2014

Tax Advisors and Conflicted Citizens

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16 Legal Ethics 322-349 (2014)

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Tax Advisors and Conflicted Citizens

Milton C Regan, Jr

INTRODUCTION

How should we think about the obligations of a lawyer who counsels and provides legal advice outside of litigation? Thousands of lawyers are involved every day in advising clients in this setting. These lawyers counsel companies or individuals on how they can benefit from or avoid violating statutes, regulations, and other sources of law.

Legal counsellors do their job behind closed doors. They engage in conversations that are usually protected from disclosure. They move in the shadows, and their influence can be hard to trace. That influence can be profound, however. It can determine who is exposed to what chemicals, who keeps and who loses their jobs, who will be able to count on retirement savings and who won’t.

Rules of professional responsibility devote remarkably little sustained attention to the role of the advisor. American Bar Association (ABA) Model Rule 2.1 is the only rule that explicitly refers to the lawyer as advisor. It simply says that a lawyer ‘shall exercise independent professional judgment and render candid advice’. In doing so, an advisor ‘may’ refer to considerations such as ‘moral, economic, social and political factors’.

By contrast, most of the other Model Rules are premised on a conception of the lawyer as an advocate. This model is relatively clear and straightforward, and can provide an appealing default template for thinking about the obligations of the advisor. It suggests that the lawyer take a relatively aggressive approach to interpreting the legal provisions applicable to a client in order to maximise the client’s freedom of action. If a client’s behaviour would be permissible according to the literal terms of a statute, for instance, an advocate should urge the client to behave in that way on the ground that assessing the behaviour’s consistency with the purposes of the statute is inappropriate. If the literal terms of the law proscribe behaviour in which the client is engaged, the advisor as advocate may counsel to continue it on the ground that it is in accordance with the law’s purposes.

While an advisor who acts as an advocate may adopt either approach, Doreen McBarnet and Christopher Whelan argue that advisors who act as advocates in the regulatory context often focus on the literal terms of the law to help the client engage in what they call ‘creative compliance’. This involves structuring transactions, relationships or entities according to

‘McDevitt Professor of Jurisprudence and Co-Director, Center for the Study of the Legal Profession, Georgetown University Law Center, USA. My thanks to Tanina Rostain for thoughtful comments on an earlier version of this paper.'
the letter of the law in a way that allows the client to avoid as much of the substantive impact of regulation as possible. Corporations and wealthy clients tend to have the legal resources necessary to arrange their activities so that they are in technical compliance with the law, and therefore may have less need than other clients to invoke a law’s purposes to justify literal noncompliance. An advisor acting as an advocate in representing these clients is thus likely often, although not always, to be arguing for a formal interpretation of a law’s requirements.

An alternate conception of the advisor is as a trustee of the legal system who assumes some responsibility for ensuring its integrity as a mechanism for ordering social life. The trustee is inclined to go beyond creative compliance in counselling clients. She therefore is generally more likely than the advocate to see herself as having an obligation to ensure that the client complies with not only the letter of the law but its spirit. This approach acknowledges the inherent limitations of language in fully capturing a law’s underlying purpose, and the inevitable need in interpreting a law to consider what it is attempting to accomplish.

Should we adopt the model of the advocate or the trustee in prescribing the obligations of the advisor? Litigators have the benefit of a model that offers relatively clear guidance. Is it reasonable for advisors to seek comparable clarity? In what follows, I argue that we should eschew a single prescriptive model of the advisor in favour of a pluralistic conception that bases responsibilities on the salient factors of the context in which the advisor operates. In this respect, at least with regard to the lawyer acting as advisor, I follow William Simon’s suggestion that we adopt a contextual, rather than categorical, approach to decision making about lawyers’ professional responsibilities. My framework is also consistent with Stephen Pepper’s approach to determining when a counsellor should provide information about a law, its enforcement patterns, and the sanctions for violating it.

Finally, my approach is consistent with Bradley Wendel’s claim that it is misguided to assume a single model of the lawyer that applies in all contexts. He suggests that we should distinguish between the lawyer acting in the litigation context and acting outside of it. The significance of this distinction is that ‘the most important feature of the lawyer’s role that varies by context is the permissibility, or not, of asserting relatively creative or aggressive legal positions.’ I agree with this point and go further. We should not only distinguish between the lawyer acting as litigator and as advisor; we should also distinguish between the different contexts in which an advisor is acting.

2 William H Simon, The Practice of Justice: A Theory of Lawyers’ Ethics (Harvard University Press, 1998) 9. Indeed, my models of the advocate and the trustee bear some resemblance to his models of what he calls the Dominant View and the Public Interest View, respectively.
5 Ibid, 84.
The models of the advocate and the trustee each speak to important features of the relationship between government and citizens in the regulatory setting. Different regulatory regimes may possess different features that impose different obligations on lawyers who advise on them.

I will analyse the provision of tax advice as an example of a particular regulatory regime that acknowledges the claims of the advocate and the trustee. For the vast majority of wealthy individuals and corporate taxpayers, obtaining assistance from a tax lawyer is essential in order to determine one’s tax obligations and to file a return. The tax code is highly complex and uses terms that have specific technical meanings. In addition, understanding the meaning of one provision often requires reference to another provision that may be in an entirely separate section of the Code. Compounding the complexity are various regulations and agency announcements, as well as judicial decisions.

Aside from assisting the client in determining tax liability, tax advisors provide advice on how a client may structure particular activities and operations in order to minimise the tax obligations that result from them. A tax lawyer may provide an opinion to a taxpayer of the likelihood that taking a particular position on the income tax return would be upheld by a court if challenged by the Internal Revenue Service (IRS). Receipt of this opinion can protect a taxpayer from having to pay a penalty if the IRS rejects the client’s position.

Tax advice is an especially notable advisory practice setting because its key features can militate especially strongly toward both the advocate and trustee models of the lawyer. This is because our attitudes toward taxation are acutely conflicting, reflecting simultaneously in strong form the perspectives of the private and public dimensions of citizenship.

The current tax practitioner regulatory regime reflects this tension. The system allows advisors to be relatively aggressive on behalf of clients in situations that involve what I call ordinary tax returns, while it imposes much stricter standards if a client’s position reflects reliance on a tax shelter. This is the case despite the fact that all taxpayers are required to sign their returns and declare under penalty of perjury that ‘to the best of [their] knowledge and belief, [the return is] true, correct, and complete’. It is also the case despite the fact that no clear line separates tax shelters from other efforts to minimise tax obligations. Some observers have urged that the law reconcile this disparate treatment of ordinary returns and those that involve shelters by imposing the stricter standard applicable to shelters to ordinary returns. I do not assess that argument here, although it has much to commend it. Instead, I will argue that the current disparity, and likely difficulty in eliminating it, reflects the competing claims of two powerful conflicting conceptions of the taxpayer.

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6 See nn 76–88 and accompanying text.
Advisor as Advocate

Given the influence of the litigator in discourse about the legal profession, it comes as no surprise that many assume that we should conceptualise the advisor as an advocate. Not only does the model of the advocate provide guidance for the litigator; more broadly, there is a tendency for both lawyers and others to use litigation as a metaphor for our entire system of law. It is common to hear the claim that the American legal system as a whole is based on adversary principles and zealous representation. For lawyers this means, as David Luban puts it, that ‘the adversary system is defined by the structure of the lawyer-client relationship rather than by the structure of adjudication’.7 When lawyers regard themselves as client partisans unaccountable to broader values ‘in negotiation and counseling as well as courtroom advocacy, and they attribute this to the adversary system, they are speaking of the adversary system in the wide sense’.8

The role of the advocate, drawn from the litigation setting, offers a well-developed account of a lawyer’s duties. An advocate is devoted to the cause of the client, constrained only by the limits of the law. The advocate is entitled to seek every advantage, propose every colourable interpretation of law, and make every argument that furthers the client’s interest. She embodies what William Simon describes as the dominant view of lawyers’ ethics: ‘the lawyer must—or at least may—pursue any goal of the client through any arguably legal course of action and assert any nonfrivolous legal claim’.9

The advocate is not licensed to pursue the client’s interest by any means possible. Specific rules provide that there are times when being partisan should be qualified by concern for the integrity of the adversary process or by other social values.10 These occasions, however, represent exceptions to what most people regard as the general rule that an advocate is a partisan of the client.

