TWELFTH ANNUAL GRISWOLD LECTURE BEFORE THE AMERICAN COLLEGE OF TAX COUNSEL: EXPERT TESTIMONY ON THE LAW

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This article is based on the Twelfth Annual Erwin N. Griswold Distinguished Lecture that I was privileged to present to the American College of Tax Counsel at its annual meeting on January 31, 2004.[1] Its purpose is to elicit thought and discussion on an important issue—the propriety and admissibility of expert testimony on questions of tax law in litigation between private parties.

Readers should know that I have served, and am currently serving, as an expert witness in cases involving the liability of a Big Four accounting firm that rendered tax opinions to clients who made investments usually referred to as "tax strategies."[2] In the typical case, professional advisers, accountants and lawyers, urged their clients to purchase the investments so that the clients would thereby gain the tax benefits that the professionals said the strategies would generate for them. The Service, however, correctly denied the tax benefits.

Historical custom and the black letter rule of today provide that the witness stand is the place for *facts* to be adduced and presented to the trier of fact (whether jury or judge), and that *opinions* on questions of domestic law are to be presented by way of counsel's argument to the judge at the bar of the court.[3] It has been and is the law, however, that a party may prove the law of a foreign country by the testimony of an expert witness.[4]

The rule as to domestic law takes as its predicate the proposition that facts, to be established by testimony from the witness stand, are separate and distinct from law. All of us who are in the law know, however, that the facts and the law are often intertwined, often inseparably so. At times lawyers find it virtually impossible to address the jury without discussing the law, although it is suppos-

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[1]Erwin N. Griswold, known world wide for his many years as Dean of Harvard Law School and professor of federal tax law, was a pioneer in tax law scholarship and teaching, and a skilled and dedicated practitioner both in private practice and for the Government in the Tax Division of the Justice Department and as the Solicitor General of the United States.

[2]I mention this time-to-time professional activity of mine so that readers will be aware of it in case self-interest has crept into my remarks. I believe, however, that my views on the subject are objective and are based on what I think are appropriate and helpful to our legal system in the resolution of certain types of litigation.

[3]*See generally* Note, *Expert Legal Testimony*, 97 HARV. L. REV. 797 (1984).

[4]". . . The court, in determining foreign law, may consider any relevant material or source, including testimony, whether or not submitted by a party or admissible under the Federal Rules of Evidence. The court's determination shall be treated as a ruling on a question of law." FED. R. CIV. P. 44.1.

edly the exclusive function of the judge to state and explain the law to the jury. Sometimes lawyers in argument to a judge find it necessary to refer to undecided facts that the lawyers expect the judges to take for granted as they often do.

As an aid to the fact finders (whether juries or judges), one side or the other or both sides will often call expert witnesses to testify to their opinions on specialized, usually technical, subjects outside the presumed ken of the typical lay juror or the judge. Ordinarily, fact witnesses may not express an opinion when they testify,[5] but expert witnesses have the expression of their opinion as their principal function.[6] For example, in a malpractice action against a doctor, the plaintiff, a former patient, will introduce testimony by a cardiologist that the defendant, his former doctor, negligently failed to take into account data showing that the patient's condition called for the implant of a pacemaker.

The cardiologist's testimony is specialized and comprises both fact and opinion, but it is not *legal*, or so it is said, and it is both necessary to the plaintiff's case and admissible. However, that testimony is relevant and probative only to the extent that it is based on a legal rule that establishes the standard of care to which doctors are held and states how the standard and its breach are to be presented in court.

The expert's testimony will refer directly to the standard. Tradition—*the law*—calls for the expert to testify that the defendant doctor violated the legal standard of care, that his failure to take the relevant data into account was a breach of a standard requiring careful attention to such data because it is the standard customarily observed by doctors in the field of practice in the community served by the defendant. Indeed, a plaintiff's case cannot make it to the jury unless he produces evidence of a breach of that standard, one the witness will refer to and counsel will refer to in his closing argument, as he probably also did in his opening statement. And so the expert's testimony is necessarily and inextricably a mix of fact (specialized, expert data) and opinion that the legal standard has been breached.

