownership of the shares does not occur until December 31, 2009, the backdating fabricates the date of the transfer. In this event, the backdating is improper unless it was not intended to

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<sup>147</sup> A C corporation is a corporation not governed by Subchapter S of the Internal Revenue Code. See I.R.C. § 1361(a)(2) (2000). As such, a C corporation is treated as a separate taxpaying entity and subject to a corporate-level tax on its income. See *id.* § 11. In addition, the shareholders of a C corporation are normally taxed on dividends and other corporate distributions. See *id.* §§ 301, 302, 331 (2000 & Supp. V 2005).

harm a third party, does not adversely affect the rights of any third party, and does not violate any law.

### PROBLEM 6

*Facts:* Same as Problem 5, but CHC is an S corporation for federal tax purposes.<sup>148</sup> As such, the income of CHC is taxed proportionately to its shareholders on each day of the year.<sup>149</sup> Because the parties treat the stock transfer as occurring on January 1, 90 percent of CHC's 2009 income is reported on Sole Shareholder's 2009 tax return and the remaining 10 percent of CHC's 2009 income is reported on Key Executive's 2009 tax return.

*Discussion:* If, as a matter of law, the transfer of ownership occurred on January 1, the December paperwork memorialized the transfer. But if the transfer of ownership does not occur until December 31, the backdating fabricates the date of transfer and is improper because it supports erroneous tax reporting. Specifically, if the transfer of ownership did not occur until December 31, Sole Shareholder would be responsible for reporting 100 percent of the S corporation's 2009 income.<sup>150</sup>

### PROBLEM 7

*Facts:* General Partnership ("GP") is treated as a partnership for federal tax purposes and uses the calendar year for tax reporting.<sup>151</sup> As such, the income of GP is taxed directly to its partners in accordance with their partnership agreement.<sup>152</sup> On January 1, 2009, GP has two partners (Partner A and Partner B) who have always shared profits and losses equally. On January 1, 2009, the partners agree to amend their agreement to cause Partner A to be entitled to 2/3 of GP's 2009 profits. However, the paperwork to implement this amendment is not completed until December 31, 2009, and is dated "as of" January 1, 2009. The parties treat the amendment as effective on January 1, 2009. As such, 2/3 of GP's 2009 profits are reported on Partner A's tax return and 1/3 of GP's 2009 profits are reported on Partner B's tax return.

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148. An S corporation is governed by Subchapter S of the Internal Revenue Code. *See id.* § 1361(a)(1) (2000). As such, the income of the S corporation is generally taxed directly to its shareholders, and no additional tax is normally imposed when earnings are distributed to shareholders. *See* I.R.C. §§ 1366–68 (West 2002 & Supp. 2007); *but see* I.R.C. §§ 1374–75 (2000 & Supp. V 2005) (imposing corporate-level taxes on certain S corporations that were formerly C corporations).

149. *See* I.R.C. §§ 1366, 1377 (West 2002 & Supp. 2007).

150. *Id.* *See also* Treas. Reg. § 1.1377-1(a)(2)(ii) (as amended in 2006) (treating seller of S corporation stock as owner of the shares for the day of disposition).

151. A partnership for tax purposes is an unincorporated enterprise governed by Subchapter K of the Internal Revenue Code. I.R.C. § 761(a) (2000); *see generally* I.R.C. §§ 701–61 (West 2002 & Supp. 2007). The income of a partnership is taxed directly to its partners and no additional tax is normally imposed when partnership profits are distributed to the partners. *See* I.R.C. §§ 702, 705, 731, 733 (2000 & Supp. V 2005).

152. *See id.* §§ 702, 704. For purposes of this Problem, assume that all agreed to allocations have "substantial economic effect." *See id.* § 704(b) (2000).

*Discussion:* If, as a matter of law, the amendment to the partnership agreement is effective on January 1, 2009, the December paperwork merely memorializes the amendment. But if the amendment is effective on December 31, 2009, the December paperwork fabricates the date of the amendment. The fabrication does not violate federal tax law because, under these circumstances, the partnership agreement can be retroactively amended to January 1, 2009, until April 15, 2010.<sup>153</sup> Consequently, even if the amendment did not occur until December 31, 2009, it would be permissible for the partners to report GP's 2009 income in accordance with the agreement reached on that date. Nevertheless, the backdating would still be improper unless it was not intended to harm a third party, does not adversely affect the rights of any third party, and does not violate any other law.

### PROBLEM 8

*Facts:* On December 29, 2009, a new client asks attorney to prepare a deed reflecting the client's desire to make a gift to the client's daughter of certain real estate. In January 2010, attorney prepares the deed and sends it to client. The deed is signed by the client but no date is inserted. When attorney brings the missing date to client's attention, client asks attorney to insert "as of December 31, 2009," the date on which he says he told his daughter about the gift. No extraneous information suggests the gift was actually made on December 31, 2009.

*Discussion:* The attorney has no evidence the gift was made on December 31, 2009, and contrary evidence exists because the attorney knows the deed was executed after that date. Moreover, the attorney has no past experience with the client that might prove helpful in assessing the client's veracity. Thus, it appears the client is requesting the attorney to fabricate the date of the transfer of ownership which would violate state law and could adversely impact the rights of a third party.<sup>154</sup> Hence, the backdating would be improper.

### PROBLEM 9

*Facts:* Same as Problem 8, but assume that the attorney has worked with the client for many years and that all of client's past actions have reflected integrity.