Reflecting this perspective, legal ethics rules adopted by state bar associations have been drafted for the most part with the litigator in mind. Those rules strongly endorse the model of the lawyer as partisan. They narrowly limit the circumstances in which the lawyer can depart from that role. The rules provide only minimal guidance for lawyers acting as advisors. Finally, the hold of the litigator on the cultural and intellectual imagination is also reflected in the fact that the extent to which advocates should be bound by or excused from the demands of ordinary morality is a common debate within the legal academy.11

Applied to counselling, the model of the advocate says that the lawyer should look mainly to the client’s interest in advising on what the law does and does not permit. Enabling the

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8 Ibid.
9 Simon (n 2) 7.
10 Rules 1.6, 3.3, 3.4.
client to engage in creative compliance permits the client to conform to the terms of a law while minimising its substantive impact on the client’s freedom of action. The client can plausibly claim that she is not violating the law but is complying with it, even though her activity may seem to be the kind of behaviour at which the law is aimed. Creative compliance sometimes involves looking beyond the terms of a law to its ostensible purposes when those terms do not favour the client. At the same time, regulatory resistance to client claims sometimes takes the form of insisting on the applicability of the literal terms of a provision. Nonetheless, ‘[c]reative compliance highlights the limits of formalism as a strategy of legal control’, since sophisticated clients are able to draw on lawyers to create legal structures that satisfy formal legal requirements.

A company that is the beneficiary of creative compliance and one that violates the law may both be able to escape regulation. The former, however, is regarded as engaging in ‘avoidance’, which is legitimate, while the latter is engaged in ‘evasion’, which is not. The lawyer for the first company therefore enables the client to avoid both legal penalties and the opprobrium that attaches to violation of the law. The advisor as advocate may advise against a course of action because of the risk that the government or another party will successfully challenge it. This, however, is a prudential, not a normative, constraint. The lawyer takes account of arguments about the purpose of the law to predict obstacles that may confront the client, not to identify a consideration that should have intrinsic importance to the client.

Those who argue that a legal advisor should adopt the model of the advocate have some appealing arguments. One is that the lawyer must be a champion of the client in all circumstances because people in modern society need to navigate the law in order to fulfil their goals. In this way, a lawyer can help clients realise their autonomy. A second argument is libertarian. A lawyer should be able to advise a client to take any action within a colourable interpretation of the letter of the law, because that ensures strict limits on the state’s ability to intrude on citizens’ freedom.

A third argument is that the model of the advocate is justified because it reflects modesty on the lawyer’s part. She does not attempt to pass judgment on what the client wants to do, nor to impose her own view of the client’s civic obligations. She has no special moral expertise by virtue of being a lawyer, and thus properly defers to the client’s goals.

The advocate argues that it is inappropriate for an advisor to look beyond the client’s interest when the client would be in compliance with the literal terms of the law. First, as

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12 See Countryside Limited Partnership v Commissioner of Internal Revenue, 132 Tax Ct 347 (2009) (court accepted taxpayer argument that communications with counsel did not fall within the exception to the tax practitioner-client privilege for communications relating to the ‘promotion’ of a shelter because legislative history suggested that ‘promotion’ is not meant to encompass routine tax advice by a long-time advisor).
13 See eg Valero Energy Corp v United States, 569 F 3d 626 (7th Cir 2009) (court accepted government’s argument that interpretation of exception to tax practitioner-client privilege for communications relating to the ‘promotion’ of a tax shelter did not require going beyond words of the statute).
14 McBarnet and Whelan (n 1) 851.
15 For a more elaborate description and critique of the model of the partisan advocate in general, see Luban (n 7) 67–103.
16 See Pepper (n 11).
a practical matter, the purposes of a law can be hard to discern, and may be inconsistent. Or they may be framed at such a high level of abstraction that they provide little guidance for specific behaviour. What should an advisor do in these situations? In addition, laws vary in the normative significance we attach to them. Some express deeply rooted values, others reflect political compromises, and still others embody rent-seeking by certain interests. As Donald Langevoort asks, for instance, ‘What is the right way to advise a business person whose company is facing burdensome new regulation that is the product of effective lobbying by a trade group representing its competitors?’

Skepticism about the advisor acting solely as a trustee is also fuelled by a broader concern that lawyers should protect citizens from the state, not be conscripted into serving the state’s objectives. This suggests that we should be wary about encouraging advisors to look to public purposes when advising clients who are in compliance with the letter of the law. As the discussion below will elaborate, this concern has particular resonance with respect to tax advice.

**Advisor as Trustee**

While treating the advisor as an advocate has some appeal, it also raises concerns. First, and most obvious, counselling occurs without any of the checks and balances of the litigation process. There is no tribunal, no discovery, and no opportunity to challenge a partisan lawyer’s claims. There are none of the safeguards, in other words, that make unqualified advocacy acceptable in the litigation process. As Bradley Wendel observes, ‘It is a serious mistake … to generalize from the special context of litigation to other settings. the image of pushing against the boundary of the law … suggests that some other actor will be pushing back.’

Second, approaching the law’s requirements simply as a partisan advocate can undermine the effectiveness—and the very integrity—of the law. This can happen in two ways. First, as a practical matter, a client’s exploitation of gaps or anomalies in the law can frustrate the law’s underlying purposes.

Consider an example from William Simon. A law limits the availability of federally subsidised irrigation to farms of fewer than 160 acres. The purpose of this limit is to favour small family-owned farms over large corporate ones. Counsel for a large agricultural company advises the company to establish separate companies that each holds fewer than 160 acres of farm land. Unless the statute authorises treating the separate companies as part of the larger one, the statute by its terms entitles each company to federally subsidised irri-

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18 Wendel (n 4) 83.
20 Simon (n 2) 4–5.
gation. If this practice is sufficiently widespread, however, it could defeat the law’s purposes by eventually wiping out small family-owned farms.

The advisor who acts as an advocate can also threaten the integrity of the law by undermining citizens’ respect for and confidence in it. Clients may come to view the law as a set of rules established by an adversary to avoid whenever possible, rather than as a source of reasons for action based on social norms. A society comprised of such Holmesian ‘bad men’\(^{21}\) might find it hard to survive as a liberal democracy. Its members would lack any sense of law as a cooperative venture designed to support a common life together.

In light of these criticisms, perhaps it makes sense to think of the advisor not as an advocate but as someone who has responsibility to ensure that clients act in a way that is consistent with the purposes of the law. After all, even a litigator—operating in the domain where the lawyer-as-advocate model makes the most sense—is also an officer of the court with some responsibility for preserving the integrity of the legal process.

Similarly, one might argue, an advisor who serves as a client’s source of information about the law should act as a trustee. She must protect the law’s integrity by, for instance, advising the client to abide by its purpose, not simply its letter. While she will inform the client of lawful options, she should refuse to help the client exploit literal terms of the law that are inconsistent with its spirit. The advisor as trustee must, in other words, prompt the client to adopt a view of the law as possessing intrinsic normative weight. In this way, the advisor helps to encourage the civic virtue on which the legal system depends.

By contrast, that civic virtue may be endangered by creative compliance. As McBarnet and Whelan observe, ‘A formalistic approach, which relies on a “cookbook” or code of specific and rigid rules and emphasizes the legal form of transactions, can “fail” to control for a variety of reasons.’\(^{22}\) They point out, for instance, that

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\text{the letter of the rule may not accord with the spirit in which it was framed; a literal application of the rules may not produce the desired end; it may be counterproductive; there may be gaps, omissions or loopholes in the rules which undermine their effectiveness. The rules may be out of date and no longer relevant … The legal form of a transaction or relationship may not reflect its legal or its economic or commercial substance. The totality of a transaction or relationship may not be reflected in any individual part. There may be a dynamic adaptation to escape rules. Formalistic regulation may increasingly drift from any relationship with the real world and any chance of effectively controlling it.}\^{23}
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For these reasons, the model of the trustee has attraction for those who are uneasy with the notion that the lawyer is a ‘hired gun’ with no responsibility for the integrity of the legal system. It aspires to connect lawyers to a professional tradition that calls for the exercise of expansive practical judgement.

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\(^{22}\) McBarnet and Whelan (n 1) 851.

