INTERVIEW WITH JAMES P. HOLDEN, TAX SECTION DISTINGUISHED SERVICE AWARD RECIPIENT

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JAMES P. HOLDEN

INTRODUCTION: Jim Holden has been an active member of the Tax Section and a respected member of the tax bar for many years. He is the co-author of two books on ethics in tax practice and a nationally recognized expert on standards of tax practice. In addition to being a partner at the Washington, DC-based law firm of Steptoe & Johnson, LLP and having served as Chair of the Firm and head of its tax practice, Jim has taught as an adjunct professor at Georgetown and served on the Commissioner's Advisory Group. He was Chair of the Tax Section from 1989–90 and has received numerous awards, including the American College of Tax Counsel's Erwin Griswold award in 1999 and the Section's Distinguished Service Award for 2002.

Q You are the co-author of two leading texts in the area of standards of practice in the tax area. In your view what are the most pressing ethics issues facing tax attorneys today?

A The fundamental issue in the ethics of tax practice has always been about trying to be a good person while also trying to be an effective tax lawyer. That, I think, is the fundamental objective. Many of the difficult ethical issues that we encounter in daily practice center around two subjects: One is confidentiality of client information, and the other is conflict of interest. The ABA Ethics 2000 Commission addressed both of those subjects over the past several years with, in my opinion, somewhat mixed results.

One of the major problems in the area of confidentiality is presented by the fact that ABA Model Rule 1.6 does not permit a lawyer to disclose a client's confidences absent a threat of death or bodily harm. That is a pretty high standard. Most of the states on the other hand permit a lawyer to disclose information as necessary to prevent or to rectify a client's fraud practiced upon another person. The Ethics 2000 Commission recommended that Model Rule 1.6 be expanded to allow disclosure of client fraud, but the ABA House of Delegates rejected that recommendation after a very contentious debate. Thus, the ABA Model Rules remain out of step with the majority of the states by continuing to elevate confidentiality over respect for the rights of those who have been wronged by client fraud.

A troublesome issue also exists with respect to conflicts of interest. In this day and age when lawyers move from firm to firm with considerable frequency, there is a problem when a lawyer arrives at the new firm having been exposed at the old firm to some knowledge about a case that is being handled by the new firm. The new firm may be required to give up representation in such a case unless client consent to a screening mechanism can be obtained. Many observers believe that this unduly interferes with the freedom of lawyers to move to another law firm. The Ethics 2000 Commission proposed to allow the moving lawyer to be screened by the new firm from contact with the existing case without the need to seek client consent. That recommendation was also hotly debated and rejected by the ABA House of Delegates. This troublesome issue of conflicts surrounding the moving lawyer thus remains to be resolved.

I suspect that both of these issues will be revisited in the future and that the Model Rules in question will be broadened along the lines of the Commission's recommendations.

Q Have you been involved on either side of the so-called Multi-Disciplinary Practice issue? What are your views on these entities and where does the ABA stand at present with respect to the legality of such organizations?

A I have been involved in the MDP debate. Indeed, I think I was the first witness to testify before the so-called Simmons Commission, which was a commission established by the ABA and chaired by former Tax Section Chair Sherwin Simmons to look at the MDP issue and to develop recommendations concerning the ABA's position.

The fundamental issue in this area is how to bring some form of professional regulation to the many lawyers who perform legal services in firms other than traditional law firms. For

convenience sake, I would refer to those non-law firms as "NLF firms" and to the lawyers practicing in them as "NLF lawyers." This makes the terms of reference a little easier. The important thing to recognize is that the economics of the marketplace have demanded NLF firms and those same economics have demanded NLF lawyers. That is not going to change. There is nothing that the ABA can say or do that is going to prevent NLF practice from occurring.

Now, the NLF firms maintain that they are not practicing law, which is a gross misstatement, made only to escape from regulation. Obviously the lawyers in those firms are advising clients with regard to the application of the tax law and many other areas of law. While the Enron and Andersen meltdowns may generate rules that preclude auditing firms from providing consulting services to their clients, those rules are not going to spell the end of NLF law practice. So, we have to recognize that NLF law practice is here to stay. And the disappointing thing is that the American Bar Association has chosen essentially to ignore the subject.

The Simmons Commission recommended that NLF lawyers be permitted to practice so long as they and their firms subscribe to the professional rules for lawyers in the jurisdictions where they practice. The ABA, after another contentious debate, rejected the Simmons Commission's recommendation. This action leaves the matter where it arose, that is, we have a great many NLF firms and a great many NLF lawyers, and nobody is regulating them. The ABA position seems to be that if we simply ignore the problem, it will go away. That's clearly not going to happen.

