ERWIN N. GRISWOLD LECTURE

2020 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Tomorrow Is Another Day—How Did We Get Here Ethically

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It is an honor for me to present the 2020 annual Erwin N. Griswold lecture to members of the American College of Tax Counsel.

We can appreciate that Dean Griswold had a significant early impact on the growth of tax law. As a Harvard Law School professor, dean and later as Solicitor General of the United States, he was a major influence to the tax profession throughout the tax system during his career, and even today.

My own early legal training started in Oregon, where my father had practiced law before World War II. I had every expectation to practice in Oregon, until I accepted a teaching fellowship at New York University and came under the influence of Gerald Wallace, Charlie Lyon, Jim Eustis, Carr Ferguson, and others in the NYU Masters in Tax Program.

My formal legal career began with a three-year military commitment to the Army Judge Advocate General's Corp in 1963. After basic combat training in Georgia, and then JAG school at the University of Virginia, I was initially assigned to teach Military Law at West Point, perhaps because of my experience teaching at the NYU law school. Then two weeks before arrival, my orders were changed to the Pentagon, where I handled tax cases and procurement law for the Army during the Vietnam War.

It was an auspicious beginning, finally leading to a legal career in private practice in California, along with 40-plus years as an adjunct professor teaching Advanced Business Planning and Advanced Corporate Taxation in the Masters tax program at the University of San Diego.

I have enjoyed my many experiences in both the California Bar and the American Bar Association, especially with ACTC and as Chair of the ABA Tax Section in 2003-2004.

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It has been 60 years since I started in the legal profession in 1959. The 1954 tax code was new, corporate practice was the primary business choice, partnerships were of limited use, Subchapter S was just enacted in 1958, LLCs and disregarded entities would not become new tax creations until the distant future. I remember the maximum marginal tax rate in 1959 was 91%, compared to the later high 28% rate in 1988 and 37% today.

Throughout my career the tax laws have been frequent vehicles for social, economic, and political programs. Many of us have watched the development of retirement laws. Remember the Kintner regulations, H.R. 10, and now 401(k)s, IRAs, ROTH IRAs, and special provisions for children, the disadvantaged and the elderly, such as the Kiddie tax, refundable credits, and opportunity zones, as examples.

My goal for this evening is to select a broad topic of sufficient interest to keep all of you inspired and awake.

I am reminded of a dinner where the international scientist, Buckminster Fuller, of geodesic dome fame, was to give a brief after-dinner speech. Midway through his extended two and one-half hour lecture, he quit, walked up to a dinner table and kicked a guest in the shin to wake him up. After that, companions were hesitant coming to future dinners. I anticipate you will all stay awake.

In preparation for this evening, I've had the opportunity to review articles prepared by our predecessor lecturers. Ethics and tax compliance have been common themes.

I note that Jim Holden in 1999,[1] Carr Ferguson in 2000,[2] and Randolph Thrower in 2001[3] vigorously attacked abusive tax shelters, and finally Pam Olson in her 2006 lecture concluded that the tax shelter war was over with the passage of tax shelter provisions in the American Jobs Creation Act of 2004.[4] Karen Hawkins recently expressed her view that Circular 230 has become almost broken upon the unsuccessful effort to regulate standards for tax

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[1] James P. Holden, *1999 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Dealing with the Aggressive Corporate Tax Shelter Problem*, 52 TAX LAW. 369 (1999).

[2] M. Carr Ferguson, *2000 Erwin N. Griswold Lecture Before the American College of Tax Counsel: How Will The Court Rule?*, 53 TAX LAW. 721 (2000).

[3] Randolph Thrower, *2001 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Is the Tax Bar Going Casual—Ethically?*, 54 TAX LAW. 797 (2001).

[4] Pamela F. Olson, *2006 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Now That You've Caught the Bus, What Are You Going To Do With It? Observations from the Front Lines, the Sidelines, and Between the Lines so to Speak*, 60 TAX LAW. 567 (2007); *see* Richard A. Shaw, *Enhanced Reporting Penalties: The Newest IRS Weapons*, 7 BUS. ENTITIES 6 (Mar./Apr. 2005).

return preparers.[5] Last year, Dick Lipton devoted his attention to judicial doctrines and economic substance.[6]

I could pick a topic for us from one of my own special tax law areas, Subchapter S or closely held entities,[7] but I realize I would lose most of you. I doubt that you want to listen to the details on the 247 pages of regulations on the 20% Qualified Business Income Tax deduction.

Instead, I have chosen a somewhat broader topic which, I believe, is important to all of us as tax lawyers.

Development of Ethics in Tax Practice

This tale is going to be a tour of what we are, and how we got here as tax lawyers.

Let's examine the development of ethics, compliance, and perhaps a little malpractice in the tax world as viewed by a tax lawyer in private practice with six decades in the tax profession.[8]

There are many issues to consider.

- What is our obligation to ourselves, to our clients, and perhaps to the tax system?
- What are our ethical duties as lawyers with a specialty in tax practice?
- When are we subject to Circular 230?[9]
- How have we, as tax lawyers, been affected by changes in the recent past?

Let's start with a few simple questions.

Question 1

You are an attorney who has handled many clients before the IRS. While planning a business transaction with Client A, he informs you he recently forgot to report federal taxes on the sale of Blackacre, with a $1 million capital gain. What are your duties to the client and the IRS?