\(^{23}\) *Ibid.*
Conclusion

The models of the advocate and the trustee both have appeal in the context of advisory practice, but they both also have important limitations. This suggests that we may not be able to posit a unified model of the legal advisor in the same way that we have a single dominant model of the litigator. Different advisory settings may require that we give different weight to the roles of advocate and trustee. In other words, we need a pluralistic account of the advisor’s role and the responsibilities that it entails—multiple narratives that are sensitive to the values, behaviour and interests that characterise different advisory settings. This is consistent with recent calls for greater appreciation of context in deliberating about lawyers’ professional responsibilities.24

Differences among practice areas and regulatory domains are likely to demand that we consider multiple interests whose respective importance varies in different situations. This requires that we take account of factors such as the individual and social interests that are at stake in the area of practice, the extent to which the law is seen as expressing important moral convictions, characteristics of the enforcement regime, factors that affect the likely degree of voluntary compliance, the market for legal services in the field in question, and the role that the lawyer plays in the regulatory regime. The weight of these and other considerations should inform how an advisor is expected to balance the claims of the models of the advocate and the trustee.

Tax advice is an area of practice that makes this task especially challenging. For various reasons, the advocate and the trustee each make especially powerful competing claims on the advisor. This results in a regulatory regime that is not entirely consistent in its demands on taxpayers and tax advisors. As I will argue, this tension reflects an effort to demarcate separate domains in which the models of the advocate and the trustee each have precedence.

TAX ADVICE IN CONTEXT

The Advocate Model

Protection of Private Property

Tax law is a setting that raises particular concern about the scope of state power, since taxation represents the authority of the state to demand citizens’ property with minimal actual consent. While no one likes to pay taxes, suspicion of them may be especially deeply embedded in the political culture of the United States. As David Schizer observes, ‘The tax collector is unlikely to be a hero in a national founded in rebellion against British taxes. The rhetoric of limited government and individual initiative is pervasive in U.S. public

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Similarly, Marjorie Kornhauser notes, ‘[I]n America anti-tax sentiment goes beyond the natural desire to keep more money for one’s own use. In the United States, anti-tax sentiments, along with anti-government sentiments generally, are an intrinsic aspect of American patriotism and national character.’ From this perspective, the state is separate from, and a potential adversary of, the taxpayer. Citizens therefore are entitled to fair notice and clear guidance regarding the claims the state can make on them, particularly regarding the amount of property they must surrender to the state.

A tax advisor who acts as an advocate can thus be seen as acting consistently with this conception of the relationship between the taxpayer and the state. She works aggressively to help the client minimise the claim that the state has on her property. She vindicates the principle of fair notice by adopting an approach to the tax code that often focuses on its literal terms rather than its more contestable supposed purposes. As David Schizer puts it:

"in our adversarial system, lawyers generally owe duties to their own client, but not to the other side. In tax planning, the other side is the government, and even when a lawyer is giving advice about planning, she focuses on what would happen if the matter is litigated. Will the client’s strategy succeed if tested in court? How can the client’s position be strengthened? To a tax advisor who is thinking through these issues, the government is, quite frankly, the enemy."

**Tolerance of Tax Avoidance**

Wariness about taxation is also reflected in attitudes toward tax avoidance. The United States is not unique in this regard, although these attitudes may be especially strong here. While citizens may acknowledge a basic obligation to help support the government by paying taxes, most regard it as perfectly appropriate for a taxpayer to minimise the taxes that she pays. In the well-known words of Judge Learned Hand, ‘Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one’s taxes … [T]here is nothing sinister in so arranging affairs as to keep taxes as low as possible.’

A taxpayer can structure her activities to pay lower taxes than she would if she did the very same thing in a different way. She generally can reduce her tax burden, in other words, simply by manipulating the form of her activity, while engaging in the same substantive conduct, without incurring any moral stigma. Acting in this way constitutes tax ‘avoidance’, which is legitimate because it is based on the language of the law. This differs from tax ‘evasion’, which relies on fraud or deception to escape taxation.

Furthermore, tax law gives taxpayers wide latitude to resolve uncertainty about tax obligations in their own favour. In filing a tax return a taxpayer, with the advice of counsel, makes decisions about how to characterise various transactions, expenses and the like. Each

27 Schizer (n 25) 344.
28 Helvering v Gregory, 69 F 2d 809, 810 (1934).
decision results in what is known as a tax position. Each position results in a dollar figure that is plugged into the overall calculation of the taxpayer’s liability.

Tax law provides that taxpayers can satisfy their duty of compliance, and avoid tax liability, by taking a position for which there is very weak support, despite a much stronger argument that they should owe more money to the government.

For instance, a taxpayer is subject to a penalty for substantially understating her tax liability in an amount equal to 20 per cent of the shortfall. The taxpayer can avoid this penalty, however, if the understatement is due to a position that the taxpayer has taken that she discloses and for which she has a ‘reasonable basis’, as long as her underpayment is not due to the use of a tax shelter. This is regarded as satisfied by a 20 per cent chance of prevailing on the merits. If the position responsible for the understatement is not disclosed on the return, there is no penalty if the taxpayer has ‘substantial authority’ for it. This standard is generally regarded as satisfied if the taxpayer has as low a chance of prevailing as 40 per cent. A taxpayer can satisfy these standards by reasonably relying in good faith on the opinion of a tax advisor regarding the probability that she will prevail if her position is challenged by the IRS. If a taxpayer obtains such an opinion, she therefore may adopt a position on her tax return that she knows is likely incorrect.

To some degree this tolerance acknowledges the complexity of the tax code, which can make it easier to be mistaken about the law’s requirements than other regulatory regimes. Nonetheless, the permissible low levels of confidence in the accuracy of one’s estimated tax obligation are striking. Consider, for example, the tenability of permitting a company to discharge emissions on the basis of an interpretation of environmental law that the company knows has an 80 per cent likelihood of being wrong. Furthermore, arranging one’s activities to avoid tax liability contrasts with many areas of regulation. It depends on the provision, but on average we are less likely to be forgiving of using form to trump substance in, say, food and drug law or occupational safety regulation. Someone likely would be subject to moral criticism if she structured risky activity in a certain way simply to avoid being subject to regulation intended to reduce the risk of that behaviour. We do not, however, levy comparably stern criticism against those who manipulate the form of their activity to avoid taxes.

This tolerance is mirrored in some of the provisions relating to those who prepare tax returns for others. A person who prepares a tax return, for instance, is subject to the same standard as is a client for the purpose of determining if she is subject to a penalty for a return that substantially understates the client’s tax liability. A return preparer can

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29 26 USC 6662(a)(2013).
33 Holmes (n 31) 203.
34 26 CFR 1.6664-4(b).
35 A return preparer need not actually prepare and sign a return to fall within the definition of a ‘tax return preparer’. That definition includes anyone who renders advice that is ‘directly relevant to the determination of the existence, characterization, or amount of an entry on a return or a claim for refund’, if she prepares a ‘substantial portion’ of a return. See 26 CFR 301.7701-15(b)(2).
avoid a penalty if there is ‘substantial authority’ for an undisclosed position responsible for
the understatement.\textsuperscript{36} She can avoid a penalty if there is a ‘reasonable basis’ for a position
responsible for the understatement that is disclosed on the return.\textsuperscript{37}

A tax advisor advising a client on a return that does not involve a tax shelter is thus
titled to prepare a return that reflects an undisclosed position that has a 60 per cent
probability of being rejected if challenged on the merits, and a disclosed position that has
an 80 per cent chance of being so rejected. She has no obligation to urge the client to take a
position that reflects the best interpretation of the tax law, but has wide latitude to serve as
an aggressive advocate for the client.

\textit{Congruence with Ordinary Morality}

Tax law as a whole expresses the moral norm that citizens should pay their fair share in
supporting government as a collective good. While a taxpayer may accept this general norm
of civic obligation, she may not perceive any given provision as the expression of a powerful
moral norm. Income tax law is a welter of highly complex technical rules that establish
when income is subject to taxation. Any particular rule may reflect the influence of special
interests or distinctions and criteria that on their face have minimal moral valence. Many
specific provisions therefore may not embody underlying moral principles of tax law in
clear enough form that compliance with them is regarded as a compelling moral obligation.

It is true that a given provision may embody a more specific principle that undergirds
our particular tax system. For instance, deductions for expenses incurred in producing
income are based on the principle that a citizen should pay tax only on the amount of
the net economic gain resulting from business activity. Deducting expenses incurred for
personal consumption not connected to business activity is inconsistent with this principle.
Similarly, there are rationales for provisions that deal with, for instance, how to treat prop-
erty contributed to a partnership or the calculation of depreciation.

While a taxpayer may appreciate the logic behind these and other specific provisions,
in many cases that logic will not evoke a visceral moral response to the law’s demands. This
contrasts with other regulatory schemes, where the harm that the law seeks to prevent is
likely to be more apparent on the face of many—even if not all—particular provisions.

