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The Criminality of "Tax Planning"

Michelle M. Kwon

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THE CRIMINALITY OF "TAX PLANNING"

by

Michelle M. Kwon[*]

ABSTRACT

In recent years, the federal government has adopted an aggressive prosecution policy that targets tax advisors who help their clients evade taxes. Increased prosecutions coupled with the present-day sophistication of tax practice call for a critical examination of the willfulness standard applied to tax advisors who use the Code and Treasury regulations as part of their regular practices. This is something no previous legal scholarship has done.

To establish willfulness, the government must show that a person accused of a tax crime intentionally violated a known legal duty. Because knowledge of illegality is an element of the government's tax evasion case, prosecutors must negate a defendant's claim of ignorance or misunderstanding of the law, which is evaluated subjectively. The mistake of tax law defense and the knowledge of illegality standard are anomalies since ignorance of the law usually is not an excuse. The Supreme Court, however, has said that tax law is special due to the need to protect average citizens from prosecution for innocent mistakes made due to the complexity of the tax laws. The same high standard of willfulness that applies to average citizens also applies to tax professionals.

This Article aims to do two primary things. First, it demonstrates that consideration should be given to broadening the current willfulness standard as it is applied to

* Associate Professor, University of Tennessee College of Law. Thank you to Scott Schumacher for his helpful and insightful comments and to audiences at the University of Kentucky Developing Ideas Conference and the Texas State Bar Advanced Tax Law Course, where I presented earlier versions of this paper. Thanks also to Shawn Ross and Donielle Hubbard for their research assistance and to the administration of the University of Tennessee College of Law for its generous research support.

tax advisors. Second, it evaluates the suitability of Samuel Buell and Lisa Kern Griffin's work on "consciousness of wrongdoing" as one possible approach to consider.

Beyond tax scholars and practitioners, this Article may resonate with those interested in criminal law generally and white collar crime in particular, as well as those interested in issues of professional responsibility.

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"[Willful is] a very dreadful word . . . . Maybe it is useful. It's an awful word! It is one of the most troublesome words in a statute that I know."[1]

Judge Learned Hand

I. INTRODUCTION

Tax evasion has been popularized by convictions of celebrity tax evaders such as Al Capone, the organized crime boss, and Heidi Fleiss, the "Hollywood Madam," who failed to file their income tax returns, failed to report or pay all the taxes they owe, or illegally stashed away their income or assets.[2] Section 7201 makes it a felony for any person to willfully attempt to evade or defeat any tax imposed by the Internal Revenue Code,[3] but section 7201 is not limited to those attempting to evade or defeat their own tax liability.[4] Advisors may be prosecuted for the tax evasion they help their clients commit.

In recent years, the federal government has adopted an aggressive prosecution policy that targets advisors who help their clients evade their taxes. Increased prosecutions coupled with the present-day sophistication of tax practice that often relies on the deliberate exploitation of ambiguity in the law, call for critical consideration of the willfulness standard as applied to tax advisors. This is something no previous legal scholarship has done.[5]

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1. MODEL PENAL CODE § 2.02(10) cmt. n.47 (1985) (quoting Judge Learned Hand's response in an exchange between the Reporter and Judge Learned Hand).

2. See Pamela H. Bucy, Criminal Tax Fraud: The Downfall of Murderers, Madams, and Thieves, 29 ARIZ. ST. L.J. 639, 639 (1997) [hereinafter Bucy, Criminal Tax Fraud].

3. I.R.C. § 7201. Tax evasion is punishable by imprisonment of not more than five years or a fine of not more than $100,000 ($500,000 in the case of a corporation) or both. *Id.* The term "willfully" is used to define other tax crimes, including those in I.R.C. §§ 7202–7207, and that term has the same meaning in all tax-related offenses, both misdemeanor and felony. United States v. Bishop, 412 U.S. 346, 361 (1973).

4. It is irrelevant that the tax owed is that of the client rather than the advisor because the statute applies to "any person" and is not limited to the taxpayer. United States v. Townsend, 31 F.3d 262, 267 (5th Cir. 1994) (holding that a violation of section 7201 "is not limited to prosecution of those who evade taxes they may owe themselves."); Tinkoff v. United States, 86 F.2d 868, 876 (7th Cir. 1936).