In the arena of tax practice a taxpayer will have received and paid handsomely for an opinion from a tax adviser, lawyer or CPA, advising him of the favorable tax consequences of a tax strategy the adviser encouraged him to buy. The taxpayer makes the investment; the Service denies the tax benefits; the courts sustain the Service, and the taxpayer incurs a tax deficiency, interest, perhaps penalties, and substantial legal and related expenses in the course of the controversy. The taxpayer sues his adviser, now having been correctly advised by adviser #2 that the original advice he received from adviser #1 was fatally flawed, and that adviser #1 should have known so, and indeed may have known

[5]FED. R. EVID. 701.
[6]FED. R. EVID. 702.

so, because the flaw would have been clear to a careful, attentive tax professional.[7]

The taxpayer will testify as to the advice he received, to the Service's rejection of it, and to the huge tax deficiency that was assessed and the expenses he incurred as a result. All of that testimony, if it is by itself without more, will not be sufficient for his case to go to the jury, and a motion for dismissal will be granted. The taxpayer needs testimony that adviser #1 was not only wrong, but that he was careless, negligent, or perhaps motivated by financial self-interest or the interest of another client. The taxpayer requires this in light of the fact that adviser #1 should have known, or he did know, that his opinion was wrong, and that competent, independent tax advisers in the community would not have given that advice because they would have realized that such an investment as adviser #1 recommended would not yield any of the tax benefits that he said it would.

So far all sounds so simple and so right. But when adviser #2 comes to serve as the taxpayer's expert witness and testifies to the standard he has based his advice on, and he states it is the applicable and appropriate standard, is he not testifying to law? Is he not doing so when he testifies as to what was wrong with adviser #1's opinion and also when he explains that the governing ethical standards require the undivided loyalty of the adviser?

In 1976 the Second Circuit decided *Marx & Co. v. Diners Club*[8] in which there was a contract dispute. The parties' main difference was in their interpretation of the language of their contract. One of the parties called an expert on contracts to testify as to the correct interpretation of the contract. The court held that such testimony was inadmissible; that contract interpretation was for the court; that the lawyers were to *argue* the law to the court, not offer an expert witness on the subject for the trier of fact. This also sounds so right. But then what does the misadvised taxpayer do in light of *Diners Club*?

If adviser #2 testifies as I indicated he would, arguably he does so in opposition to *Diners Club*, and at least in the Second Circuit the legal opinion could be inadmissible. If inadmissible as expert opinion evidence, it would have to be argued to the judge who would then charge the jury. The Second Circuit, however, accepts expert witness testimony in complex security law cases to the extent that the testimony goes to general background law.[9] Recently, in an opin-

[7]There are differences of opinion as to whether a wrongly advised taxpayer may hold his mis-adviser liable for his tax deficiency and interest, in addition to the items as to which a mis-adviser's potential liability is undisputed, i.e., the costs the taxpayer incurred in defending against the Service's claims and the payments he made to his advisers. The argument against allowing the taxpayer to recover the tax deficiency and interest from his mis-adviser is that the taxpayer would have been liable for the tax in any event; the mis-adviser's fault lay in his failing to provide a way to avoid it, but not in his bringing on a tax that would not otherwise have been due. The argument for holding the mis-adviser liable for the tax deficiency is based on benefit-of-the-bargain contract law theory. Although I have views on the question, I take and express no position on it in this article, nor did I do so in presenting the Griswold Lecture to the American College of Tax Counsel.

[8]550 F.2d 505 (2d Cir.), *cert. denied*, 434 U.S. 861 (1977).

[9]*See* United States v. Cohen, 518 F.2d 727 (2d Cir. 1975); United States v. Bilzerian, 926 F.2d 285 (2d Cir. 1990).

ion by a magistrate judge, a district court in the Second Circuit held that "in a legal malpractice action an expert should be permitted to testify to the substantive law applicable to the underlying proceeding at least to the extent needed to explain the expert's conclusion that the defendant did or did not exercise the appropriate standard of care."[10]

In *United States v. Garber*,[11] a criminal tax evasion case, the central question was whether *blood money* is income, whether selling one's blood on a regular, periodic basis is the providing of a service for which the seller receives ordinary compensation income, as the Government contended, or is the sale of property (a capital asset) the proceeds from which constitute capital gain, as the taxpayer urged.[12] The admissibility of expert legal testimony on those questions, offered by both the Government and the taxpayer, are discussed in the court's and in the dissenters' opinions. Although the trial court had admitted the revenue agent's opinion testimony to the effect that the money received constituted personal service income, and the Fifth Circuit did not reverse, and the case has not been explicitly overruled, it has been held narrowly to its facts. Admitting the agent's testimony was not in accord with the general rule of inadmissibility applied in *Diners Club*.

