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2020 Erwin N. Griswold Lecture before the American College of Tax Counsel:

Tomorrow Is Another Day-How Did We Get Here Ethically

Richard A. Shaw¹

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.

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

¹Special council with Higgs, Fletcher & Mack, LLP, San Diego, CA, Former Chair, American Bar Association, Section of Taxation and earlier the California State Bar Tax Section.

become new tax creations until the distant future. I remember the maximize 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, HR10, 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 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 1/2-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 Holden², 1999, Carr Ferguson³, 2000 , and Randolph Thrower⁴, 2001, vigorously attacked abusive tax shelters and finally Pan Olson⁵ 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 2004⁶ Karen Hawkins⁷ recently expressed her view that Circular 230 has become almost broken upon the unsuccessful effort to regulate standards

² 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)

³ 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)

⁴ 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).

⁵Pamela 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*, 54 *Tax Law* 567 (2001)

⁶ See Richard A. Shaw, , *Enhanced Reporting Penalties: The Newest IRS Weapons*, 7 *Business Entities*, No.2, 6 (Apr. 2006).

⁷ Karen L. Hawkins, *2015 Erwin N. Griswold Lecture Before The American College Of Tax Counsel: A (Not So) Modest Proposal* , 70 *Tax Law*, 647 (2015)

for tax return preparers. Last year Dick Lipton⁸ devoted his attention to judicial doctrines and economic substance.

I could pick a topic for us from one of my own special tax law areas Subchapter S⁹, or closely held entities¹⁰, but 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.¹¹

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 230¹²?

How have we, as tax lawyers, been affected by changes in the recent past?

Lets start with a few simple Questions

⁸ 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).

⁹ E.g. Richard A. Shaw, *Structuring S Corporations After Fifty Years*, 66th NYU Institute On Federal Taxation, Ch.13, 1 (2008)

¹⁰ E.g. Richard A. Shaw and Thomas J. Nichols, *Choice of Entity In Light of Recent and Proposed Tax Changes*, 68th NYU Institute on Federal Taxation, 13-1 (2010)

¹¹ See, Richard A. Shaw, *Ethics and the Internal Revenue Service*, 59 USC Institute on Federal Taxation, 14A-1 (2007).

¹² 31 CFR, Subtitle A, Part 10, published as Circular 230.

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 Million dollar capital gain.

What are your duties to the client and the IRS?

Should you Advise A to file an amended return? even though there is no statutory requirement to file 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 duty to report the error to the IRS? Note that Circular 230, section 10.20, presently requires disclosure unless attorney believes in good faith and on reasonable grounds that the information is privileged.

Does the the attorney-client privilege protect him? Is it even available?

Should your duty to the tax system public override any attorney client privilege?

If the client does not file unamended return —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.

LETs 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 \$1000 or \$1,000,000?

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.¹³

Carr Ferguson¹⁴ observed in his lecture that Dean Griswold was always a lawyer first and only then as an expert in taxation.

Boris Bittker¹⁵ 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. He wrote;

“(t)here 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 “

Randolph Paul¹⁶ questioned whether the high standards applied in circular 230 were really distinguishable from the high standards applied to all lawyers in their practice.

¹³ 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), and Michael Hatfield, *Committee Opinions and Treasury Regulation: Tax Lawyer Ethics, 1965-1985*, 15 Fla. Tax Rev. 675 (2014). (hereafter Hatfield II)

¹⁴ Ferguson, *supra* at 722

¹⁵ Hatfield I, *Supra* at 22, citing Bittker Professional Responsibility in Federal Tax Practice xi (1965)

¹⁶ Hatfield I, *Supra* at 23

Norris Darrell¹⁷ 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”

NYU Professor Jerome Hellerstein¹⁸ 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.” and therefore tax lawyers “owe to our Government and to ourselves” a duty to improve the tax morality of the community¹⁹. 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 position²⁰.

On the issue of full disclosure, Professor Gerald Wallace²¹ 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.