5. A few commentators have criticized the narrow standard of willfulness that applies to taxpayers charged with tax crimes. *See, e.g.*, Mark D. Yochum, *Ignorance of the Law is an Excuse for Tax Crimes*, 27 DUQ. L. REV. 221, 235 (1989) ("[Tax] crimes should not be described or interpreted with the timidity of a young regulatory idea sneaking up on an unsuspecting public, but as social obligations as familiar as 'thou shalt not steal.'") [hereinafter Yochum, *Ignorance of the Law*]; Mark C. Winings, *Ignorance is Bliss Especially for the Taxpayer Evader*, 84 J. CRIM. L. &

Even though the tax evasion statute has been on the books for years, federal prosecutors only recently ratcheted up enforcement through targeted criminal actions against tax and banking professionals.[6] The government historically sought civil penalties from those whose taxes were underpaid while exculpating the advisors.[7] More recently, however, the government has been criminally prosecuting the advisors and settling with taxpayers with outstanding tax obligations.[8]

The government's unprecedented decision to indict tax advisors was in response to a run of serious tax shelter activity. A vigorous tax shelter market became firmly established in the 1990s and reached its peak in the latter part of the decade.[9] The tax shelter market flourished because of good, old-fashioned supply and demand in an essentially unregulated market. During the 1990s, the United States experienced the best and longest economic performance in decades, which translated into higher amounts of income and gain recognition for taxpayers.[10] Taxpayers, who undoubtedly were motivated to minimize their tax bills, were driving up demand;[11] practitioners, who were

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CRIMINOLOGY 575, 590 (1993) (discussing the need for an objective standard for a mistake of law defense). No one has addressed the willfulness standard as it applies to tax advisors specifically.

6. *See* Scott A. Schumacher, *Magnifying Deterrence by Prosecuting Professionals*, 89 IND. L.J. 511, 522–23 (2014) [hereinafter Schumacher, *Magnifying Deterrence*]. Assessing the effectiveness of this change in prosecution policy is beyond the scope of this Article. Professor Schumacher has evaluated the prosecution policy and concluded that it is "consistent with the goals of tax enforcement and with the theories underlying criminal liability." *Id.* at 547.

7. *Id.* at 512.

8. *Id.* at 521–24. Pursuant to various settlement initiatives, taxpayers agree to concede the underlying tax liability and, in exchange, the Service agrees to concede some or all of the civil penalties and may permit the taxpayer to deduct transaction costs. *See* IR-News Rel. 2005–129, 2005 U.S. Tax Rep. (RIA) ¶ 86,497; Announcement 2005–80, 2005–2 C.B. 967; Announcement 2002–2, 2002–1 C.B. 304.

9. Tanina Rostain, Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry, 23 YALE J. ON REG. 77, 86–92 (2006) [hereinafter Rostain, Sheltering Lawyers].

10. Ethan S. Burger, Don Mayer, & Peter Bowal, *KPMG and "Abusive" Tax Shelters: Key Ethical Implications for Legal and Accounting Professionals*, 31 J. LEGAL PROF. 43, 49 (2007). *See generally* JEFFREY FRANKEL & PETER R. ORSZAG, AMERICAN ECONOMIC POLICY IN THE 1990S (MIT Press 2002) (characterizing "U.S. economic performance during the 1990s [as] outstanding").

11. Philip A. Curry, Claire Hill, & Francesco Parisi, *Creating Failures in the Market for Tax Planning*, 26 VA. TAX REV. 943, 946–48 (2007); *see* TANINA ROSTAIN & MILTON C. REGAN, JR., CONFIDENCE GAMES: LAWYERS, ACCOUNTANTS, AND THE TAX SHELTER INDUSTRY, 251–52 (MIT Press 2014) (noting that during the 1990s, corporate tax departments were motivated to reduce the corporation's effective

motivated by lucrative fees and anticipated their clients' needs, were all too willing to oblige.[12] Strong financial incentives for taxpayers and advisors coupled with weak regulatory controls permitted the tax shelter market to thrive. Taxpayers had little to lose because they could avoid civil penalties by relying on tax opinions from their advisors, and advisors likewise had little downside risk.[13]