In cases posing issues of expert legal testimony there is no uniformity from jurisdiction to jurisdiction; federal circuits as well as state appellate courts are in conflict. I have testified in several trials in which the issue did not involve the standard of care in a malpractice case against an adviser but in which I have given my opinion as to the meaning and correct application of specific corporate tax provisions of the Code. When retained to do so, I thought it not unlikely that my testimony would be ruled inadmissible, and I said so to counsel. In two of three cases that I recall well, however, my testifying did not evoke an objection from the other side. In the one case in which the other side objected, the court overruled the objection, allowing me to testify as to statutory meaning; the other side then had its expert testify, giving his contrary legal opinion from the witness stand. We were both cross examined.

Today the tax issue is typically presented in a complex case involving claims by a taxpayer that he relied to his detriment on an accountant's or lawyer's written opinion that an investment he was to make would produce tax benefits that would "more likely than not" be allowed by the Service.[13] That is taken to mean that the chances of Service approval are greater than 50%. In these cases

[10]Middle Mkt. Fin. Corp. v. D'Orazio, No. 96-CIV-8138-SWKHBP, 2002 WL 31108260, at *8, 2002 U.S. Dist. LEXIS 17817, at 26 (S.D.N.Y. Sept. 23, 2002).

[11]607 F.2d 92 (5th Cir. 1979).

[12]The taxpayer's blood had rare antibodies useful to many people, and so he sold quantities of it on a regular, periodic basis. Even if the money received had been treated as proceeds from the sale of property, a capital asset, the full amount would have constituted gross income since the basis for the property would have been zero.

[13]On December 29, 2003 the Treasury re-proposed regulations that impose strict standards under Circular 230 for tax shelter opinions given by tax practitioners. REG-126016-01. For the full text online see http://www.gpoaccess.gov/fr./index.html.

the investment (often in a tax shelter) is widely marketed, and a copy of the tax opinion goes with each investment to each investor, with the opinion-giver compensated for each sale.[14]

Taxpayer's counsel concludes that he needs an expert witness to testify to the opinion's flaws and to the accountant's negligence (or recklessness) or disloyalty in rendering the opinion. The witness will prepare an "expert report," will give his deposition, and will testify at trial where he will be examined and cross-examined. The policy question to be weighed is this: Should he be allowed to testify, or must the breach of standard, the incompetence, negligence or recklessness or conflict of interest or self-interest, be solely for the judge in his charge, without the benefit of expert testimony, but after hearing argument by counsel? A distinguished federal trial judge, writing to me recently in private correspondence, answered both that question and the more general one as to the desirability of expert legal testimony in cases involving other than the standard of care for malpractice. He wrote "The increased complexity of the law—particularly in Tax, SEC & other matters warrants help [to the court] no less than in 'foreign law.' We can't do what we once could—call on our favorite professor—since this is now unethical. This [expert testimony] technique is good since it's out in the open. We also can call for and get amicus briefs. Why not come in as a witness subject to X."[15]

To that judge it would appear sensible to allow expert legal testimony not just in cases involving the standard of care for determining an adviser's malpractice. From his statement he seems open to allowing such testimony to help illuminate and clarify the law in cases in which it is esoteric and complex. In such instances, as with foreign law, he would allow expert legal testimony when a party offered it and it was relevant and potentially helpful in resolving the dispute.[16]

As we have seen, the admissibility of expert legal testimony is an issue in two quite different settings. In the standard-of-care malpractice case it is clear that such testimony is not only admissible but is essential to a plaintiff's case against his professional adviser, just as it is to a patient's case against his doctor.

The second setting does not involve malpractice. It presents a case in which the parties dispute the meaning of the law underlying the claim or the defense. In the case of foreign law, a party may establish it by testimony. In the case of disputed domestic law, however, expert legal testimony is generally but not universally precluded. Where precluded, the issue is for the judge, not the jury, and the parties' differing positions are presented to the judge in the arguments of counsel.