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[5] Karen L. Hawkins, *2017 Erwin N. Griswold Lecture Before the American College of Tax Counsel: A (Not So) Modest Proposal*, 70 TAX LAW. 647 (2017).

[6] Richard M. Lipton, *2019 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Proper Application of the Judicial Doctrines and the Elimination of Section "I Don't Like It,"* 72 TAX LAW. 621 (2019).

[7] *See, e.g.*, Richard A. Shaw, *Structuring S Corporations After Fifty Years*, 66 N.Y.U. ANN. INST. FED. TAX'N 13-1 (2008); Richard A. Shaw & Thomas J. Nichols, *Choice of Entity in Light of Recent and Proposed Tax Changes*, 68 N.Y.U. ANN. INST. FED. TAX'N 13-1 (2010).

[8] *See* Richard A. Shaw, *Ethics and the Internal Revenue Service*, 59 U.S.C. INST. FED. TAX'N 14A-1 (2007).

[9] 31 C.F.R. §§ 10.0–10.93 (published as Circular 230).

- Should you advise A to file an amended return even though there is no statutory requirement to file an amended return? Note that Circular 230, section 10.21, only requires you to inform the client of the fact of noncompliance, error, or omission and the consequences under the Code and regulations.
- Should you ethically remind him that the statute of limitations is about to expire?
- Should you inform him ethically of audit risks, currently only 0.45%?
- Do you have a duty to report the error to the IRS? Note that Circular 230, section 10.20, presently requires disclosure unless an attorney believes in good faith and on reasonable grounds that the information is privileged.
- Does the attorney-client privilege protect him? Is it even available?
- Should your duty to the tax system and the public override any attorney-client privilege?
- If the client does not file an unamended return, do you have any duty to resign?

One very senior Treasury officer on a panel with me, once asserted the failure of the lawyer to disclose the omission would make the attorney a co-participant in a federal crime.

Let's go one step further.

Question 2

You now represent client A in an IRS audit examination. You know the auditor is only looking at minor expense deductions. Assume the client says "let it ride."

- What do you do when the auditor asks you if there are any unreported items?
- Do you have a duty to withdraw if the auditor may rely on your silence to corroborate the position of the client that there is no unreported item?
- Really, does it make a difference to you whether the error is $1,000 or $1 million?

Question 3

Client B is a corporation and you are asked to give a written opinion on the structure of a possible corporate reorganization. There are tough facts, representations, and assumptions involved.

- Are you required to follow Circular 230, section 10.37, standards in drafting the written opinion as a tax attorney? Remember sections

> 10.51(a)(13) and 10.52(a) would impose sanctions if your errors are made recklessly, willfully, or through gross incompetence.

These are serious ethical questions all tax attorneys face.

A Primary Duty

The primary duty of a lawyer is to the client and not to the federal tax system. Here are observations from some members of our tax profession in the past.[10]

Carr Ferguson observed in his lecture that Dean Griswold was always a lawyer first and only then as an expert in taxation.[11]

Boris Bittker made it clear in his mind that in a tax controversy the government is the adversary and the attorney must be devoted to the client.[12] He wrote:

> There is a shadow of Big Brother . . . in these suggestions that the attorney has special obligations to the Treasury because it regulates his admission to practice or because it represents "all of us" and hence embodies a virtue superior to any of us.[13]

Randolph Paul questioned whether the high standards applied in Circular 230 were really distinguishable from the high standards applied to all lawyers in their practice.[14]

Norris Darrell observed "you of course, have a double duty: a duty to do your best for the client and not to bring the lightning down upon him, and a duty to live up to your professional responsibility."[15]

NYU Professor Jerome Hellerstein argued that the relationship between the citizen and the government is not comparable to that between an ordinary plaintiff and defendant because the citizen owes "his government and his neighbors the duty to pay his share of taxes"[16] and, therefore, tax lawyers "owe to our Government and to ourselves" a duty to improve the tax morality of

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[10] Special appreciation must be given to Michael Hatfield for his two extended articles giving a detailed historical review of ethical duties from 1945 to 1985. *See* Michael Hatfield, *Legal Ethics and Federal Taxes, 1945-1965: Patriotism, Duties and Advice*, 12 FLA. TAX REV. 1 (2012) (hereafter Hatfield I); Michael Hatfield, *Committee Opinions and Treasury Regulation: Tax Lawyer Ethics, 1965-1985,* 15 FLA. TAX REV. 675 (2014) (hereafter Hatfield II).

[11] Ferguson, *supra* note 2, at 722.

[12] Hatfield I, s*upra* note 10, at 22 (citing BORIS I. BITTKER, PROFESSIONAL RESPONSIBILITY IN FEDERAL TAX PRACTICE 267 (1965)).

[13] *Id.* (quoting BORIS I. BITTKER, PROFESSIONAL RESPONSIBILITY IN FEDERAL TAX PRACTICE 267–68 (1965)).

[14] Hatfield I, s*upra* note 10, at 23.

[15] *Id.* at 22.