Thus, even if we accept the view that the tax law as a whole serves crucial moral
purposes, that conviction may operate at too high a level of abstraction to serve as a durable
motivation for robust compliance with particular provisions. Contrast this, for instance,
with criminal law. That is also a regulatory scheme crucial to the functioning of ordered
society—but compliance with many criminal provisions tends to be strongly bolstered by
powerful moral norms.

\textsuperscript{36} 26 CFR 1.6694-2(a)(ii).
\textsuperscript{37} 26 CFR 1.6694-2(a)(iii).
Conclusion

Certain features of the tax system provide a potentially strong basis for the claim that a practitioner advising a client on tax obligations should assume the role of an advocate. Especially in American society, taxes can elicit resentment as an unwelcome government intrusion on private property. Tax law appears to acknowledge this attitude by providing taxpayers with wide latitude in calculating their tax obligations without fear of paying a penalty for substantially understating them. The desire for clear notice of when the government has a legitimate claim on income provides the basis for an advocate to argue that taxpayers should be responsible for complying with the literal terms of the tax code rather than with more amorphous purposes ostensibly embodied in various provisions. Indeed, the complexity and opacity of many sections of the code would seem to make reference to purpose a hazardous enterprise in many cases. The desire for predictability therefore ostensibly authorises an advocate to emphasise the literal terms of the tax law without regard to its purposes and to obtain whatever benefits for the client those terms may provide.

The Trustee Model

Material Foundation for the State

As Justice Holmes declared, ‘Taxes are what we pay for civilized society’.\textsuperscript{38} Tax revenues provide the material support that is necessary for government to be able to operate. The most basic function of tax law is to ensure that government receives this support, and that citizens contribute their fair share of it. At a minimum, society has an interest in preserving the ability of tax law to meet this objective. As economist Joel Slemrod suggests, the alternative to reliance on taxes for funding government is ‘to run large budget deficits, financed either by borrowing or the printing of money. This strategy runs the risk of causing high interest rates and high inflation, hurting private investment, and damaging … long-term prospects for economic growth.’\textsuperscript{39}

Research indicates that appreciating this crucial role of taxes is more likely than sanctions to induce taxpayers to comply with their tax obligations. Approaches that ‘reinforce and encourage taxpayers’ devotion to their responsibilities as citizens’ thus play an important role in reinforcing a properly functioning system of taxation.\textsuperscript{40} This suggests that a tax advisor who assumes the role of a trustee may be playing a particularly important social role. As one tax lawyer has put it, ‘In killing poor tax schemes, the tax practitioner is rendering invaluable service to his country. A good [lawyer] can kill more such schemes in a year than ten revenue agents could examine and settle in five years.’ Playing such a role helps ensure that the government has the basic resources it needs to function.

\textsuperscript{38} Compania General De Tabacos De Filipinas v Collector of Internal Revenue, 275 US 87, 100 (1927), Holmes J dissenting.


Reliance on Taxpayers

In tax law the government’s resources are especially small compared with the percentage of the public that is subject to regulation. Other regulatory areas focus on specific segments of the population who are engaged in particular types of activity. By contrast, the income tax law applies to everyone who earns income. The meagreness of the IRS’s resources compared to the scope of tax obligations is reflected in the fact that the IRS is able at most to audit 1 to 2 per cent of tax returns a year.

Furthermore, the income tax system relies in the first instance on taxpayers to determine their own liability rather than demanding that they submit all information necessary for the government to do so. As Rachelle Holmes describes it:

Each year, taxpayers determine the amount of taxes they believe they owe to the U.S. government, file a federal tax return reporting those self-assessed amounts, and then submit any required payments to the U.S. Treasury. If the taxpayer has critical information that the IRS needs to know, they are typically the only party in the position to provide it. This is particularly problematic because tax results can turn on even the smallest of facts, and accurate complete information is often necessary to calculate a taxpayer’s ‘true’ tax liability.41

This asymmetry of information, combined with the low audit rate, means that the government is especially vulnerable to violations of tax law compared to other regulatory regimes. Imagine, for instance, if the government had to rely on the assurances of companies subject to environmental law that they are in compliance with all regulations, with minimal opportunity to verify these assertions.

The Psychology of Compliance

Research indicates that high rates of compliance with tax obligations are significantly correlated with what is called high ‘tax morale’: ‘the intrinsic motivation to pay taxes based on citizens’ sense of obligation to their state’. This sense of obligation is not simply an internally derived attitude. It is highly sensitive to the attitudes and behaviour of others, as well as influenced by perceptions of government.42

41 Holmes (n 31) 193.
As one researcher puts it, tax compliance is ‘a social act’. A sense of intrinsic obligation is the product of ‘conditional cooperation’. Research indicates that if a taxpayer perceives that there is a high percentage of other taxpayers who avoid paying their fair share, she is less likely to comply with her own obligations.

In those circumstances, she does not want to be a ‘sucker’ who incurs the cost of helping support a cooperative scheme for free riders who benefit from it without contributing to it. In addition, less tangibly, lower compliance in this situation may reflect the desire to conform to norms of social behaviour. In any event, tax morale, and thus compliance, decreases as people believe tax evasion to be more common.

In one study, for instance, as perceived tax evasion by others rises by one percentage point, the percentage of persons reporting high tax morale declines by more than seven percentage points. Research on the impact of correcting taxpayers’ impression that other persons have a lower commitment to compliance than they do is consistent with this sensitivity. When such taxpayers are shown that this perception is incorrect, and that people have a sense of tax obligation that is higher than they thought, they exhibit a higher level of compliance than they did before receiving such information. Research on tax morale thus suggests a certain paradox: a taxpayer’s sense of categorical obligation to pay taxes is conditioned on the perception that a critical mass of others have the same attitude.

Taxpayers’ sensitivity to others’ behaviour can create a particular challenge for tax law because research suggests that most people believe that other taxpayers are less committed to paying their fair share of taxes than they are. As a result, any given taxpayer contemplating compliance may begin with an attitude of suspicion that potentially could disrupt conditional cooperation. As one scholar describes it, ‘The systematic misperception that other people hold norms and views that are less supportive of honest taxpaying could lead to a vicious cycle of people adapting their own ethics and behavior to these perceived norms and thus contributing themselves to the invidious culture.’

Tax morale is influenced not only by perceptions of other taxpayers’ behaviour, but also by a taxpayer’s attitude toward the government. This involves her sense of both distributive and procedural justice. The first reflects satisfaction with the goods and services that a person’s taxes enable the government to provide. The second involves a belief that government decision-making processes in general, and tax proceedings in particular, are fair, transparent, and provide sufficient opportunities for citizens to influence their outcomes.

A taxpayer’s sense of the latter is influenced significantly by the quality of her interactions with the tax office. Not surprisingly, respectful treatment by tax officials increases tax morale, while more imperious treatment decreases it. As one pair of researchers puts it, ‘If [tax officials] treat taxpayers as partners in a psychological tax contract, instead of as inferiors in a hierarchical relationship, taxpayers have incentives to pay taxes honestly.’ The less this is the case, the more likely a taxpayer is to draw upon her private identity and regard the state as an adversary.

The lawyer can serve as both an explicit and implicit source of information for the client about other taxpayers’ behaviour. Clients reasonably assume that a lawyer who is a

43 Wenzel, ‘Misperceptions’ (n 42) 881.
tax specialist is familiar with a large number of other taxpayers. She may explicitly tell the client that most people are taking advantage of certain tax provisions. Or she may convey the idea that others treat tax law as rules that define the terms of a contest with the IRS. She also may implicitly convey such information through the way she discusses the code and the remarks she makes about the IRS. The perception that other taxpayers lack a sense of civic obligation can erode the foundation for conditional cooperation. It can lead the client to adopt a similar attitude in self-defence.

The tax system therefore is vulnerable because it is a regulatory scheme especially likely to elicit a purely self-interested approach to compliance that can be destructive of the overall system. The technical complexity of the law can obscure its purposes, and can limit the extent to which law can enlist ordinary moral responses in prompting compliance. These features, combined with deep-seated resistance to state claims on property, have the potential to threaten the very ability of the state to function.

Because taxation involves the immediate prospect of surrendering a portion of one’s property to the state, an attitude of resistance has a deep and visceral resonance that perpetually threatens a more fragile public-regarding perspective. Lawyers who see themselves as advocates devoted only to creative compliance can erode the conditions that support acknowledgement of taxation as a social obligation.