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[14] In one of the situations, I understand that the accounting firm received $50,000 in each instance, making millions. The shelter was disallowed, and the accounting firm has been sued by hundreds of investors. At least one of the suits has been settled.

[15] Since I have not sought or received his permission to do so, I will not name the judge. Suffice it to say that I have never appeared before him and have no expectation of doing so.

[16] The judge was not saying what he *would* admit in his courtroom. Obviously he would have to reach that conclusion only after determining what the law was on the admissibility of expert legal testimony in his circuit. He stated what he thought would be the most helpful approach.

In general I think the law has it about right. The court in *Diners' Club* decided the case before it sensibly, correctly. The rule of inadmissibility that *Diners' Club* applied, however, is often stated and sometimes applied too rigidly, *i.e.*, that *no* expert testimony on law is admissible. In fact, expert legal testimony is usually admissible in standard-of-care cases, and it should be. In other types of cases involving domestic law, those in which the parties differ as to the meaning of the law applicable to a case, generally the judge, not the jury, should decide, and generally the parties should present their positions by argument not testimony. If, however, the case is one in which law and fact are significantly intertwined, it may be sensible and helpful to have legal experts offer their understanding of the law that underlies the parties dispute, and so their testimony should be admissible and subject to cross examination.

Moreover, even in the absence of the significant intertwining of law and fact, a trial judge should have the discretion on his own motion to appoint a legal expert to testify on domestic law, or to allow such testimony when a party proffers it. When the judge believes that the area of law is one that calls for highly specialized legal expertise that he does not have sufficiently, and he thinks that a jury will be more likely to understand the law or legal setting applicable to the facts of the case if it hears the testimony of legal experts for both sides who present their opinions subject to cross examination, the proffered testimony should be admitted. Indeed, I think that serious consideration should be given to amending Federal Rule of Civil Procedure 44.1 so that it will not be limited to foreign law and will read as follows: ". . . The court, in determining foreign or domestic law, may consider any relevant material or source, including testimony, whether or not submitted by a party or admissible under the Federal Rules of Evidence. . . ."

I will conclude by setting out two of the opinions (with the parties' names changed) to which I have testified in a deposition as expert witness for the plaintiffs in a standard-of-care case against one of the Big Four accounting firms. What is your opinion as to their admissibility?[17] In mine, they are admissible and should be.

Opinion 1. It is my opinion that at and before the time it marketed the tax strategies to Mr. Gullible in the Fall of 2003, XYZ should have known and, in light of its long experience and expertise, may well have known, that the tax

[17]For an extensive collection of citations on the admissibility of expert testimony on questions of domestic law, but with little as to testimony with particular focus on tax law, see Annot., 66 A.L.R. 5th 135 (1999). *See generally* Note, *supra* note 3. My view and The American Law Institute's position on the admissibility of expert testimony in case involving a practitioner's standard of care are essentially the same. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 52, Cmt. g (2000). *See also* Carl M. Selinger, 13 J. LEGAL ETHICS 405 (2000) (generally supporting admissibility in standard of care cases and providing references to a number of articles and commentators on both sides of the question, although none focusing on tax law). For an article by a commentator dead-opposed to the admission of expert legal testimony generally, but with a narrow, somewhat reluctant, exception for standard-of-care cases, see Thomas E. Baker, *The Impropriety of Expert Witness Testimony on the Law*, 40 U. KAN. L. REV. 325 (1992).

strategies it helped sell to the plaintiff would not work; that the Service would reject the tax strategies and would disallow the capital loss Mr. Gullible would claim; that Mr. Gullible would likely be required to pay a substantial tax deficiency with interest, subject to the possibility of penalties; and that he would be subjected to substantial ancillary costs, including legal and accounting fees.

Opinion 2. As a recognized professional and expert in the federal tax field on whom taxpayers rely for tax advice, the XYZ firm had a duty to use the skill and the knowledge and care commonly used by other expert professionals in the field.

XYZ should also have acted with undivided fidelity to its client, Mr. Gullible. Instead, it acted carelessly and recklessly, violating its duties to serve Mr.Gullible competently and loyally, placing its own financial interests ahead of his. XYZ failed to observe the standard of care expected of tax accountants and other professionals.