[16] *Id.* at 14.

the community.[17] He also argued for disclosing all positions, even when it was reasonably clear the government would oppose the taxpayer's position regardless of the strength of either position.[18]

On the issue of full disclosure, Professor Gerald Wallace at NYU thought that when the attorney believes the government position is wrong there should be no duty to disclose information for the purpose of inviting closer examination.[19]

The views expressed to us recently by Emily Parker in 2016 are also relevant.[20] Her presentation stated:

> A tax lawyer who only advises client to take positions that the IRS has expressly approved, or would approve, will not be a very successful lawyer. A tax planner and advisor sometimes must advise clients to take positions that present some risk, including the risk of an IRS challenge.[21]

Law is not always clear.

The reality is that tax law is not always clear. The tax statutes and supporting regulations are often drafted hastily, with ambiguity and much room for reasonable interpretation. Sometimes the United States Supreme Court *Chevron* case review standards must be applied to resolve a tax law interpretation.[22] In many instances, the underlying facts are unclear and unresolved. In some complex instances, the government's position may be considered too conservative, with litigation anticipated.

A good example of the difficulties is *Gitlitz v. Commissioner*, where the United States Supreme Court used the plain language of the Code, section 1366(a), to override three lower appellate court decisions that had favored the Commissioner's view on a shareholder basis issue.[23] In one case, I had to succeed at both the District Court and the United States Court of Appeals

[17] Hatfield II, *supra* note 10, at 690 n.81.

[18] Hatfield I, *supra* note 10, at 16.

[19] *Id.* at 32.

[20] Emily A. Parker, *2016 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Stroke of The Scrivener's Pen: Role of a Tax Planner and Litigator,* 69 TAX LAW. 477, 478 (2016).

[21] *Id.*

[22] Chevron U.S.A., Inc. v. Nat'l Res. Def. Council, Inc., 467 U.S. 837 (1984). The standard asks whether Congress has directly addressed the precise question at issue. If the statute is silent or ambiguous on the issue, the court will determine whether the government's interpretation is based on a permissible interpretation of the law. At this level, the government's construction is permitted unless it is arbitrary, capricious, or manifestly contrary to the statute involved. *See also* Mayo Found. for Med. Edu. & Research v. United States, 562 U.S. 44 (2011).

[23] 531 U.S. 206 (2001); *see* Richard Shaw, *Subchapter S + 108 = Basis (an Analysis of* Gitlitz*),* 60 N.Y.U. ANN. INST. FED. TAX'N 21-6 (2002).

levels before the government conceded issues that should never have been raised in the first place.

Where should one begin a review of our ethical obligations as tax lawyers?

State Law Rules

Actually, as lawyers, we should start with our own obligations as licensed attorneys in our respective states and the District of Columbia.

The state rules set the basic standards for competence, due diligence, and avoidance of conflicts of interest, and related ethical rules that must be followed. Actually, by now most states have adopted a version of the ABA Model ethical rules as last revised in 2002. California finally came on board in 2018.[24]

The ABA ethical rules should not be taken lightly, as they are also the required rules used in the federal courts, including the United States Tax Court.

When I moved to California in 1968, there was no recognized specialty for tax lawyers. There were only two recognized specialties, patent law and admiralty law.

A premier early tax case on special skills was *Horne v. Peckham*,[25] which established in California that the subject of federal income taxation is an area requiring special skills, and that a general practitioner who elects to practice in the field of federal tax law should be held up to the same standard of care expected of other persons practicing in the tax law specialty community. The case involved planning a defective 10-year "Clifford Trust" under pre-1986 tax law. Thereafter, the courts began to recognize that other areas of the law required special skill and experience.

It was only through the efforts of the California tax attorneys that California in the 1970s formally recognized taxation law specialization, for which most states now require certification and continued education requirements, including ethical courses, in order for a lawyer to be recognized as a taxation law expert. Just as important to us as tax lawyers is the fact that state law qualification is also a pre-condition for a lawyer to represent clients before the IRS or the federal courts.

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[24] I am informed that Maryland and Illinois do not offer tax law specializations.

[25] 97 Cal. App. 3d 404 (1979); *see* Jerald D. August, Richard A. Shaw & Mark L. Silow, *Avoiding Tax Malpractice in Advising Owners of Closely-Held Businesses*, 63 N.Y.U. ANN. INST. FED. TAX'N 15-1 (2005) (discussing *Horne v. Peckham* in greater detail); s*ee also* Bent v. Green, 39 Conn. Supp. 416, 466 A.2d 322 (1983); Bowman v. Doherty, 235 Kan. 870, 686 P.2d 912 (1984).

Fiduciary Duties

Before we proceed further it is important to consider that attorneys owe a fiduciary duty to the client.

The following are fiduciary standards which have been applied by the courts in California.

> The relation between attorney and client is a fiduciary relation of the very highest character, and binds the attorney to most conscientious fidelity.[26]

> An attorney at law should be a paragon of candor, fairness, honor, and fidelity in all his dealings with those who place their trust in his ability and integrity . . . .[27]

> The fiduciary attorney-client relationship must be a purely personal relationship involving the highest personal trust and confidence.[28]

These fiduciary obligations will be at risk when we talk of an independent high duty to the tax system.

The Tax System

Tax lawyers for many decades have discussed whether tax lawyers have a separate subjective duty to protect the American tax system.

What is the "tax system" we are talking about?