The tax advisor is also in a position to affect a client’s sense of the extent to which tax law reflects principles of distributive and procedural justice. An advisor who adopts the model solely of the partisan advocate engaged in creative compliance approaches the state as an adversary. Any gain for the IRS is a loss for the taxpayer. Conceptualising the IRS as simply an adversary suggests that the government is interested only in collecting as much tax as possible, not that tax collection is part of a larger effort to achieve common objectives. An advisor devoted to creative compliance can also promote the view that the complexities of the tax code are undeserving of respect because they reflect nothing more than the influence of special interests and irrational political compromises. This implies that the process by which such burdens are imposed is unfair and lacks legitimacy.

Such perceptions create distance between the citizen and the state, making her private identity more salient than her public one. If the tax code has no claim to fairness, why should a citizen have a sense of civic obligation to pay taxes? Why not seek whatever advantage she can to minimise her tax obligations?

In these ways, the tax advisor is in a position to affect tax morale, and thus tax compliance. The United States historically has been characterised by a high rate of tax compliance compared with many other countries. In part, this reflects the fact that the government uses automatic withholding, and matches employer and employee forms, to enforce taxes on salary income. But taxpayers have considerable discretion in claiming deductions, and in reporting income from other sources. For many people, this means that the odds of successfully evading taxes are reasonably high.

However, a much smaller percentage of these people evade taxes than the odds would suggest. Studies indicate that the level of tax compliance in the US is far higher than it would be if citizens complied only because they feared being caught if they did not. Joel Slemrod
has referred to this as ‘pathological honesty’. Research concludes that this reflects a widespread belief that paying taxes is a civic obligation because of its critical role in enabling the state to function.

Finally, one might argue, a regime in which tax advisors act as trustees is unlikely to deter productive behaviour that otherwise would occur. Resources spent on avoiding taxes arguably generate no social benefits, but represent a deadweight loss to society. From this perspective, transactions that taxpayers forgo because they fear that the IRS will disallow tax benefits from them do not represent lost social benefits even if they might have been held justified under the tax code.

**Feasibility of Gatekeeping**

Another consideration in assessing the suitability of the model of the trustee for the tax advisor is the practical feasibility of the advisor assuming this role. The literature on ‘gatekeeping’ is useful in conducting this assessment. We can think of a regime in which the law requires a tax advisor to serve as a trustee as one that imposes the duty on the advisor to prevent overly aggressive client tax positions by withholding support for them. As Reinier Kraakman suggests, ‘This support—usually a specialized good, service, or professional certification that is essential for the wrongdoing to succeed—is the “gate” that the gatekeeper keeps.’ In the tax context, the gate is an opinion that can help a client gain protection from the requirement to pay a penalty.

Imposing gatekeeping responsibility can also make sense when directly influencing the behaviour of potential wrongdoers is difficult. This is the case in tax enforcement, given that the system relies on self-assessment and that the IRS is able to audit at most 1 to 2 per cent of returns each year. In addition, unlike other regulatory regimes such as securities law, there are no private parties injured by taxpayers’ violations on whom the government can rely to supplement its efforts.

The effectiveness of gatekeeping duties can be undermined by the existence of illicit markets in which potential wrongdoers can obtain the support that conscientious gatekeepers refuse to provide. As Kraakman suggests, ‘small numbers of corrupt gatekeepers may be able to satisfy much of the demand for illicit support and thus render enforcement by honest gatekeepers largely irrelevant to wrongdoers who know the market.’ Another potential risk is that clients intent on wrongdoing may be able to corrupt gatekeepers by offering sufficiently large payments to secure their cooperation. Kraakman notes:

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47 Ibid, 62 (distinguishing between ‘market gatekeepers’ sensitive to private enforcement incentives and ‘public gatekeepers’ who are not).
48 Ibid, 66.
When wrongdoers cannot evade detection by gatekeepers or rely on illicit markets, they must resort to the mainstream (or ‘licit’) gatekeeping market to obtain the goods or services that misconduct requires. Here, the success of gatekeeping depends on the ease of corrupting ordinary gatekeepers who derive the bulk of their returns from legal transactions, and whose incentives depend largely on the organization of the licit gatekeeping market.49

These ways in which gatekeeping can be rendered ineffective reflect Kraakman’s point that ‘[c]omplex gatekeeper regimes rely on more than the services of individual gatekeepers; they enlist the entire private ordering that frames the gatekeeper’s role and contracting practice’.50 This suggests that a full assessment of the gatekeeping potential of tax advisors needs to examine the dynamics of the market for tax advice and the implications for practitioner norms. The next two sections provide a short account of how that market and those norms have evolved.

**The Traditional View of Tax Advice**

A review of debates between tax lawyers and the bar as a whole over the obligations of tax practice indicates that lawyers in leading positions in the tax bar historically have resisted attempts to characterise tax advisors solely as partisan advocates. At the same time, an analysis of tax practice literature and interviews with tax lawyers suggests that there is some difference of opinion within this practice setting about how stringent the limits on partisanship should be.51

The traditional position of the elite bar was expressed by Randolph Paul, one of the founders of the law firm Paul, Weiss. Paul declared in 1953 that a lawyer’s duty to his client in a dispute with another citizen ‘is paramount and exclusive’. At the same time, he said, tax lawyers:

> as ministers of law, cannot countenance or be accessory to an escape by taxpayers of their duty to their Government … [T]he tax practitioner has a dual responsibility. He must be loyal to his client, but he is also duty bound to the Government to see that his client does not ‘avoid his just share of the tax burden’.

This sense of obligation expressed by Paul and felt by others undoubtedly reflected a complex mixture of public-regarding attitudes, pragmatic advice to clients, and professional self-interest on the part of elite tax lawyers.52 Nonetheless, for several decades of the twentieth century a critical mass of tax lawyers appeared to see their role as helping clients fulfil their civic duty to engage in an accurate self-assessment of tax obligations. They were advocates, but also trustees.

49 **Ibid**, 69.
50 **Ibid**, 81–82.
51 For a lengthier discussion of this history, see Tanina Rostain and Milton C Regan, Jr, *Confidence Games: Lawyers, Accountants, and the Tax Shelter Industry* (MIT Press, 2014).
The tension between this position and the strong influence of the model of the advocate within the legal profession as a whole is reflected in jousting between the American Bar Association (ABA) and the Section of Taxation of the ABA. The ABA's first venture into this thicket was Opinion 314 by the Committee on Ethics and Professional Responsibility in 1965. In that Opinion, the Committee considered the ethical obligations of lawyers practising before the IRS, which included those who provide advice to taxpayers about their tax returns.

The Opinion began by describing the IRS as an 'adversary party'. It approvingly quoted ABA Ethics Canon 22, which states that, within the bounds of the law, the lawyer owes 'entire devotion to the interest of the client'. It went on to say that a lawyer asked to advise on the preparation of a tax return could urge the position most favourable to the client as long as there was a reasonable basis for the position. Furthermore, since a lawyer need not disclose weaknesses in his client's case to an adversary, he need not advise the client to make disclosure by flagging and explaining the position. Opinion 314 thus represented a fairly straightforward adoption of the model of tax advisor as advocate.

The Tax Section eventually took direct issue with Opinion 314's adoption of the adversary model. It said explicitly: 'A tax return is not a submission in an adversary proceeding.' The Section noted that the government bears a substantial burden because of the complexity of tax laws, difficulties in training IRS agents, and the dependence of the system on taxpayer disclosure and self-assessment. For these reasons, it is especially important that a tax return 'provide a fair report of matters affecting tax liability'.

The Tax Section recommended that the standard should be that a lawyer may advise a position that was 'meritorious'. This required honest belief in a potentially favourable outcome in the courts, which was advanced in good faith, as evidenced by a 'practical and realistic possibility of success' if litigated. The Section suggested that if a lawyer is unable to conclude that there is 'substantial authority' for a taxpayer's position, which meant that the taxpayer could be subject to a penalty, 'the lawyer should advise that adequate disclosure of the position be made'.

The Tax Section thus maintained that a lawyer providing tax advice should not view herself simply as an advocate. She should recognise that she is acting within a tax system that relies on self-reporting, and that she is helping a taxpayer provide an accurate account of her tax liability. In this respect, the tax advisor has some responsibility as a trustee.

In Opinion 85-352 the following year, the ABA Committee acknowledged that the tax lawyer may play the roles of both advisor and advocate. It gave precedence, however, to the latter. 'In many cases,' it said, '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, the Committee said, when the lawyer advises an aggressive position on a tax return.