The views expressed to us recently by Emily Parker²² in 2016 are also relevant. 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 challenge”

Law is not always clear

The reality is that tax law is not always clear. The tax statutes and supporting

¹⁷ Hatfield I, *Supra* at 22

¹⁸ Hatfield I, *Supra* at 14

¹⁹Hatfield II, *Supra* n. 81 at 690.

²⁰ Hatfield I , *Supra* at 16

²¹ Hatfield I, at 52

²² 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 (2017)

regulations are often drafted hastily, with ambiguity and much room for reasonable interpretation. Sometimes the United States Supreme Court *Chevron*²³ case review standards must be applied to resolve a tax law interpretation. In many instances the underlying facts are unclear and unresolved. In some complex instances the government position may be considered too conservative, with litigation anticipated .

A good example of the difficulties is *Gitlitz v. Commissioner*²⁴ ,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. In one case, I had to succeed at both the District court and the United States Court of Appeals 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 Standards

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 2018²⁵

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.

²³ *Chevron U.S.A. Inc. v. National 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 interpretation is based on a permissible interpretation of the law. At this level , the governments construction is permitted, unless it is arbitrary, capricious, or manifestly contrary to the statute involved. See, also *Mayo Foundation for Med. Edu. & Research v, U. S.*, 1341 S. Ct. 7045. (2011).

²⁴*Gitlitz v. Commissioner*, 531 U.S, 206 (2001), See, Richard Shaw, *Subchapter S + 108 = Basis (an Analysis of Gitlitz)*, 60 NYU Institute on Federal Taxation 21-6 (2002).

²⁵ I am informed that Maryland and Illinois do not offer tax law specialization.

A premier early tax case on special skills was *Horne, v Peckham*²⁶, 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. 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.

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 relationship between the attorney and the client must be of the highest character”²⁷. “It binds the attorney to a relationship of the most conscientious fidelity”. “The Attorney must be paragon of candor, fairness, honor and fidelity in all his dealings with those who place their trust in his ability and integrity”²⁸. “The fiduciary attorney client relationship must be a purely personal relationship involving the highest personal trust and confidence”²⁹

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

The Tax System

²⁶ *Horne, v Peckham*, 97 Cal. App. 3d 404 (1979). See also *Bent v. Green* 39 Conn. Supp. 416, 466 A. 2d 322 (1983), *Bowman v.. Doherty* 235 Kan. 870, 686, P @d 912 1984). The case is discussed in more detail in Jerald D. August, Richard A. Shaw and Mark L. Silow, *Avoiding Tax Malpractice in Advising Owners of Closely-Held Businesses*. 63 NYU Institute on Federal Taxation. 15-1,15-6 (2005).

²⁷ *Cox vc. Delmas*, 99 Cal. 104 (1893)

²⁸ *Sanguinetti v, Rossen*, 12 Cal. CaL App. 623 (1910)

²⁹ See also Am. Jur. 2d, Attorneys at law, section 137

Tax lawyers for many decades have discussed whether tax lawyer have a separate subjective duty to 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 payment³⁰”

Yes, there is a fundamental legal obligation for each taxpayer to pay his or her tax obligation, and, at least, it 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 Tax Advocate has just reported that the recent 381 Billion Dollars in unpaid taxes in 2019, leads to an additional \$3000 tax burden on each household, to subsidize the noncompliance.

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 client and the public

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 an 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**³¹ in 1965, which was specifically directed to tax lawyers. Opinion 314 explained that the IRS is not a judicial tribunal, and

³⁰*United States. v. Galletti*, 541 U.S. 114, 122 (2004)

³¹ ABA Formal Opinion 314, ABA Committee on Ethics and Professional Responsibility (1965), reprinted in 51 A.B.A. 671 (1965)

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."

It clearly applied the litigators view that the IRS is an adversary, and no special duties are owed to it. None the less, 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 the 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

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 Tax Advocate reported that just last year, the IRS only audited 0.45 % of 2019 tax returns, compared to 1.1 % 10 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 need lots of help.

