from acting as private enforcers?), would attempt to take on every audit now underway. Presumably, if Professor Sims wants to rid society of tax shelters, the private enforcers would require the Service's authority to issue judicially enforceable document requests. For the Service to find tax shelters on audit now it issues endless document requests. Every corporation, then, might end up answering endless document requests from hundreds or even thousands of private enforcement firms.

In his counterpoint, Professor Sims suggests that auctioning off the right to audit tax returns would solve some of these problems. I disagree. As discussed, the Service does not find what it considers a tax shelter until it has already requested numerous documents; private enforcers would probably do no better. Prior to the discovery of what one might consider a tax shelter, bidders may value a corporate tax return as the cost to the company of avoiding litigation. Even corporations that engage in only legitimate transactions may therefore be held hostage to freelance private enforcers. Similarly, corporations that do engage in illegitimate transactions with huge tax savings might be able to buy off the winning bidder before any action is taken for an amount much less than the tax the evading corporation might end up paying if subject to government enforcement.

At bottom, Professor Sims' proposal is to fight fire with fire. He perceives taxpayer abuse of the system, so he proposes a system of private enforcers with no accountability. It is hard to doubt that private enforcers would abuse the system and eventually bring the system down. Private enforcement in the securities field led to the Private Securities Litigation Reform Act of 1995. In the legislative history, Congress criticized private enforcer abuse and sought to rein it in. Tax law with its fuzzy lines would likely attract even more abuses than the securities field and lead to enforcement actions against legitimate transactions. Taxpayers engaging in legitimate transactions ought to be able to remain free from the abuse of private tax law enforcers. In tax law, the enforcement function should remain with the government. ■

COUNTERPOINT: PRIVATE AUDITING MAKES SENSE

by Theodore S. Sims, Boston, MA

In response to my short piece in *Tax Notes,* in which I suggest that if corporate returns are to be publicly disclosed we might also consider private audit and enforcement, Allen Madison essentially argues that (1) our system of self-assessment through confidential returns and government enforcement ain't broke, and (2) fixing it would inflict unacceptable collateral damage. I think Mr. Madison makes a persuasive case for neither of those claims.

Part of Mr. Madison's argument is addressed to the predicate question of public disclosure, which I took as given for purposes of my piece, and on which I will therefore not dwell. The standard claim is that public disclosure would compromise "trade secrets." Much of what Mr. Madison enumerates, while commonly viewed as confidential, does not rise to the level of a true trade secret, and is not actually disclosed in the return. If the need to preserve trade secrets is the principal objection to disclosure, I think it incumbent on those making the objection to be specific about just what actually is a trade secret, what might actually be disclosed, and what harm the disclosure would actually do.

Mr. Madison's principal ground for asserting that the system needs no fixing is the claim that the Service's resources are already adequate to its tasks. He points to the creation of an Office of Tax Shelter Analysis, and the fact that the Service is currently requesting only modest increases in its budget. But the creation of the new Office—*not* the first "special" group to combat tax shelters ever created by the Service—is no substitute for adequate resources. And the absence of a request for increased funding, by a deficit-plagued Administration for which tax reduction appears to be more of a priority than tax enforcement,[1] is hardly persuasive evidence that we are devoting sufficient resources to the task.

There is ample evidence that we are not. Between 1975 and 2000, when the number of individual returns grew from about 82.2 million to over 127 million, audits of individual returns declined from 1,839,558 to 617,765 (or by more than 65 percent). During the same period audits of corporate returns fell by over 80 percent, from 154,889 to 27,835. In just the six years between 1995 and 2000, the examination rate for all individual returns dropped from nearly 1.7 percent to under 0.5 percent, or by nearly two-thirds, and the audit rate for all corporate returns declined from over 20 percent to nearly 11 percent. For large corporations the decline was even more dramatic, from over 48 percent examination to just over 16 percent. As noted by the Service on February 16, 2001, these declines reflect the combined effects of a 17 percent decline in overall staffing between 1992 and 2000, a 13 percent growth in the number of returns, the additional burdens and customer service obligations imposed by the 1998 Restructuring Act, and the ongoing use of outdated information systems. Those same concerns were underscored in the Commissioner's September 2002 Report to the IRS Oversight Board. It is hardly a picture

[1] Witness the apparent assertion by Mark Weinberger, former Treasury Assistant Secretary for Tax Policy, that, since the Bush administration was "against capital gains taxes in general," it would "not take any action against" the apparent misuse of exchange funds. David Cay Johnston, "A Tax Break for the Rich Who Can Keep a Secret," *New York Times,* C1, col. 2 (September 10, 2002). While Mr. Weinberger did not confirm the exact quote, he apparently did not contradict it either, saying only that he "recalled making much less-definitive remarks."