In the words of the United States Supreme Court in *United State v. Galletti*, "the Federal tax system is basically one of self-assessment whereby each taxpayer computes the tax and then files the appropriate form of return along with the requisite payment."[29]

Yes, there is a fundamental legal obligation for each taxpayer to pay his or her tax obligation, and, at least, it is fair to say there is expected to be a national code of honor that expects each taxpayer to satisfy his or her full and honest self-assessment commitment to support our federal tax system.

If a taxpayer defrauds the government of a million dollars, the rest of our citizens will be burdened because of the tax deficiency. It is disappointing to note that the National Taxpayer Advocate has just reported that the recent $381 billion in unpaid taxes in 2019 leads to an additional $3,000 tax burden on each household to subsidize the noncompliant.

This raises the important question whether we as tax lawyers are prepared to promote higher ethical and legal standards and use them to assure the fair application and integrity of the tax system, for ourselves, our clients, and the public.

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[26] Cox v. Delmas, 99 Cal. 104, 123 (1893).
[27] Sanguinetti v. Rossen, 12 Cal. App. 623, 630 (1906).
[28] 7 Am. Jur. 2d, Attorneys at Law, § 137 (1980).
[29] 541 U.S. 114, 122 (2004).

The answer has been a serious subject for many years, especially with leaders of the ABA Tax Section and members of the American College of Tax Council.

During my career, there has been a continued effort to assure that tax lawyers have clear, reasonable ethical guidelines for giving tax advice, which will be consistent with the taxpayers' legal obligations under the tax system. It is helpful to focus on a few historical events as guidelines.

ABA Formal Opinion 314

At the request of the Tax Section in the 1960s, the ABA Ethics and Professional Responsibility Committee for the first time examined the issue of a separate ethical role of tax lawyers.

This resulted in new ABA Formal Opinion 314 in 1965, which was specifically directed to tax lawyers.[30] Opinion 314 explained that the IRS is not a judicial tribunal, and therefore the tax lawyer has a duty to zealously represent the client's cause. It emphasized that so long as the client's case is fully arguable, the lawyer is under no duty to disclose weaknesses to the IRS. On the issue of tax advice, it observed the attorney "may freely urge the statement of positions most favorable to the client as long as there is a reasonable basis for those positions."[31]

It clearly applied the litigators view that the IRS is an adversary, and no special duties are owed to it. Nonetheless, Opinion 314 also explained that the lawyer had a duty not to assert false statements of fact and a duty not to mislead the IRS affirmatively either by misstatements or silence or by permitting the client to so mislead the IRS.

Thereafter, many ethical tax professionals concluded that aggressive tax planners were simply using the new "*reasonable basis*" test merely as a "classic primer for rationalizing unethical conduct"[32] and "the use of any colorable claim to justify exploitation of the [audit] lottery."[33] L. Ray Patterson also observed, "[a] poor lawyer is he who cannot find a reasonable basis for his client's position."[34]

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[30] ABA Standing Comm. on Ethics & Prof'l Responsibility, ABA Formal Op. 314 (1965), *reprinted in* 51 A.B.A. J. 671 (1965).

[31] *Id.* at 672.

[32] *See* L. Ray Patterson, *Tax Shelters for the Client—Ethics Shelters for the Lawyer*, 61 TEX. L. REV. 1163, 1165 (1983) (reviewing BERNARD WOLFMAN & JAMES HOLDEN, ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE (1981)).

[33] ABA Section of Taxation Proposed Revision to Formal Opinion 314 (May 21, 1984), *reprinted in* BERNARD WOLFMAN & JAMES HOLDEN, ETHICAL PROBLEMS IN FED. TAX PRAC. 71 (2d ed. 1985). For a detailed discussion, see J. Timothy Philipps, *It's Not Easy Being Easy: Advising Tax Return Positions*, 50 WASH. & LEE L. REV. 589, 610 (1993).

[34] Patterson, *supra* note 32, at 1165.

It is helpful to remember the audit rate in 1965 had fallen to 1.2%, and as usual, there was inadequate funding for audits and the educational needs of the IRS personnel. As a result, taxpayers were ready to make judgments on uncertain tax issues in their own favor.

It is unfortunate to learn that the National Taxpayer Advocate reported that just last year, the IRS only audited 0.45% of 2019 tax returns, compared to 1.1% ten years ago, a reduction of 59.1%, that the budget has dropped to 80% of the level in 2010, and that the IRS is suffering a dramatic reduction in employee staff, a reduction to 78,000, after a loss of 30,000 employees.

The Commissioner needs lots of help.

Perhaps, some of you will remember the famous quote, attributed to Plato around 343 B.C.: "[W]hen there is an income tax, the just man will pay more and the unjust less on the same amount of income."[35]

ABA Formal Opinion 85-352

Let us move forward 20 years to 1985. Two decades after Opinion 314, in the 1980s, the Standards of Tax Practice Committee of the Tax Section took up the charge and sought to have the ABA revise its Opinion 314 position.[36]

The committee's premise was that the client's relationship with the IRS is not an adversarial proceeding, and the audit is only an administrative process to discover and assess a correct tax under our self-assessment system. It proposed that any advice given by any attorney should be "meritorious" and given "in good faith, as evidenced by a practical and realistic possibility of success, if litigated."[37] The realistic possibility of success condition was intended to provide an objective standard to support the subjective, good faith belief of the attorney.