In seeking a standard to guide the lawyer in advising a client on a tax return, the Committee looked to ABA Model Rule 3.1, which governs the presentation of claims in litigation. It relied on that rule in concluding that a lawyer may advise taking the position that is most favourable to the taxpayer as long as the lawyer has a good faith belief that the position is warranted. The Committee said that this requires that there be some
‘realistic possibility of success if the matter is litigated’. The lawyer need not believe that the client’s position will prevail. The Committee said that the standard set forth in the opinion is ‘consistent with the basic duty of the lawyer to a client: zealously and loyally to represent the interests of the client within the bounds of the law’.

Thus, while Opinion 85-352 acknowledges that a tax lawyer may play a role as advisor in addition to that of an advocate, the ABA Committee adhered to its view that a lawyer involved in tax practice is primarily the latter. It therefore looked to the ethical rules governing litigators to define the standard for giving tax advice.

The ABA Tax Section responded with a Report on the ABA’s Opinion that suggested that it was an improvement on Opinion 314. It took heart from the fact that the Committee had acknowledged that litigation standards do not apply in unqualified fashion to advising on tax returns. The Tax Section went beyond the Committee’s cursory gesture, however, to emphasise that ‘a tax return initially serves a disclosure, reporting, and self-assessment function. It is the citizen’s report to the government of his or her relevant activities for the year.’

The ABA has thus drawn liberally on the model of the advocate in defining the role of tax advisors. Indeed, it has explicitly characterised the IRS as an ‘adversary’. By contrast, the Tax Section of the ABA has maintained that ‘a tax return is not a submission in an adversary proceeding’. It has maintained that a tax advisor’s role is to help the citizen provide an accurate self-assessment of her tax obligations.

A Shift in Norms

There are indications that various factors in recent decades have led to an erosion of consensus about the weight that a tax advisor should give to the role of the advocate. These factors include an increasing tendency for corporate clients to treat their tax departments as profit centres charged with achieving the lowest possible effective tax rate, the attenuation of long-term ties between law firms and corporate clients, heightened competition for tax work among law firms and accounting firms, and the ascendance of a ‘textualist’ approach to statutory construction that emphasises reliance on the literal words of legal provisions. These forces have led to greater willingness on the part of tax advisors to be more aggressive in advising clients about the tax positions they can take, with less concern about consequences for the larger tax system.53

An indication of this shift was the participation of lawyers in respected mainstream law firms in the massive wave of abusive tax shelters that arose in the late 1990s and early 2000s. A tax shelter is a transaction that is designed to shield much or all of a taxpayer’s income from taxation. In basic terms, the government regards a tax shelter as abusive if it involves a transaction in which the taxpayer exploits formal provisions of the tax code to reduce or eliminate her taxable income in a way that Congress has not intended.

A key feature of such a transaction is that it results in a tax loss without the taxpayer incurring any meaningful financial risk or pursuing any opportunity for profit. In such

53 For elaboration on these influences, see Rostain and Regan (n 51).
cases, the taxpayer suffers no actual economic loss; indeed, her economic position is essentially unchanged as a result of engaging in the transaction. To combat this exploitation of the tax code, courts have adopted doctrines that require that an investor enter a transaction for a business purpose other than to reduce taxes, and that the transaction have economic substance in order to claim a tax loss from it.\textsuperscript{54} Similarly, the IRS has reserved the right to deny tax benefits resulting from a transaction even if it complies with the literal terms of the tax law.

The previous surge of shelters in the 1970s and 1980s involved more marginal accounting firms, investment advisors and law firms that focused mainly on relatively simple shelters for professionals seeking to shelter income by investing in businesses in which they took no active part. By contrast, the shelters that emerged at the turn of the twenty-first century were marketed in huge numbers to high-wealth individuals and major corporations, involved the use of complex financial instruments, and relied on the efforts of lawyers in several elite accounting and law firms. The criminal investigations conducted in response to these shelters resulted in the largest number of prosecutions against lawyers in connection with any episode of wrongdoing in United States history.

The greater schism in the elite bar over practice norms is reflected in the fact that some members of the tax bar were highly critical of these shelters. The New York State Bar Association Tax Section took an especially prominent role in urging the government to take steps to deter corporate tax shelters. In responding to the administration’s proposals to combat corporate tax shelters in connection with the 2000 budget process, the Section described such shelters as ‘a major problem for our system’.\textsuperscript{55} It suggested that there was

\begin{quote}

some significant number of transactions that most members of Congress would view as resulting in a substantial unintended loss of revenue. In many cases, the lack of rational justification for the significant tax benefits achieved together with the fact that no substantial business purpose or economic effect, other than the reduction of taxes, is served by the transactions would make it obvious to anyone that the revenue loss is unwarranted.\textsuperscript{56}
\end{quote}

The Section also spoke from the perspective of the trustee when it noted, ‘An easy consensus would also likely be reached that the tax revenue lost in a somewhat smaller group of transactions that do, in significant respects, have business purpose and economic substance is clearly unjustified in terms of the purpose and structure of our income tax statute.’\textsuperscript{57} Aside from lost revenue, the Section articulated concern that

\begin{quote}

conscientious practitioners are increasingly demoralized by what they perceive to be the degrading effect of such transactions on their profession. It is also clear that the perception of our tax system held by both corporate America and the general public has been altered, and that, as time goes on, such transactions breed a disrespect for the system which will ultimately have significant compliance consequences. Coping with aggressive tax planning has also obviously
\end{quote}

\textsuperscript{54} This latter requirement has now been codified in the Internal Revenue Code.
\textsuperscript{55} 1999 TNT 82-29 NYSBA Tax Section Applauds Some Anti-Corporate Tax Shelter Proposals, Rejects Others (Section 6703—Abusive Shelter, etc Penalties) (Release Date: 23 April 1999).
\textsuperscript{56} \textit{Ibid.}
\textsuperscript{57} \textit{Ibid.}
proven difficult for the Internal Revenue Service and Treasury Department, frequently fraying the relationship between the government and private sector.\textsuperscript{58}

These concerns led the Section to support the proposal that corporate taxpayers should no longer be able to rely on tax opinions to avoid penalties for underpayment due to the use of tax shelter transactions. Under such a rule, ‘corporate taxpayers would be forced to incur a real risk from entering into such transactions, and would be induced to seek balanced, well-reasoned tax advice concerning such transactions rather than tax opinions intended principally to serve as insurance against the imposition of penalties’.\textsuperscript{59} In other words, the law should encourage taxpayers to use the services of tax advisors who attempt to accommodate the interests of both the private and the public citizen, rather than those who promote only the interest of the former by acting solely as advocates. The Section also supported imposing more substantial penalties on taxpayers failing to disclose the material facts regarding their use of shelter transactions.

The tax shelter crisis starkly revealed the fragmenting consensus within the elite tax bar, but some tax lawyers express concern that advice on tax positions that do not involve shelters has also become more aggressive. This activity is much harder to identify, and the task of distinguishing appropriate from questionable positions is more difficult than it is for transactions whose principal purpose is to minimise tax liability. Nonetheless, to the extent that impressions are accurate that lawyers are blessing more aggressive return positions, it indicates increasing emphasis on the role of the advisor as an advocate.

Finally, while tax advisors may be well situated to serve as gatekeepers, there is less lawyer willingness than there once was to play this role. Some advisors may place relatively strict limits on how aggressive they will be on behalf of a client, but a larger percentage than before seem to be prepared to go further. As a practical matter, this suggests that regulation imposing the obligations of a trustee may need to be modest and targeted.

Conclusion

Certain features of the tax system support the claim that a tax advisor should serve as a trustee of the system who encourages clients to comply with the spirit as well as the letter of the tax code. The very ability of the government to function is dependent on tax revenues, and taxpayers’ willingness to meet their obligations rests on the fragile foundation of confidence that others will do so. If tax advisors act simply as advocates, they risk causing damage to tax morale that can trigger a self-reinforcing cycle of distrust and tax evasion. The government’s reliance on taxpayer self-assessment and its dependence on taxpayers for information can make this cycle extraordinarily difficult to reverse. By contrast, if advisors act as trustees they can bolster tax morale by instilling a sense of respect for the tax system and confidence that other citizens are paying their fair share. At the same time, we need to take account of greater acceptance of the advocate role among practitioners than a generation ago.