I note also that the claim that the Service's resources are currently sufficient is inconsistent with the need for growth in funding outlined in outgoing Commissioner Rossotti's final Report to the IRS Oversight Board. *See* Rossoti, Assessment of the IRS and the tax System (September 2002).

of consistent vigor in enforcing the Internal Revenue laws.

As for my suggestion that corporate "compliance" has become more cost-benefit calculation than compliance, evidence on this is (for obvious reasons) not easy to come by. But it is more than just rhetorical flourish, as Mr. Madison's discussion itself reflects. After dismissing my description of corporate tax departments as "profit centers," he immediately acknowledges that "the pursuit of tax efficiency" is "in itself good . . . and should not be frowned upon." That, I suggest, is the crux of the matter, and the temptation to be aggressive in pursuing tax "efficiency" becomes harder to resist as the prospect of enforcement declines.

Historically, the business folk did the expected value calculations; the lawyers' job was to try to ensure that their clients remained within the law. As lawyers have increasingly been forced to compete with, or been assimilated into and made answerable to, more business-oriented enterprises like accounting and/or consulting firms, the line has increasingly become blurred between rendering a dispassionate assessment of the law, and assisting in determining the expected cost of getting caught—taking into account the probability of detection, the prospect and cost of litigation, and the probability and cost of not prevailing if it comes to that. When high-powered, aggressive practitioners get seven-figure, multi-year guarantees from accounting firms, and with all the emphasis on creating "products" that can be "marketed" to clients, it seems clear that something more than figuring out the most "tax efficient" way of structuring existing (or even new, but legitimate) business operations is going on. Mr. Madison invokes Learned Hand's oft-cited dissent in *Commissioner v. Newman*. But it is rather more difficult to imagine Judge Hand declaiming that there is "nothing sinister in so obscuring an impenetrably aggressive position in Schedule M as to create a reasonable likelihood that the matter will go undetected, be misunderstood by the examiners, or be mishandled by a federal court."

Such tactics are, I suggest, an important aspect of the reality that currently prevails. As reflected in the Commissioner's September 2002 Report to the IRS Oversight Board, they are of profound concern to the Service. I simply disagree with Mr. Madison's sanguine view that shelters (corporate and otherwise) reflect no real erosion of our system of voluntary self-assessment, and I think the problem is more than mere "misperception." What is going on is both real and almost surely increasingly widespread. When forced to choose between what Mr. Madison characterizes as a "fiduciary duty . . . to insure compliance" and the opportunity to make their operations more "tax efficient" at what they assess as modest risk, it seems increasingly the latter that corporate tax professionals are inclined to choose. The bottom line impact is immediate, while the (possible) unpleasant consequences are contingent and remote. So, even though responsible practitioners will continue to insist on some colorable basis for the positions they take, the benign, high sounding "duty to minimize your taxes" too readily becomes the more pernicious "whatever you can reasonably expect to get away with to reduce your taxes is legit." I have heard an acquaintance of mine—an intelligent, skillful practitioner and an honorable individual, who made the transition from law practice to accounting firm—defend his efforts by saying, "It's not as though we never say 'No.'" It seems to me the more pertinent question is "To what have you recently said 'Yes'?" Maybe it's naive to believe it was ever otherwise, but I think it clear that the system by now is somewhat broke.

As for the drawbacks to private enforcement, Mr. Madison points to the prospect of administrative and judicial chaos and soaring compliance costs as private auditors, responsible to no one and nothing but their own economic self-interest, descend like buzzards to pick over every corporate return. I suspect the picture is overdrawn. Even if it isn't, the problem can be readily overcome. After the close of each filing season we could just auction the right to audit each return. The winning bidder—and, apart from the government, only the winning bidder—would then be entitled to audit that return. That single feature would address the collateral problems to which Mr. Madison alludes: it would eliminate the prospect of multiple audits and the absence of coordination that he fears; discovery would be confined to one private auditor per corporate return per year; each auditor could be pledged to preserve (except to the extent properly disclosed in litigation) the confidentiality of any genuine trade secrets disclosed in the audit. As for the need to avoid "chilling" legitimate transactions, that's what courts are for. And as for coordination of the government's guidance and litigation strategy, the Service could continue to give National Office advice, it could (absent misrepresentation) continue to be binding in favor of the recipient, and it would continue to be binding in favor of no one else. While examination and litigation would be up to the private auditor in the first instance, we could still reserve to government officials the right to audit any return for which there was no adequate private audit, and responsibility for deciding which adverse judicial decisions to appeal. The only real incremental burdens experienced by corporate enterprises would be those of more tenacious audits, and more effective enforcement of the law.