As I said, the Simmons Commission believed that each state should take over the responsibility for regulating NLF firms and lawyers practicing in the state, just as the states now regulate the practice of lawyers active in their jurisdictions. My concern with this recommendation was whether it would be workable. The regulation of law practice on a state-by-state basis might have made sense when law practice was largely confined to in-state matters. With the advent of large, national firms, that balkanized form of regulation is already showing wear at the seams. If it were extended to include, for example, the law practice of truly national and international accounting firms, I doubt that it would be workable. First you would have to assume that, if the ABA did amend the Model Rules to recognize law practice by NLF firms, the states would fall in line and adopt those rules. That might happen, but it seems to me very unlikely. Second, if it did happen, it would be only over a long period of time, meaning an absence of regulation for that long period.

In my testimony before the Simmons Commission, I suggested that they think outside the box and consider some form of national regulation that would be available to those NLF firms (and indeed to traditional law firms as well) that elected national regulation. This would permit observance of single set of standards that could be applied nationally. My suggestion, however, is apparently much too radical for many segments of the bar and it has not been well received, despite its practical advantages.

Q Would that national system have involved the federal government?

A Probably, although if we are thinking outside the box, not necessarily. I might analogize this concept to the Securities and Exchange Commission, which effectively regulates accounting firms on a national level. While there is some state-level regulation of accounting firms, those that operate on a national level are effectively regulated on that same level. It does not seem like heresy to me to suggest that truly national law firms and NLF firms could benefit from a similar form of regulation. As matters now stand, there is a total absence of regulation, both state and federal, of law practice in NLF firms, and that cannot be the right answer.

Q On the Congressional front concerning changing the scope of services that audit firms can provide through consulting services, have you seen any consensus emerging on The Hill this year on that issue?

A I think you see more of a consensus emerging on what I would call broad consulting activities by firms that provide audit services. They don't seem to have focused as closely on tax consulting services, which in my mind are indistinguishable from other consulting services and should be subject to the same restrictions.

Q You graduated from law school in 1960 and have had a wide-ranging career in tax. How has the practice of tax changed since your first decade of practice?

A There have been an amazing number of changes. Some of them I would characterize as atmospheric, others I would characterize as more substantive. In terms of the atmospherics, there has been a dramatic change in the size of law firms. Today we have huge firms that would have been unthinkable in the early 1960s.

Another interesting change is the more limited access that we have to government officials. When I started practicing law if you wanted to accomplish something at the Internal Revenue Service you simply walked down and entered any door in the building and went to the office that you wanted to be in and, generally, had quick access to the government officials. That, of course, has dramatically changed with the current restrictions that are born out of legitimate security concerns.

Also, in those days there was an absence of portability of lawyers. When lawyers joined firms, they tended to form deep personal relationships with the firms and their fellow lawyers. There wasn't the kind of movement among firms that exists today.

Another major and desirable change is the dramatically increased presence of women in both law practice generally and in tax practice particularly. When I went to law school there were only two women in my class of several hundred graduates. In most firms, there were few, if any, women lawyers. Now it is not surprising to find that half or more of graduating classes and law firms are composed of women. That represents a major change in the atmospherics of the practice.

On the substantive side, I think the big change is the massive complexity of the tax law, including in the international area of the practice. When I started, there was no subpart F, which was enacted shortly after I started practicing. In the employee benefits area, there was no ERISA. In trust and estates we worried only about things like the marital deduction; there were no concepts such as generation-skipping trusts. In the corporate area we didn't have any anti-*General Utilities* provisions to deal with. The well-rounded tax lawyer in the old days could competently and confidently represent a client in almost any area of tax practice. I could handle an international transaction, create a pension plan, handle an estate plan, or deal with a corporate liquidation, redemption, or reorganization. Today, with the level of sub-specialization that exists, most of us feel substantially more restricted in the areas where we can profess true competence.

Another area in which major change has occurred is the legislative process. In the old days Treasury would annually develop a plan, would present that plan to the Ways and Means Committee, which would hold orderly hearings. The House would act and then its bill would move over to the Senate, where the Finance Committee would hold hearings and act. There would often be 10 or 12 pieces of tax legislation each year, most of which were considered on the basis of their tax policy merit, without regard to other considerations. Now the tax legislative process has been subsumed into the budget process, and changes to the tax law are essentially a byproduct of that much larger event. Changes to the tax law are now often motivated by pressures such as revenue loss offsets as distinguished from their contribution to tax policy.