\textsuperscript{58} Ibid.
\textsuperscript{59} Ibid.
Finally, one might claim, it is unlikely that advisors acting as trustees will result in complete conscription of taxpayers and tax lawyers into the service of the state. First, the code does not always dictate a single obvious tax result that should apply to a given transaction. In the face of this, tax law generally places more lenient duties on citizens to adopt a reasonable interpretation of their obligations than the law imposes in other contexts. Second, taxation is a scheme in which regulated parties have more latitude than in many other areas of the law to take steps to avoid the impact of regulation without incurring a moral stigma. Third, the system will still depend on taxpayer self-assessment and control over information.

**Conclusion: Conflicted Citizens**

Tax advice is a practice setting in which there are powerful strains of argument for an advisor to assume the roles of both advocate and trustee. This reflects the potentially conflicting roles of the taxpayer as a private and a public citizen. The private citizen jealously protects her property and is suspicious of government’s claims on it. The public citizen appreciates that the state cannot function to protect property or liberty unless all taxpayers contribute their fair share of revenues. A tax advisor who assumes an adversarial posture toward the state advances a citizen’s private interest but may do so at the expense of her public identity. An advisor who embraces the model of the trustee may provide assurance that the needs of the public citizen will be met, but may risk providing insufficient protection for the private citizen against state power by resolving all close questions in favour of the government. As the next section discusses, this ambivalence about taxation is reflected in the regulation of taxpayer and advisor conduct.

**CONFLICTED REGULATION**

The tensions that I have described between taxpayers as private and public citizens, and tax advisors as advocates and trustees, are reflected in the regulations that affect tax advisors. These include provisions regarding furnishing advice to taxpayers, preparing and signing returns, and issuing opinions that allow taxpayers to avoid penalties for inaccurate tax payments. These regulations distinguish between tax positions that reflect the use of shelters and those that do not. What I will call positions on ‘ordinary’ returns that do not involve shelters are subject to considerably less stringent requirements than returns on which one or more positions reflect the use of a shelter.

**Ordinary Returns**

The standards governing ordinary returns provide generally that a practitioner may not advise a client to take a position that lacks a reasonable basis, and may not sign a return or claim for refund that lacks such a basis.\(^{60}\) A practitioner also may not advise a client to

\(^{60}\) 31 CFR 10.34(a).
take a position on a ‘document, affidavit, or other paper submitted to the Internal Revenue Service’ unless the position is ‘not frivolous.’ This non-frivolous standard is the same as the one that applies to lawyers presenting claims or defences in litigation under the ABA Model Rules of Professional Conduct.61 A person who advises a client with respect to a position or who prepares or signs a return must inform a client of any penalties reasonably likely to apply to a position, as well as let the client know of opportunities to avoid a penalty by making adequate disclosure. Finally, a tax practitioner advising a taxpayer to take a position on a tax return, document, affidavit or other paper submitted to the IRS ‘generally may rely in good faith without verification upon information furnished by the client’, unless she is on notice that she should make reasonable inquiry.62

A taxpayer who faces the possibility of a ‘substantial understatement’ can reduce the size of an understatement by an amount attributable to a tax position for which there is currently or was at the time of the transaction substantial authority, which constitutes a 40 per cent chance of prevailing on the merits. If she discloses the relevant facts regarding a position, she can reduce the size of her understatement by an amount for which there is currently a reasonable basis, which involves a 20 per cent chance of prevailing.63 Apart from the opportunity to reduce the size of her understatement, a taxpayer may avoid a penalty for an inaccurate ordinary return if she demonstrates that there was reasonable cause for her position and that she acted in good faith.64 She may rely on the opinion of a tax advisor to make this showing.

Tax Shelters

Taxpayers who file returns that include positions based on the use of a tax shelter face more stringent standards, as do practitioners who advise them.65 First, corporate taxpayers who are liable for a substantial underpayment of taxes resulting from tax shelters are not eligible for any reduction in the shortfall caused by a shelter.66 A non-corporate taxpayer whose underpayment is due to involvement in a tax shelter may reduce the size of her understatement by an amount attributable to a position for which there is currently substantial authority and if she believed at the time of filing her return that the position more likely than not was correct.67 The effect of this is to provide a significant objective constraint on a taxpayer’s subjective belief. In essence, the taxpayer must at the time of filing the return

61 ABA Model Rules of Professional Conduct, r 3.1.
62 31 CFR 10.34(d).
64 26 USC 6664(c)(1)(2013).
65 For purposes of taxpayer liability for accuracy-related penalties, ‘tax shelter’ is defined generally as an arrangement for which a ‘significant purpose’ is ‘the avoidance or evasion of Federal income tax’: 26 USC 6662(d)(2)(c)(iii). Treasury regulations provide that the avoidance or evasion of tax will be considered a significant purpose if tax benefits ‘constitute an important part of the intended results of the transaction’. Notwithstanding this purpose, a transaction will not be treated as a tax shelter if the taxpayer participates in it ‘in the ordinary course of its business in a form consistent with customary commercial purpose’ and there is a ‘generally accepted understanding that the expected tax benefits are “properly allowable”:’ 26 CFR 301.6111-2(b)(3).
66 26 CFR 1.662-4(g)(1).
have a reasonable belief that a tax position has a 51 per cent chance of prevailing and the actual probability at the time of the adjudication must be deemed to be at least 40 per cent.

With respect to penalties applied to understatements, no defence is available to a taxpayer whose understatement is attributable to use of a tax shelter deemed to lack economic substance.68 A taxpayer whose understatement reflects use of a ‘reportable transaction’, defined as one that ‘is of a type which the Secretary determines as having a potential for tax avoidance or evasion’,69 can assert a defence based on criteria more stringent than those that apply to other taxpayers. She must disclose all relevant facts regarding the tax position resulting in the understatement, must show that there was or is substantial authority for the position, and must reasonably have believed that the position more likely than not would prevail if challenged.70 She can satisfy the last criterion by reasonably relying on a ‘covered’ opinion by a tax advisor that reaches this conclusion.71

Regulations prescribe the conditions that advisors must satisfy in providing such a ‘covered’ opinion.72 With respect to factual matters, these include the requirement to use reasonable efforts to identify and consider all relevant facts; the injunction not to base the opinion on any unreasonable factual assumptions, including ‘that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits’; and the prohibition on relying on any ‘unreasonable factual representations, statements or findings of the taxpayer or any other person that the advisor knows or should know is incorrect’. A practitioner may not rely on a representation that a transaction has a business purpose ‘if the representation does not include a specific description of the business purpose’. The opinion must identify in a separate section all factual representations, statements, or findings of the taxpayer on which the practitioner relies.

With regard to legal conclusions, the opinion ‘must consider all significant Federal tax issues’.73 It must also ‘provide the practitioner’s conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant Federal tax issue considered in the opinion’.74 If the practitioner is unable to reach a conclusion with respect to one or more of those issues, the opinion must indicate this and describe the reasons for it. If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant Federal tax issues, the opinion must ‘prominently disclose’ this fact and that the opinion cannot be used by the taxpayer to avoid a penalty based on those issues.75

68 26 USC 6664(c)(2)(2013).
69 26 USC 6707(c)(1)(2013).
71 A covered opinion is defined as written advice concerning one or more Federal tax issues arising from a transaction that is the same as or substantially similar to a transaction that the IRS has listed as abusive, that has as its ‘principal purpose’ the ‘avoidance or evasion of tax imposed by the Internal Revenue Service’, or that has such an objective as a ‘significant purpose’ if the advice is, inter alia, provided for penalty protection: 31 CFR 10.35(b)(2)(i). The ‘principal purpose’ of an arrangement is tax avoidance or evasion if ‘that purpose exceeds any other purpose’: 31 CFR 10.35(b)(10).
72 31 CFR 10.35.
73 31 CFR 10.35(c)(3)(i).
74 31 CFR 10.35(c)(3)(ii).
75 31 10.35(e)(4).
A covered opinion must also provide an overall conclusion about the likelihood that the tax treatment of the transaction or matter that is the subject of the opinion is proper, and the reasons for that conclusion. If the practitioner is unable to reach such a conclusion, the opinion must disclose this and describe why it is the case.