That leaves, finally, Mr. Madison's question about why I prefer private enforcement to more resources for the Service. In fact I would welcome an infusion of resources into the Service, though I think the prospects, realistically, are dim. But there isn't any real reason why we should have to choose. If, as I believe, compliance has become too much a matter of expected value calculation, the more effective short-term solution (though condemned by Mr. Madison) is *pre-*

SEE **POINT & COUNTERPOINT** PAGE 34

CLE CALENDAR

For more information about upcoming CLE events, visit the Tax Section website at www.abanet.org/tax/, the ABA CLE website at www.abanet.org/cle/, and the ALI–ABA website at www.ali-aba.org.

TOPIC	DATE	CONTACT
ABA Connection Teleconference: Tax Issues from a Tough Year	Nov. 20, 2002 1–2pm ET	ABA CLE 800/285-2221 www.abanet.org/cle/
Tax Section *Last Wednesday* Teleconference: State & Local Taxes Program	Nov. 27, 2002 1–2:30pm ET	ABA CLE 800/285-2221 www.abanet.org/cle/
19th Annual National Institute on Criminal Tax Fraud, San Francisco, CA	Dec. 4–6, 2002	ABA CLE 800/285-2221 www.abanet.org/cle/
Tax Section *Tax Link Live* Teleconference: "What Engagement Letter?"	Dec. 11, 2002 2–3pm ET	ABA CLE 800/285-2221 www.abanet.org/cle/
ABA Connection Teleconference: The Final Word on Ethics 2000	Dec. 18, 2002 1–2pm ET	ABA CLE 800/285-2221 www.abanet.org/cle/
Tax Section *Last Wednesday* Teleconference: Administrative Practice and Tax Controversies Program	Jan. 29, 2003 1–2:30pm ET	ABA CLE 800/285-2221 www.abanet.org/cle/

POINT & COUNTERPOINT

FROM PAGE 18

cisely to fight fire with fire. The incentives offered by private enforcement will bring high-powered resources to bear on challenging abstruse but aggressive tax-saving schemes more expeditiously than would additional appropriations for the Service. It would, moreover, do so at no real budgetary cost. Auctioning enforcement rights would effectively compensate the government in advance for the market's assessment of the expected understatement (net of anticipated enforcement costs) in a given corporate return. The necessity of bidding for the privilege would induce prudence on the part of prospective private auditors; it would curb abuse, and tend to insure that conservatively prepared returns were left alone; it would simultaneously ensure searching audits by those who successfully bid. It would, I acknowledge—it is *intended to*—make consumption of aggressive planning products both hazardous and costly. In short order it would reduce the expected returns to aggressive planning, and eventually tip the balance in favor of submitting squeaky-clean returns. Once that happens, and corporate managers come to realize that there is a financial *premium* on conservatively prepared returns, we should then expect to find few bidders for the privilege of auditing those returns. That's the real virtue of what I have suggested.

Finally, Mr. Madison invokes the distrust and concern for abuse of private enforcement reflected in the Securities Litigation Reform legislation enacted in 1995. While the causes are surely multi-faceted, given the outright fraud (WorldCom, Enron) and downright plundering (Tyco, Enron) that have materialized since 1995, that is not an argument with which I would choose to close. But to those who share Mr. Madison's concern, I suggest that, at least in the context of auditing corporate tax returns, abuse could be controlled by requiring prospective auditors to bid and to pay for the right to audit a return. Whether they deplore it or applaud it, I think most tax professionals would agree that, as matters stand where enforcement is concerned, the deck is currently stacked against the Service. And, to paraphrase Judge Hand one final time, I do not think the government is compelled to structure its enforcement so as to maximize the rewards to aggressive private efforts to pay less than what the law demands. If, as Ken Kies has been (approximately) heard to say, "We don't need more laws, all we need is to enforce the laws we have," there is nothing even remotely unfair about getting *really* serious about enforcing the laws we have. ■