The ABA response gave some relief. Finally, in new Formal Opinion 85-352, the ABA set a new revised ethical standard for tax lawyers.[38] The new opinion stated:

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[35] PLATO, THE REPUBLIC 27 (B. Jowett trans., Vintage Books 1960).

[36] Proposed Revision to Formal Opinion 314, *supra* note 33, at 71.

[37] *Id.* at 73.

[38] ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 85-352, *reprinted in* 39 TAX LAW. 631 (1986). A special report was approved by the ABA Tax Section Council on February 2, 1986, which analyzed the application of the opinion. *Report of the Special Task Force on Formal Opinion 85-352*, 39 TAX LAW. 635 (1986).

Earlier in 1981, the ABA had released Formal Opinion 346 related to tax shelters. ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 346 (1981), *reprinted in* 67 A.B.A. J. 1057 (1981). Opinion 346 was subsequently revised in 1982. ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 346 (1982), *reprinted in* 68 A.B.A. J. 471 (1982). Opinion 346 set forth ethical and disciplinary standards to be applied to lawyers rendering formal tax opinions on tax shelter investments targeted for third-party potential investors who were not present clients of the lawyers. In this sense, a tax shelter opinion was intended to be a marketing tool to induce the

> A lawyer may advise reporting a position on a tax return so long as the lawyer believes in good faith that the position is warranted in existing law or can be supported by a good faith argument for an extension, modification or reversal of existing law and there is some realistic possibility of success if the matter is litigated.[39]

It was important that the advice could no longer be based just on the unsatisfactory "reasonable basis" test for advising a position. It was now significant that the new standard required both *a good faith argument by the lawyer* and a *realistic possibility of success* if litigated.

There was now an objective standard applied to a subjective belief. That test would require at least a one-in-three chance of prevailing on the merits. The minimum tax position could not be frivolous.

The 1985 ABA opinion still maintained that ethical standards governing tax attorneys are no different than those applied to others in civil matters, and therefore the attorney should still zealously and loyally represent the interest of the client within the full bounds of the law.

It retained the premise that the tax return process is adversarial by its nature, and it recognized that the potential adversary relationship may occur even before the tax return is filed. Opinion 85-352 stated in part:

> In many cases a lawyer must realistically anticipate that the filing of the tax return may be the first step in a process that may result in an adversary relationship between the client and the IRS. This normally occurs in situations when a lawyer advises an aggressive position on a tax return, not when the position taken is a safe or conservative one that is unlikely to be challenged by the IRS.[40]

The ABA had just adopted a new modified set of ABA Model Rules of Professional Conduct in 1983, which it then applied to tax lawyers in the opinion.[41] It was material that the ABA opinion relied on Rule 3.1 of the new Model Rules which stated in material part:

> A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis for doing so that is not frivolous, which

potential future clients to invest relying on the opinion. This would result in the "covered opinion" provisions of Circular 230, former section 10.35 which were deemed to be enforceable with sanctions for violation.

[39] ABA Formal Op. 85-352, *supra* note 38, at 631.

[40] *Id.* at 632.

[41] *Id.* The Model Rules replaced the 1969 ABA Model Code of Professional Responsibility which consisted of Canons (broad axiomatic norms), Ethical Considerations (aspirational objectives), and Disciplinary Rules.

> includes a good faith argument for an extension, modification or reversal of existing law.[42]

Many Tax Section members were concerned with the following summary in the 1985 opinion, which concluded that as long as there is good faith and a realistic possibility of success:

> [A] lawyer may advise reporting a position on a return even where the lawyer believes the position probably will not prevail, there is no "substantial authority" in support of the position, and there will be no disclosure of the position in the return.[43]

It was also relevant that section 6661 (now section 6662) then used the substantial-understatement-penalty test requiring either substantial authority or adequate disclosure to avoid a penalty, which was referred to in the opinion, and also that the ABA Model Rules of Professional Conduct had just two years earlier in 1983 adopted a complete updated set of ethical standards, which it used in its opinion.

Some Tax Section members subsequently expressed dissatisfaction with the low ethical standards for tax advice, since it did not even require compliance with the statutory penalty requirements of section 6661, and thereby failed to protect the integrity of our self-assessment system. Some thought a more-likely-than-not test was more appropriate.[44]

It is now 35 years later in 2020 and Opinion 85-352 has not been replaced, although the ABA completely updated and modernized its Model ethics rules again in 2002.

As we move forward to the present, Circular 230 still does not apply the lower ABA advice standards of Opinion 85-352, and instead, Circular 230, section 10.34, now requires that the minimum ethical level of tax advice on a tax return position is the higher penalty condition of section 6694(a)(2) requiring substantial authority or disclosure.

As I will discuss later, Circular 230 is no longer applicable to any tax return preparation advice in view of the *Loving* case.

Disclosure of Information and Records in 2020

A second major difference between the Tax Section and the ABA through the years has been the Tax Section's continued disagreement with the ABA litigation position on ethical standards for tax lawyers disclosing information and records to the IRS.

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[42] *Id.*

[43] *Id.* at 633 (quoting MODEL RULES OF PROF'L CONDUCT r. 3.1 (AM. BAR ASS'N 1983).

[44] For an early review, see Theodore C. Falk, *Tax Ethics, Legal Ethics, and Real Ethics: A Critique of ABA Formal Opinion 85-352*, 39 TAX LAW. 643 (1986); for a later review, see Hatfield II, s*upra* note 10*,* at 696.