Tax advisor discipline historically has been done by state licensing authorities and client malpractice actions, but neither disciplinary authority was particularly effective.[14] Before 2004, civil tax penalties were an inadequate deterrent for tax planning advisors because only nominal monetary penalties were imposed.[15]

By the late 1990s and early 2000s, both the tax bar and the federal government recognized that something had to be done to quell what two observers characterized as "the most serious episode of lawyer wrongdoing in

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tax rate because they were viewed as profit centers) [hereinafter ROSTAIN & REGAN, CONFIDENCE GAMES].

12. Rostain, *Sheltering Lawyers*, *supra* note 9, at 86–92.

13. David Weisbach & Brian Gale, *The Regulation of Tax Advice and Advisers*, 130 TAX NOTES 1279, 1287–88 (Mar. 14, 2011) [hereinafter Weisbach & Gale, *Regulation of Tax Advice and Advisers*].

14. Ted Schneyer, *An Interpretation of Recent Developments in the Regulation of Law Practice*, 30 OKLA. CITY U. L. REV. 559, 566–67 (2005). Apparently, no state bar has disciplined a tax practitioner for the quality of tax advice. Jay A. Soled, *Tax Shelter Malpractice Cases and Their Implications for Tax Compliance*, 58 AM. U. L. REV. 267, 294–95 (2008) (describing professional boards as "silent abettors"). Historically tort liability has not been very successful at regulating tax advisors. *See* Weisbach & Gale, *Regulation of Tax Advice and Advisers*, *supra* note 13, at 1296 (discussing effect of tax law uncertainty on malpractice claims); Rostain, *Sheltering Lawyers*, *supra* note 9, at 94.

15. *See, e.g.*, I.R.C. § 6700(a)(2) (maximum penalty of $1,000 or twenty percent of advisor's fees, if greater, for organizing or participating in the sale of tax shelters). In 2004, Congress adjusted the penalty in section 6700(a) by imposing a penalty equal to fifty percent of fees on persons who knowingly or with reason to know make false or fraudulent statements regarding the tax treatment of any plan or arrangement they organize or sell. American Jobs Creation Act of 2004, Pub. L. 108-357, Title VIII, § 818(a), 118 STAT. 1418, 1584 (2004). Before the 2007 amendment by Pub. L. No. 110-28, § 8246(b), 121 STAT. 112, 203 (2007), section 6694(a) imposed a $250 tax return preparer penalty. Section 6694 currently imposes a tax return preparer penalty as high as fifty percent of the advisor's fees, but it does not apply to tax planning. I.R.C. § 7701(36); Reg. § 301.7701–15(b)(2) (defining a nonsigning tax preparer as one who provides advice with respect to events that have occurred at the time the advice is rendered). This approach is consistent with the legislative history. *See* S. REP. NO. 94-38, at 350–51 (1976); *see also* I.R.C. § 6701(b) (providing a $1,000 penalty for individuals for aiding or abetting an understatement of tax liability and $10,000 for corporate clients).

the history of the American bar."[16] Although Congress, the Service, the Justice Department, and the tax bar responded in various ways, the Justice Department's decision to prosecute tax advisors was the most dramatic.[17] Beginning in 2004, the Justice Department initiated a grand jury investigation against KPMG.[18] While firms for the most part ultimately avoided criminal prosecution by entering into deferred prosecution agreements, some of their partners and employees were not so fortunate.[19] Indictments followed for