**Criticism and Proposals**

As is apparent, tax returns and advice that relate in any way to a tax shelter are subject to far more demanding regulation that those that are not. Some scholars have criticised this difference in treatment, arguing that the standards for positions on ordinary returns should be more stringent. Michael Doran, for instance, notes that reliance on taxpayer self-assessment reflects the belief that taxpayers have superior access to information about their transactions that allows them to determine their liabilities at lower cost than the government. It also reflects a judgement that taxpayers generally can be trusted to determine and report their liabilities in good faith. ‘Both those judgments’, he argues, ‘are undermined by any definition of tax compliance that does not require the taxpayer to make her best efforts to arrive at the correct determination of her tax liability.”76

Doran asserts that a penalty should apply to an understatement of a taxpayer’s liability that is due to an undisclosed position ‘that she does not reasonably and in good faith believe to be correct’.77 He notes that this is more demanding than even a more-likely-than-not standard. A position that the taxpayer believes is barely likely to prevail ‘is not necessarily a position that the taxpayer reasonably and in good faith believes to be correct’.78 In such an instance, there should be further inquiry to see if the uncertainty can be resolved. If not, the taxpayer ‘demonstrates her good faith by disclosing and describing the legal uncertainty on her return’. Under Doran’s proposed regime, reliance on an opinion from a tax practitioner expressing the view that a position is correct presumably would suffice to meet the reasonable and good faith belief standard. If a position is not disclosed, it must meet the more-likely-than-not standard.

With respect to advisors, Doran suggests that a practitioner should be subject to a penalty for providing a favourable opinion on a return position unless the advisor reasonably and in good faith believed the position to be correct.79 A return preparer would be subject to a penalty for any understatement based on a disclosed position that did not meet the more-likely-than-not standard.

This approach would impose a common standard across all types of returns and transactions, rather than distinguishing between those that involve tax shelters and those that do not. As Doran notes, ‘The labels contrived by current law—such as “tax shelter” and “reportable transaction”—suggest that taxpayers should be held to higher standards of conduct only when they engage in suspect transactions.’80 Instead, he argues, ‘a conception

77 Ibid.
78 Ibid., 155.
79 Ibid., 158.
80 Ibid., 155.
of tax compliance thick enough and robust enough for a self-assessment system requires taxpayers to satisfy a higher standard of conduct in all cases. Whether a taxpayer has acted appropriately—and what she can expect of her advisor—‘should be determined by how the taxpayer applies the law to her transaction rather than how the government happens to label it.’

Rachelle Holmes makes a similar plea for a ‘singular standard of tax legality’. She observes that under the current system of penalties, ‘a taxpayer is under no duty to report items on his tax return, with our without any additional disclosures, in a manner he believes reflects the proper amount of tax he should pay under the applicable tax rules and regulations.’ She also contends that the system ‘serves as an obstacle to the sound and efficient provision of legal advice while failing to deter significant amounts of wrongdoing.’ Holmes argues that the law should require that a tax position that is not disclosed be more likely than not sustainable on its merits for the taxpayer to avoid a penalty. This would mean that a tax advisor would have to advise a client that any position on her return must be more likely than not to be upheld if challenged, unless the taxpayer disclosed the position. If the position were disclosed, a taxpayer could avoid a penalty if the position had a reasonable basis.

Holmes would also impose the same diligence requirements for all tax opinions as currently apply to ‘covered’ opinions relating to tax shelters. Thus, for instance, a practitioner would be required to determine that a transaction had an economic effect beyond the generation of tax benefits regardless of the ultimate opinion that she renders. In addition, a signing return preparer would be required to inspect information and advice provided by the client and other advisors to confirm their accuracy. By contrast, a preparer of an ordinary opinion may currently rely on other parties without conducting such verification.

Holmes regards her proposals as explicitly designed to strengthen the role of the tax advisor as a gatekeeper who helps ensure that taxpayers meet their tax obligations. She argues that the provisions she suggests accomplish this ‘by eliminating some of the ineffective and overly adversarial elements of the system, raising the standards for tax legality and penalty protection between tax lawyers and taxpayers, and augmenting the tax lawyer’s due diligence responsibilities.’

Doran’s and Holmes’s criticisms and recommendations have considerable merit. Tax shelters do not represent a set of transactions sharply distinct from those that are not classified as such. There is a spectrum of transactions animated by motives that reflect different mixes of the desire for tax benefits and other aims. While some arrangements may be easy to classify as shelters, identifying the point at which the motive of obtaining tax advantages

81 Ibid.
82 Ibid., 156.
83 Holmes (n 31) 210.
84 Ibid., 211.
85 Ibid., 209.
86 Ibid., 210.
87 Ibid., 220.
88 Ibid., 209.
becomes significant typically is an imprecise exercise that is notoriously difficult. It seems problematic to base radically different standards of conduct for taxpayers and tax advisors on such a distinction.

Furthermore, concern about the loss of tax revenues from aggressive tax positions is not confined to positions based on the use of explicitly identified shelters. There are numerous opportunities for taxpayers and tax advisors to take questionable approaches to determining tax obligations that do not rely on arrangements that have become so widely known that they have become identified as shelters. If we care about the integrity of the tax system as a whole, we should want to create incentives for appropriate behaviour by taxpayers and advisors in all settings, not just when shelters are involved. This suggests that a single standard should apply to all taxpayers filing a return.

Why does this dramatic disparity in treatment nonetheless persist? One plausible reason, of course, is political influence. Both corporations and high-wealth individuals benefit from a system that permits taxpayers to take aggressive positions as long as they do not use a tax shelter. Arguments by such interests have particular resonance, however, because they tap into the concerns of taxpayers as private citizens who are suspicious of government efforts to intrude on private property. This perspective conceptualises government as an adversary, and maintains that taxpayers should have considerable latitude to present arguments that would limit the amount of taxes they owe as long as there is some colourable basis for their claims.

In order to present their positions effectively, citizens seeking to protect their property need to be able to rely on tax advisors who serve as advocates, not as counsellors who advise their clients to present only those positions that the government is likely to accept. Under the current regime, if a shelter is not involved, both taxpayers and tax advisors can be quite aggressive, with the advisor at liberty to serve as a zealous advocate. The ability, for instance, to advise a client to take a position that has an 80 per cent probability of being incorrect hardly encourages an advisor to take the purposes of the tax law into account. The regulations governing ordinary returns thus demarcate an area in which the interest of the private citizen and the model of the advisor as advocate hold sway.

While the regulation of ordinary returns acknowledges a domain governed by taxpayer self-interest, that realm ends at the point at which the desire to reduce taxes is a significant motive for engaging in a transaction. Returns that reflect positions based on the use of shelters fall within an area in which the perspective of the public citizen and the model of the advisor as trustee have precedence. Tax shelter activity is of particular concern because it has the qualities of a contagion. Information about the use of shelters spreads quickly, especially when shelters are mass marketed. This prompts taxpayers to exploit shelters to avoid being disadvantaged compared with their peers. Tax morale can plummet in the face of the perception that others are avoiding their fair share of obligations. This decline in turn produces less tax compliance, which further reduces morale, and so on, in a self-reinforcing downward cycle.

The relatively public nature of tax shelters thus means that they have more potential for inflicting extensive damage to the tax system than do private conversations between clients and advisors that result in lower tax burdens for single taxpayers. These characteristics may
thus be the implicit rationale for distinguishing between ordinary returns and those that reflect reliance on shelters.

None of this is to say that the current regulatory scheme is ideal, or that it strikes a proper balance between the two powerful orientations that I have described. It does suggest, however, that, whatever the merits of critiques such as those presented by Doran and Holmes, it may be difficult to impose more demanding standards on taxpayers and advisors with regard to ordinary returns.

CONCLUSION

The relationship between citizens and the state is a conflicted one. In various settings, to varying degrees, citizens may need either a trustee who evokes their sense of civic obligation or an advocate who champions their interest against the power of the state. There are numerous regulatory schemes and, within them, a variety of specific provisions. All provisions deserve respect as law, but they differ in the extent to which we regard their letter or their spirit as constituting the law.

Regulatory schemes also vary in the kinds of purposes they are intended to serve, the tools available to enforce them, the characteristics of the persons and organisations subject to regulation, the extent to which moral norms reinforce compliance, the roles that lawyers play in the affairs of the regulated parties, and the extent to which those roles are amenable to direct regulation. Determining the obligations of an advisor in a given field will require taking into account these and other considerations. I have suggested in a preliminary way how these considerations may illuminate the way in which the law currently regulates tax advisors.

Litigators tend to capture the public imagination as the heroes and villains of the legal profession. Advisors who give advice behind closed doors, however, may do far more good and inflict far more damage. We need to begin to open those doors and give more sustained attention to the kinds of conversations that we want to take place there.