As tax litigators, we know that control over information and strategy are both essential elements in an adversarial litigation situation.

Remember the ABA approach in Opinion 314, in 1965, was one requiring zealous representation and no duty to disclose any weakness in the client's tax position to the IRS. Later, Opinion 85-352 still would not require disclosure on a return so long as there was good faith and a realistic possibility of success in litigation, only about a one-in-three likelihood of succeeding on the merits.

The ABA position remained contrary to the self-assessment approach of many tax lawyers that a taxpayer is obligated to report complete information for each item on the tax return as part of the self-assessment process necessary to ascertain the correct amount legally assessed.

It is relevant that the lower ethical standards of Opinion 85-352 have not been revised by the ABA and remain applicable today.

When we move forward 35 years to the present on the disclosure issue, Circular 230, section 10.20, now provides that a practitioner is required to submit to the IRS any record or information properly and legally requested in a matter before the IRS, unless there is a good faith belief and reasonable grounds the records or information is privileged. Willful failure to comply is treated as a sanctionable offense under section 10.52(a). Under section 7202, willful failure may be a misdemeanor with a $25,000 fine ($100,000 for a corporation), and under 18 U.S.C. section 1001, it is a felony to make false statements to a federal officer.

It is important that Circular 230 and the IRS properly respect that a lawyer representing a client in an audit examination has the right to rely on the attorney-client and work-product privileges to protect the confidences between a lawyer and his or her client.

Therefore, when subject to present Circular 230, the lawyer may rely on attorney-client and work-product privileges to avoid improper disclosure.[45] This protection would extend to a lawyer's agents under the *Kovel*[46] rule and an accountant under section 7525.

The attorney-client privilege has an interesting history. The common-law doctrine is believed to have existed as early as 70 B.C. when Cicero was prosecuting the Governor of Sicily for corruption. He was precluded from examining the Governor's advocate as a witness because it would violate confidences protected under Roman law.

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[45] The material impact of Loving v. Internal Revenue Service, 742 F.3d 1013 (D.C. Cir. 2014), on Circular 230 is discussed later in this article. *See infra* text accompanying notes 52–57.

[46] United States v. Kovel, 296 F.2d 918 (2d Cir. 1961) (in which an accountant was permitted to refuse to answer a grand jury question regarding information overheard during an interview between a client and tax attorney on the basis that the accountant was hired by and under the direction of the lawyer).

Financial Reporting

Separately, it has also become very relevant to us that, even in the financial world, lawyers may no longer just use old Accounting Standard 5, which was applied in financial reporting opinions letters to accountants to advise the likelihood of success or failure on the merits of a uncertain tax position. Those financial opinions used a remote or probable likelihood of success for financial reporting purposes. Instead, lawyers may now be driven by the more-likely-than-not standards of FIN 48[47]and the controls of the Sarbanes-Oxley Act of 2002.

Tax Shelters

As we touch on the growth of ethics in tax practice, let's take a moment to reflect on the advancements made in dealing with tax shelters and reportable transactions. It took a long time to clean up a nasty mess, but perhaps the train has arrived at the station.[48]

I have practiced through multiple periods of tax shelter exposure and actually done my share of expert representation in them.

All too many tax shelters contained intentionally manipulated facts and misuse of sections of the Code designed to create artificial tax losses to offset enormous income, with no business purpose and no real economic substance to them. They carried with them a variety of labels: form over substance, sham, step transaction, and, of course, economic substance.

Congress, with Tax Section member support, stepped in with a number of statutory controls to close the door on abusive tax shelters and reportable transactions. They apply enhanced reporting requirements,[49] increased more-likely-than-not requirements on tax advice,[50] abusive-tax-shelter penalties,[51] and finally section 7701(o), which is intended to clarify and define the scope of the economic substance doctrine, while at the same time preserving the standards established in common-law cases. Detailed disclosure of reportable transactions are now specifically required to be reported to the IRS on Form 8886, Reportable Transaction Disclosure Statement.

Circular 230

Let's turn our attention to recent events that have materially affected the present status of Circular 230.

[47] FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (June 2006).

[48] *See* ABA Formal Op. 346, *supra* note 38.

[49] I.R.C. §§ 6111, 6707, and 6707A.

[50] I.R.C. § 6694(a)(2)(c).

[51] I.R.C. § 6700.

You'll recall that in 1884, Congress passed into law 31 U.S.C. section 330 that granted Treasury only authority to regulate to the "practice of representatives of persons before the Department of the Treasury." Representatives were required to demonstrate good character, good reputation, and competence to assist the taxpayers in presenting the cases. These requirements included authority for the Secretary to censure, suspend, or disbar any representative from practice before the IRS who is incompetent, disreputable, violates regulations under the Act, or who misleads or threatens a client or prospective client. An amendment permits monetary sanctions.

Since the issuance of Circular 230 in 1921, it has been applied effectively to regulate standards and restrictions for attorneys who represent clients in audits of tax returns, claims for refund, or appeals. With few exceptions, it has historically followed the ethical guideline adopted by the ABA ethical Canons, Code and now Model Rules. It promotes higher ethical standards for tax lawyers practicing before the IRS by providing guidelines for best practice (section 10.33), full requirements for disclosure (sections 10.20–10.22), standards for tax return preparation (section 10.34), competence (section 10.35), and requirements for written advice (section 10.37, formerly covered opinions under 10.35), as examples.