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153. See *id.* § 761(c) (defining partnership agreement as incorporating all amendments made by the fifteenth day of the fourth month after the close of the tax year); Treas. Reg. § 1.761-1(c) (as amended in 1997) (allowing the partnership agreement to be modified with respect to a taxable year after the close of that taxable year but *before* the filing date for the partnership return). The government can be adversely affected when partners retroactively allocate income or deductions if the partners are taxed at different rates. See *Moore v. Comm'r*, 93 T.C.M. (CCH) 1275, 1284 (2007) ("A retroactive increase in [two members'] shares of LLC profits would have necessarily resulted in a retroactive decrease in [another member's] share of those profits. Thus, aside from possible tax rate differentials among... the individuals (unsupported by any evidence in the record), the [Internal Revenue Service]... is indifferent as regards [to] the respective profit shares of each."). Limits exist on the ability of partners to allocate retroactively profits and losses for any year in which a change in a partner's interest in the partnership occurs. See I.R.C. § 706(d) (2000).

154. For example, daughter might have included the property as an asset on a December 31, 2009, financial statement that a bank relied on in granting daughter a loan.



*Discussion:* Although it will likely be harder for the attorney to say “no” in this situation, it remains prudent to reject the request because no extrinsic evidence exists that the gift was in fact made on December 31. Acceding to the client’s wishes could cause the attorney to be participating in a fabrication that violates state law and compromises the rights of a third party.<sup>155</sup>

## PROBLEM 10

*Facts:* Same as Problem 8, but client indicates the gift was made on December 1, 2009, and requests that the lawyer insert “as of December 1, 2009” on the deed. In addition, objective evidence exists that the daughter had actually assumed the benefits and burdens of ownership of the real estate on December 1. Specifically, she moved onto the property, paid the real estate taxes, and began to improve the property with her own funds.

*Discussion:* After verifying the facts and applying the facts to the relevant law, the lawyer might conclude that the backdating memorialized a gift that occurred on December 1.<sup>156</sup> If the lawyer’s conclusion is correct, the backdating is legitimate. Otherwise, the backdating would be a fabrication that violates state law and could compromise the rights of a third party in which case the backdating would be improper.<sup>157</sup>

## V. RECOMMENDATIONS

Based on the foregoing discussion, the following analysis should be employed whenever a lawyer is confronted with a backdating situation:

1. The lawyer should initially assess whether the backdating in question involves: (i) a fabrication intended to deceive or harm a third party; (ii) a fabrication utilized to achieve the goals of the parties involved where no intent exists to deceive or harm a third party; or (iii) the memorialization of a prior event.
2. An attorney should never participate in backdating that fabricates the time of an event when the backdating is intended to deceive or harm a third party.
3. Even when no intent exists to deceive or harm a third party, a lawyer should not participate in backdating that fabricates if the backdating could adversely affect the rights of a third party or violates a law. Lawyers should be extremely cautious about this form of backdating because it will often

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<sup>155</sup>. See *supra* Problem 8.

<sup>156</sup>. See *supra* Part II.A.1.b (discussing when, as a matter of law, ownership is transferred).

<sup>157</sup>. See *supra* Problem 8. Problems 8–10 also raise the issue of whether the deed could be properly notarized under these circumstances, a subject beyond the scope of this Article.

be difficult to identify all third parties who might be harmed and to assess whether the rights of any of these parties might be violated.<sup>158</sup>

4. If the backdating is intended to memorialize a prior event, the lawyer must confirm that the event in fact occurred on the earlier date. If the event is governed by ambiguous legal standards, a disciplined analysis should be undertaken to determine the actual time of the event. In all cases, the lawyer should critically evaluate all the evidence before reaching a conclusion as to when the event occurred and carefully document the facts establishing the event. If, after taking these actions, the lawyer remains uncertain as to when the event occurred, the lawyer must realize that the backdating could be a fabrication and evaluate its propriety on that basis.
5. An attorney should never assume a backdated document will remain private. The possibility of a controversy always exists and any backdated document might someday appear before a court, government entity, or some private party who was not privy to the backdating. Thus, the attorney should not participate in the backdating unless he or she is prepared to defend the legitimacy of the document in a truthful and forthright manner.
6. Backdating should always be disclosed. In the case of backdating that memorializes, utilizing "as of" dating should normally minimize the risk that a third party will be misled into believing that the document was executed on the earlier date, without creating confusion about the effective date of the document. In the case of backdating that fabricates where no intent to harm a third party exists, disclosure can provide notice to third parties who otherwise might be harmed, as well as reinforce the lack of any intent to deceive. Disclosure will not ensure the propriety of such backdating, however, because a third party could still be harmed by the backdating, notwithstanding the disclosure.

## CONCLUSION

In an ideal world, backdating would never occur. No lawyer would ever be asked to fabricate the time of an event and every event would be documented contemporaneously with its occurrence. In the real world, however, backdating questions cannot be avoided.

Certain forms of backdating are an integral part of the practice of law. Events can and must be documented after the fact so long as it can be established that the event actually occurred at the earlier time. Moreover, backdating utilized to implement the economic objectives of private parties can potentially be innocuous if the backdating is not intended to harm a third party, and does not in fact

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158. The lawyer should also realize that this form of backdating might be enforced to the detriment of a party to the backdating. See *supra* note 86. Unless those parties agree to bear this risk, the lawyer could also be subject to claims by those parties.

compromise the rights of any third party or violate any law. Although these standards are easy to state, they are often difficult to apply.

Whenever a backdating question arises, it is critical for the lawyer to confront the issue and to understand exactly what he or she is being asked to do. The lawyer should never assume that any backdating situation is harmless. Instead, careful thought and analysis is necessary in every case to ensure the propriety of the action. The consequences of an error in judgment can be severe.

It is high time to remedy the dearth of guidance that exists with respect to backdating. Both legal academics and practitioners have an important role to play in educating lawyers to deal with this pervasive issue. Hopefully, this Article will begin that process.