Perhaps, some of you will remember the famous quote, attributed to Plato around 343 B.C.³⁵

³²See, L. Ray Patterson *Tax Shelters for the Client-Ethics Shelters for the Lawyer*. 61 Tex. L. Rev. 1163,1166..

³³ABA Section of Taxation Proposed Revision to Formal Opinion 314,(May 21, 1984) See detailed discussion by J Timothy Philipps, *It'S Not Easy Being Easy: Advising Tax Return Positions*. 50 Wash. & Lee L. Rev. 589, 610 (1993).

³⁴ Patterson *Supra* at 1165.

³⁵Plato, *Dialogues Phaedras*,, Bartlett's Famous Quotations 16th Ed. Section 3453D (1992).

“When there is an income tax, the just man will pay more and the unjust less on the same amount of income”

ABA Formal Opinion 85-352

Let us move forward twenty 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 to revise its Opinion 314 position³⁶

The committee’s premise was that the client’s relationship with the IRS is not an adversarial proceeding, and the audit 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 evidenced by a practical and realistic possibility of success if litigated.” The realistic possibility of success condition was intended to provide a 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**³⁷ the ABA set a new revised ethical standard for tax lawyers. The new opinion stated:

“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, or modification or reversal of existing law and there is a realistic possibility of success if the matter is litigated.³⁸”

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 by the lawyer* and *a realistic possibility of success* if litigated.

³⁶ ABA Section of Taxation Proposed Revision to Formal Opinion 314 (May 21,1984).

³⁷ABA Committee on Ethics and Professional Responsibility Formal Opinion 85-352 (July, 1985), 39 Tax Law 631(1986). A special “Report of the Special Task Force on Formal Opinion 85-352” was approved by the ABA Tax Section Council on February 2, 1986 which analyzed.the application of the Opinion, 39 Tax Law 635 1986).

Earlier in 1982, the ABA had released Formal Opinion 346 related to Tax Shelters. It 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 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.

³⁸ Id

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”³⁹

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.⁴⁰ 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 includes a good faith argument for any extension, modification or reversal of existing law.”⁴¹

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”⁴²

³⁹ 39 Law 631,632 (1986).

⁴⁰ 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.

⁴¹ *Supra*, at n. 36

⁴² *Id.*

It was also relevant that section 6661 (now 6662) of the Code then used the substantial understatement penalty test requiring either substantial authority, or adequate disclosure to avoid a penalty, standards 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 were referred to in the ABA 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.⁴³

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 84-352, 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 Code 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 .

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 its 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 taxpayer is obligated to report complete information for each item on the tax

⁴³ For an early review see, Theodore C. Falk, *Tax Ethics, Legal and Real Ethics: A Critique of ABA Formal Opinion 85-352*, 39 Tax Law 643(1986), and later Hatfield, *Supra*, at 696

returns 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 Code section 7202 willful failure may be a misdemeanor with a \$25,000 fine (\$100,000 for corporation.), and under 18 U.S.C. 1001 it is a felony to make false statements to a federal officer.

It is important the 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 to rely on attorney-client and work product privileges to avoid improper disclosure⁴⁴ This protection would extend to a lawyer's agents under the *Kovel*⁴⁵ rule and an accountant under Code 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 witness because it would violate confidences protected under Roman law.

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

⁴⁴ The material impact of *Loving v. Internal Revenue Service*, 743 F.3d 1013 (D.C. Cir. 2014), on Circular, 230 is discussed later in this article.

⁴⁵*United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961), where 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.

by the more-likely-than-not standards of FIN 48,⁴⁶ and the controls of the Sarbane-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 shelter and reportable transactions. It took a long time to clean up a nasty mess, but perhaps the train has arrived at the station⁴⁷

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 requirements⁴⁸, increased more-likely-than-not requirements on tax advice⁴⁹, abusive tax shelter penalties⁵⁰, 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.

You'll recall that in 1884, Congress passed into law 31 U.S. Code section 330, that granted Treasury, only authority to regulate to the "*practice of representatives of persons*

⁴⁶ FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (June 2006)

⁴⁷ See ABA Formal Opinion 314 on Tax Shelter opinions discussed Supra at footnote ____.