Tax Return Preparers[52]

However, after 125 years of not regulating persons who receive compensation in the preparation of tax returns and claims for refund, the IRS launched a review in 2009–2011 to establish special rules to govern training and compliance standards for tax return preparers. The result in Circular 230 included an exam for basic qualification, as well as several hours of continuing education.

Treasury's final inclusion of tax return preparers in Circular 230, resulted in an outburst that the IRS had *no* authority to regulate tax return preparers. It opened the door for a serious look at the limits of the authority of Treasury over tax return preparers, as well as practitioners representing clients before the IRS.

Most of us are familiar with the dramatic impact of the District of Columbia Court of Appeals decision in *Loving v. Internal Revenue Service*.[53]

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[52] Section 7701(a)(36) defines a "Tax Return Preparer" as

> any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.

[53] 742 F.3d 1013 (D.C. Cir. 2014).

In *Loving*, the court concluded that the 1884 statute only authorized the Treasury to have jurisdiction when there is actual agency representation by an attorney to act on behalf of the taxpayer during an IRS examination of a tax return. The Court concluded that merely preparing tax returns does not constitute "practice of representatives" before the IRS.

The court opinion relied heavily on the 2004 Supreme Court decision in *United States v. Galletti*, discussed earlier, where the Court explained that "[t]he Federal tax system is basically one of self-assessment, whereby each taxpayer computes the tax due and then files the appropriate form of return along with the requisite payment."[54] Not until the return has been filed and then selected for audit is the taxpayer entitled to designate a representative on his or her behalf.

Simply put, the Court found that statutory authority empowering the IRS to regulate representatives did not extend to attorneys who merely advised the taxpayer in filing a return or ordinary claim for refund.

Subsequently, in *Ridgely v. Lew*,[55] the District Court of the District of Columbia found that the IRS Office of Professional Responsibility (hereafter OPR) could not impose Circular 230 limits and sanctions on the CPA who prepared an ordinary claim for refund under a contingent fee agreement prohibited in Circular 230, section 10.27(b).

It was significant that the CPA, assisting the taxpayer in preparing and filing an ordinary refund claim, would not be recognized as representing the taxpayer until after the IRS responded to the claim and the CPA then provided the required IRS Form 2848 Power of Attorney, designating the CPA as authorized client representative before the commencement of the audit proceeding.

The decision appeared to finally close the door on the right of OPR to use Circular 230 to regulate attorneys when advising taxpayers in the preparation of tax returns or a claim for refund. The case was not appealed by the government.

Shortly after Karen Hawkins gave her Griswold presentation in 2017, the Nevada District Court in *Sexton v. Hawkins* on March 17, 2017, inserted another thorn into the side of the IRS.[56]

It is an interesting case. The case involved an attorney previously convicted of fraud, who had already been disbarred in South Carolina and suspended by OPR. The attorney had been engaged to prepare a written opinion for a taxpayer, Louise Kern, analyzing her options on business tax issues. Kern, upon learning of the disbarment, sent a complaint to OPR. OPR made a

[54] *Galletti*, 541 U.S. at 122. *See supra* text accompanying note 29.

[55] 55 F. Supp.3d 89 (D.D.C. 2014).

[56] 2017-1 U.S.T.C. ¶ 50,181, 119 A.F.T.R.2d 1187 (D. Nev. 2017). Sexton had been convicted of mail fraud and money laundering and had earlier prepared tax returns for Kern.

request for information from Sexton under Circular 230, section 10.20. Sexton, in turn, then filed a lawsuit against Karen Hawkins, asserting that OPR had no jurisdiction over him.

The court, relying on the limits set in 31 U.S.C. section 330, held that Sexton was not engaged in practice before the IRS and, therefore, had no obligation to submit any information requested by OPR under Circular 230, and the IRS had no authority to impose any sanctions on him. The fact that Sexton had earlier dealt with the IRS did not give the IRS inherent jurisdiction over him.

The clear effect of the *Loving* line of cases is that lawyers giving tax advice for positions on tax returns are not subject to Circular 230 ethical standards.

Now it appears that tax attorneys giving tax advice leading to a position on a tax return will fall back to state ethical rules and ABA Opinion 85-352 as ethical guidelines. This would mean applying good faith and realistic possibly of success (a one-third likelihood of success) as the minimum ethical standard.

Congress would be well advised to amend 31 U.S.C. section 330 to authorize Treasury to set sanctionable ethical standards for paid tax return preparers for the protection of the taxpayers they serve.[57]

Lawyers as Tax Return Preparers

After all of this, it is also important to recognize that a tax lawyer may separately be treated as a non-signing tax return preparer under the Code, section 7701(a)(36), and Treasury Regulation section 301.7701-15, if the lawyer gives either oral or written advice to the taxpayer and that advice leads to a position or entry that constitutes a substantial portion of the return. The lawyer would then be at risk for penalties as a tax return preparer.