Another area of substantive change relates to guidance provided by the administrative process. In the old days, we relied on Revenue Rulings as an important source of guidance from the Service. Today, as we all know, there is really a very small flow of revenue rulings. I think the change may stem in part from the fact that in the early days Private Letter Rulings were not publicly available even in redacted form. So the only way you knew what the Service was thinking was by reading the Revenue Rulings. Today, with this great flow of Private Letter Rulings, we have a lot of information about what the IRS is thinking on a wide variety of subjects, and we don't need to depend so heavily on Revenue Rulings.

Q What areas of the Code do you believe are most in need of "fixing"? Do you see any prospects for change in those areas?

A I think the one area that is probably most significantly in need of attention, and I think is getting some now, is the international area. It seems to me that the current dispute that exists with the WTO over how much we are going to subsidize export activities of U.S. taxpayers is not likely to be the last of this kind of controversy. Unless we modify our system of taxing our citizens on a global basis to more closely match the territorial taxing systems of our major trading partners, continued collisions of this sort are inevitable. I am not competent enough in international tax law to provide the solution to that problem, but I see it as a very important problem over the near term.

Q You have spent a significant portion of your career working on tax controversy matters. Has the process changed for better or worse over the years, and what systemic changes would you recommend?

A The controversy process, I think, has probably changed less than some of the other areas of tax practice that I have talked about. On the atmospheric side, I recall that when I started practicing, the Tax Court's chambers were located in the IRS building. Eventually, the Tax Court succeeded in obtaining its own building. Also, when I started practicing, the Claims Court was composed of commissioners and of judges that heard appeals from those commissioners. The commissioners have by now become the judges of the Claims Court and the former judges have become the judges of the Court of Appeals for the Federal Circuit. So there have been significant changes in the structure of the courts that hear many of the tax cases.

In my view, there is one change to the judicial process that should receive more serious consideration than it has in the past. That change would extend the jurisdiction of the Tax Court to hear refund suits as well as deficiency proceedings. I see no rational policy reason to require a taxpayer to go to a Federal district court or to the Claims Court to sue for a refund of tax. Nor do I see any policy reason to require that the taxpayer pay all of a disputed tax amount before being able to sue for a refund. I would permit the Tax Court to hear refund suits, and I would eliminate the *Flora* doctrine that demands full payment as a ticket to a refund suit. Under today's rules, a taxpayer may have several deficiency years and several refund years, all involving similar issues, and those various years may end up in different court systems. That just makes no sense.

The Tax Court's current caseload is down. The district court caseloads are awesomely high. I suspect that the district court judges would be delighted to see the Tax Court taking some of that burden off their shoulders. And I suspect that the Tax Court judges would welcome the addition to their jurisdiction. Moreover, taxpayers

would benefit. It is hard in all of this to find any losers if my proposal were to be adopted.

Q Have you ever heard of any serious effort on the Hill to reverse the *Flora* decision and expand the Tax Court's jurisdiction to include refund suits?

A To my knowledge, there hasn't been any really serious discussion of this particular issue. A few years ago, the ABA Federal Courts Committee proposed that all appeals from tax cases be routed to a national court of tax appeals, removing those appeals from the U.S. Courts of Appeal. I was at that time Chair of the ABA Tax Section, and we were able to defeat that particular proposal in the ABA House of Delegates. It does seem important to me that generalist judges ultimately establish the appellate law in the tax area. I do not believe that tax specialists should resolve these issues to the exclusion of generalist judges. The issues decided on appeal can have very wide implications and deserve the attention of the broader community.

Q The Bush Administration has expressed a willingness to tighten rules applicable to tax shelters. How effective do you believe these efforts have been so far?

A I think that they have been only moderately effective. The corporate tax shelter problem (more accurately, the "business" tax shelter problem) is very difficult to resolve. Perhaps the most difficult aspect is to define what we mean when we call something a tax shelter. To put it more precisely, what do we mean when we call something an abusive tax shelter? We just do not have a definition.

At the same time, I don't think it is possible or even desirable to try to define an abusive tax shelter in legislation. It would be just too difficult. If it were easy to craft an effective definition, we would have seen one a long time ago because a lot of very bright people have been giving the subject a lot of attention.

It seems to me that the best way to attack the tax shelter problem is to make the downside of investing in a shelter that fails to be sustained on its merits very painful to the participants, not only to the taxpayers who invest in it, but also to those who promote and market it. The downside for investors could be increased by significantly increasing the substantial understatement penalty and by eliminating the reasonable cause and good faith exception under section 6664. With regard to promoters, I think it remarkable that a promoter can market a tax shelter, get paid, and pass on to the investor all of the problems of defending the shelter and all exposure to penalties. The tax law gives the promoter a free ride. I would advocate legislation under which a promoter incurs a penalty any time that an investor in the tax shelter incurs a penalty. The promoter penalty would be equal to the investor's penalty.