⁴⁸ Code sections 6111, 6707 and 6707A

⁴⁹ Code section 6694 (a)(2)©

⁵⁰ Code section 6700

Before the Department of the Treasury”(emphasis added). 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 Preparers⁵¹

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*.⁵²

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.

⁵¹ Code section 7701(a)(36) defines a ‘Tax Return Preparer’ as any person who prepares for compensation, or employs one or more persons to prepare for compensation, any return for tax imposed by this title or or any claim for refund imposed by this title. For purposes of the preceding sentence, the preparation 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.”

⁵²*Loving v. Internal Revenue Service*, 743 F.3d 1013 (D.C.Cir, (2014).

The court opinion relied heavily on the 2004 Supreme Court decision in *United States v. Galletti*⁵³, discussed earlier, where the Court explained that "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." 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*⁵⁴ the District Court of the District of Columbia the court 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 the IRS Office of Professional Responsibility (hereafter 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*⁵⁵on May 17, 2017 inserted another thorn into the side of the IRS.

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.

⁵³ *United States v. Galletti*, 541 U.S.114,122 (2004)

⁵⁴ *Ridgely, Jr. v. Lew*, 55 F. Supp. 3d 89 (D. D. C. 2014)

⁵⁵ *Sexton v. Hawkins*, No. 2:13-cv 00893-RFB-CVF, 2014 WL 5503200 (D. Nev. Oct.30,2017. Sexton had been convicted of mail fraud and money laundering and had earlier prepared tax returns for Kern.

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

The Court, relying on the limits set in 31 U.S. 330. held that Sexton was not engaged in practice before the IRS and, therefore, had not 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 1/3 likelihood of success) as the minimum ethical standard

Congress would be well advised to amend 31 USC 330 to authorize Treasury to set sanctionable ethical standards for paid Tax return preparers for the protection of the taxpayers they serve⁵⁶

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 constitute 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

⁵⁶ Early efforts to obtain Congressional help have thus far been unsuccessful. E.g. H.R. 4470, "Tax Return Preparer Accountability Act of 2014" and H.R. 4463 "tax Refund Protection Act of 2014".

In the mean time, OPR established a voluntary Annual Filing Season Program requiring a period of educational hour 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. Rul. 2014-42 2014-29 I.R.B. 192 (July1, 2014). Although helpful, the Program is not likely within Treasury jurisdiction approved by 31 U.S. C. 330.

Future transaction, such as a proposed reorganization, if advice given after the the transaction is completed and the relevant return is filed, is de minimus under the regulatory guidelines.⁵⁷

Attorney-client privilege and Tax Return Preparation

There remains another tax return issue that merits discussion. Since, as the Supreme Court in *Gelletti*, 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 of the Code, 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. 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.⁵⁸

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. 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.” (emphasis added)

The court in *Sexton* Observed that, at most, the section “allows the Secretary to impose standards for the *rendering* of such advice but does not provide a mechanism to sanction such advice , nor the offering of such advice.” 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 non-compliance on tax advice.

⁵⁷Code section 7701(a)(36) , Treas. Reg. Section 301.7701-15(b)(2), Examples (1) and (2).

⁵⁸ See, Martin J. McMahon and Ira B. Shepard , *Privilege and Work Product Doctrine in Tax Cases*,58 Tax Law 401,417 (2005) for a discussion. *U.S. v. Gurther*, 474 F 2d. 297 (9th Cir. 1993),*U.S. v. Frederick* 182 F3d 496,500 (7th Cir. 1995) ,*U.S. v. KPMG LLP*. 237 Supp. 2d 35 (D. D. C. 2002) *U. S v. Lawless*, 708 F. 2d 485 (7h Cir. 1983) involving an estate tax return, and. *U.S. v. Baucus*, 377 F. Supp. 468 , 472 (D.C. Mont. (1974).

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 in 10.37c), 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 belief 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, Code 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 Code 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 judgement 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