For example under the regulations, if a lawyer gives advice on a *completed* corporate transaction that is directly related to the determination of an item on the return, the lawyer will be considered a non-signing tax return preparer when it constitutes a substantive portion of a tax return. However, the regulation would not apply to any opinion on a proposed future transaction, such as a proposed reorganization, if the advice given after the transaction is completed and the relevant return is filed is de minimis under the regulatory guidelines.[58]

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[57] Early efforts to obtain congressional help have thus far been unsuccessful. *See*, *e.g.*, Tax Return Preparer Accountability Act of 2014, H.R. 4470, 113th Cong. (2014); Tax Refund Protection Act of 2014, H.R. 4463, 113th Cong. (2014). In the meantime, OPR established a voluntary Annual Filing Season Program requiring a period of educational hours leading to Record of Completion then used to indicate some degree of IRS training that may be used by tax return preparers for taxpayer returns. *See* Rev. Proc. 2014-42, 2014-2 C.B. 192. Although helpful, the Program is not likely within Treasury jurisdiction approved by 31 U.S.C. section 330.

[58] I.R.C. § 7701(a)(36); Reg. § 301.7701-15(b)(2), Ex. (1) and (2).

Attorney-Client Privilege and Tax Return Preparation

There remains another tax return issue that merits discussion. Since, as the Supreme Court in *Galletti* asserts, tax return preparation is simply a self-assessment reporting process, with no agency representations, there remains a significant argument that a lawyer, or a CPA under section 7525, may not rely on the attorney-client privilege to protect client information or documents used in the tax assessment process as there is no agency representation for federal tax purposes.

This is consistent with cases such as the *Frederick* case in the Seventh Circuit Court of Appeals holding that tax return preparation is an accountant's function, and communications relating to accounting services are not privileged, even if rendered by an attorney.[59] Therefore, any tax opinion or other tax advice presented in conjunction with the preparation of the tax return that an accountant would normally do is at risk of being treated as accounting services and not privileged.

Written Advice and Circular 230

There is one final matter for those engaged as tax planners. *Sexton v. Hawkins* is also significant because of language raised in 31 U.S.C. section 330(e) regarding written tax advice and related sanctions. That section of the Act permits the Secretary of the Treasury to

> impose *standards* applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which the Secretary determines as having potential for tax avoidance or evasion.[60]

The court in *Sexton* observed that, at most, the section "allows the Secretary to impose standards to the *rendering* of such advice—but does not provide a mechanism to sanction such advice, nor the offering of such advice."[61] It has become apparent that this interpretation authorizes OPR to only regulate practice by setting out best practice standards for written advice, including formal opinions, but does not permit OPR to impose any sanctions for noncompliance on tax advice.

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[59] United States v. Frederick, 182 F.3d 496 (7th Cir. 1999); *see* United States v. Gurtner, 474 F.2d 297 (9th Cir. 1973); United States v. Lawless, 709 F.2d 485 (7th Cir. 1983); United States v. KPMG LLP, 237 F. Supp.2d 35 (D.D.C. 2002); United States v. Baucus, 377 F. Supp. 468 (D. Mont. 1974); *see also* Martin J. McMahon & Ira B. Shepard, *Privilege and the Work Product Doctrine in Tax Cases*, 58 TAX LAW. 405, 417 (2005).

[60] 31 U.S.C. § 330(e) (emphasis added).

[61] *Sexton*, 2017-1 U.S.T.C. at 83,424, 119 A.F.T.R.2d at 1192 (emphasis in original).

However, it is noted again that present section 10.37 still identifies specific requirements for written advice, which is intended to be enforced with sanctions under 10.52(a). In view of the *Sexton* case, any sanction effort on written opinions by OPR may be unenforceable.

Even so, OPR will continue to use its own standards of opinion review under section 10.37(c) to evaluate the reasonable reliance on a position taken and acceptance of a reasonable cause defense in the event of any substantial understatement.

Concluding Observations

Circular 230 sets helpful high ethical standards for attorneys who are retained to represent clients in audits or on appeals. It is designed to preserve a fair and honest tax system that promotes integrity. Subpart B of Circular 230 defines fully the higher ethical expectations of OPR for lawyers engaged in practice before the IRS. It is important to tax attorneys that Circular 230 retains higher ethical standards than those prescribed by the ABA in Formal Opinions 314 and 85-352.

However, when advising the taxpayer, either in general tax planning or on filing a tax return, the lawyer may properly apply the lower ABA ethical standards requiring only a reasonable believe in good faith and that the advice will lead to a realistic possibility of success if litigated. This is the ABA position in Opinion 85-352 for tax lawyers, and it is higher than the ethical standard used by other attorneys.

They are an acceptable standard in most instances for tax lawyers but any tax advice needs to be of sufficient quality to protect the client with a reasonable cause defense, section 6664(a)(3), if the position is not successful.

It is also evident that we needed the higher more-likely-than-not test for tax shelters and reportable transactions that have a significant risk of tax avoidance or tax evasion as now defined in section 6662(d)(2)(c).

Nonetheless, it is always important that taxpayers have the privilege and obligation to pay only the minimum tax owed and the right to question the judgment and accuracy of our tax laws and government representatives in our tax system. Our government should not be the "Big Brother" in the science fiction novel *1984* by George Orwell in 1949.

Just as important, tax lawyers must always be conscious of the improved civil and criminal penalties that apply within the official legal tax system. Our members have done much through the years to support those penalties as a means of reducing abusive tax avoidance or evasion.

In the end, high ethical standards are important to us as we carry out our own legal responsibilities to our clients and our role in the tax system.

Thank you.