Q The courts have issued a number of decisions in recent years addressing alleged tax shelters and the economic substance doctrine. Some believe these decisions are in conflict and may send mixed signals to corporations considering tax-saving devices. Do you believe the law in this area is in an appropriate posture, or are major changes needed?

A This is very similar to the last question. I think we have to admit that the cases are in conflict, and it is extremely difficult to reconcile them, particularly cases where investments have been made in exactly the same shelter but the courts have gone in different directions. As matters now stand, we leave it to the courts, applying the economic substance doctrine, to attempt to define abusive tax shelters for us. And that may be the best that we can do for now, even though the cases are often inconsistent and unpredictable. As a matter of fact, that lack of predictability may itself contribute to the cause by discouraging tax shelter investment on the ground that it is inherently dangerous.

I return to the notion that the best way to deal with the problem is to make tax shelter investments unattractive because the downside risk is high enough to generate concerns that are effective to modify conduct. When we faced the individual tax shelter problem of the 1970s, the solution was ultimately found in tax law changes like the at-risk rules. Those rules proved to be effective because they made the economic downside of a tax shelter investment both unavoidable and unattractive. Again, I think we have to make the economic downside of investing in the modern generation of tax shelters significant enough to capture the attention of investors, and we need to extend that downside potential to the promoter of such products.

Q Your practice often involves representing clients before the Office of Appeals of the IRS. How has that office been changed in recent years in scope of responsibility and mandate, and how do you believe those changes have affected its core mission?

A I think we should recognize at the outset that the Appeals Division of the Service has been extraordinarily successful over the years in accomplishing its mission. It is probably the most successful ADR program in the country. If the tax cases that get settled in Appeals were instead to make their way to the courts, the courts would be unable to handle that caseload with the resources available today. So that Appeals, I think, is critically important to our tax administration process.

It is unfortunate that the appeals system has been saddled in recent years with some important but less attractive responsibilities. From the point of view of any tax professional involved in the controversy process, there are good tax cases and there are bad tax cases. Good tax cases are those that present meaningful and substantive issues of tax law that can be evaluated and resolved. Bad tax cases

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GOVERNMENT SUBMISSIONS BOXSCORE

Since the last issue of the NewsQuarterly, the Tax Section has coordinated the following Government Submissions, which can be viewed and downloaded free of charge from the Section's website at www.abanet.org/tax/pubpolicy/regindex.html. If you have any questions or need assistance in locating these documents please contact the Tax Section office at (202) 662-1783.

I.R.C. §	DATE	TITLE	COMMITTEE	CONTACT
414(v)	6/26/02	Comments Regarding Proposed Treasury Regulation § 1.414(v)-1	Employee Benefits	Leonard S. Hirsh Bernard F. O'Hare
various	6/27/02	Comments to IRS and Treasury Dept. Regarding Tax Shelter Proposals dated March 20, 2002	Section of Taxation	Richard M. Lipton
n/a	6/28/02	Comments Concerning Limited Scope Income Tax Examinations in the Internal Revenue Service's Large and Mid-Size Business Division	Administrative Practice	Melissa E. Welch Thomas J. Callahan Gregory J. Gawlik
1441	7/24/02	Comments Regarding IRS Notice 2002-41: Withholding Foreign Partnership and Withholding Foreign Trust Agreements	U.S. Activities of Foreigners and Tax Treaties	Edward J. Tanenbaum Jason S. Bazar
n/a	8/5/02	Comments Concerning Proposed Amendments to Tax Court Rules	Court Procedure & Practice	Nancy T. Bowen
n/a	8/13/02	Comments Concerning Proposed Amendments to Tax Court Rules	Low Income Taxpayers	Elizabeth A. Copeland Leandra Lederman
various	9/13/02	Comment Letter to Treasury Dept. regarding Recommendations of the AICPA/ABA/TEI Task Force on Tax Simplification	Section of Taxation	David Glickman Terrill A. Hyde

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involve issues that you would rather not have to wrestle with, such as collection due process hearings. You are not really working with the tax law; you are instead working with a taxpayer who has a tax liability and not much money, and you are trying to protect that person's rights while the system extracts money from him. It can be an impossible situation.

I do think there is a risk to the core mission of Appeals when it is required to perform these other assignments that tend to make the role of the Appeals Officer less attractive. We need to assure that Appeals will continue to attract highly qualified people. ■