16. ROSTAIN AND REGAN, CONFIDENCE GAMES, *supra* note 11, at 4.

17. The Service created the Office of Tax Shelter Analysis in 2000 to coordinate the government's tax shelter efforts. *Internal Revenue Service: Challenges Remain in Combating Abusive Tax Shelters*, Rpt. No. GAO-04-104T: *Before the S. Finance Comm.*, 108th Cong., at 5 (Oct. 21, 2003) (statement of Michael Brosk, Director of Tax Issues, Gov't Accountability Off.). In 2002, Congress enacted the Sarbanes-Oxley Act, which, among other things, created the Public Company Accounting Oversight Board to regulate public accounting firms, prohibited audit firms from engaging in certain non-audit services, and required audit committees to pre-approve the auditors' provision of tax services to their audit clients. SOX § 101, 15 U.S.C.A. § 7211 (creation of PCAOB), SOX § 201, *amending* 15 U.S.C.A. § 78j-1(g)-(h) (limiting the provision of specified non-audit services), and SOX § 202, *amending* 15 U.S.C.A. § 78j-1(i) (audit committee approval of permissible non-audit services). *See generally* Susan Cleary Morse, *The How and Why of the New Public Corporation Tax Shelter Compliance Norm*, 75 FORDHAM L. REV. 961 (2006) (describing how the Sarbanes-Oxley Act changed the corporate tax compliance norm with respect to abusive tax shelters). Congress also strengthened statutory disclosure requirements and civil penalty provisions. *See also* American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, Subtitle B, 188 STAT. 1418, 1575–1607 (2004) (enhancing certain penalties and disclosure requirements); Weisbach & Gale, *Regulation of Tax Advice and Advisers*, *supra* note 13 (surveying statutory and regulatory changes between 1990 and 2000). Additionally, the ABA Tax Section recommended that Circular 230 be amended to include specific due diligence requirements applicable to penalty protection opinions. *ABA Tax Section Outlines Tax Standards for Corporate Tax Shelter Opinions*, 1999 TAX NOTES TODAY, 211–11 (Nov. 2, 1999).

18. *Grand Jury Investigating Ernst & Young Tax Shelter Sales*, ACCOUNTINGWEB (May 24, 2004), http://www.accountingweb.com/topic/firm-news/grand-jury-investigating-ernst-young-tax-shelter-sales; David Kay Johnston, *Grand Jury is Investigating KPMG's Sale of Tax Shelters*, N.Y. TIMES, Feb. 20, 2004, http://www.nytimes.com/2004/02/20/business/grand-jury-is-investigating-kpmg-s-sale-of-tax-shelters.html.

19. The government agreed to defer the prosecution of a one-count Information in exchange for KPMG's agreement to, among other things, pay a $456 million fine, agree not to issue covered opinions on listed transactions, and agree to higher minimum opinion thresholds. U.S. Dep't of Justice, KPMG Deferred Prosecution Agreement, at 2 (Aug. 26, 2005), http://www.justice.gov/archive/usao/nys/pressreleases/August05/kpmgdpagmt.pdf. While the decision to avoid prosecuting corporations has been criticized, it became *de rigueur* after the criminal

numerous tax lawyers, accountants, and bankers who helped their clients evade their taxes. Many advisors were successfully prosecuted or pleaded guilty.[20] And these were not just any advisors; they came from some of the most elite and well-respected law and accounting firms, including Arnold & Porter, BDO Seidman, Brown & Wood, Ernst & Young, Greenberg Traurig, Jenkens & Gilchrist, and KPMG.[21]

More recently, the government has focused its attention on foreign banks and the bankers who have helped U.S. taxpayers evade U.S. taxes by

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prosecution and subsequent demise of Arthur Andersen in the wake of the Enron scandal. *See* James R. Copland, Ctr. For Legal Policy at the Manhattan Inst., *The Shadow Regulatory State: The Rise of Deferred Prosecution Agreements*, CIVIL JUSTICE REP., no. 14, 2012, http://www.manhattan-institute.org/pdf/cjr_14.pdf; Jonathan Weil, *Nine Are Charged in KPMG Case on Tax Shelters*, WALL ST. J., Aug. 30, 2005, http://online.wsj.com/news/articles/SB112533172910025699 (quoting then-U.S. Attorney General Alberto Gonzales as saying that the KPMG deferred prosecution agreement "reflects the reality that the conviction of an organization can affect innocent workers and others associated with the organization, and can even have an impact on the national economy").

20. ROSTAIN & REGAN, CONFIDENCE GAMES, *supra* note 11, at 217. *See infra* note 21. The defendants were charged with tax crimes under Chapter 75 of Subtitle F of the Code, as well as under Title 18 of the U.S. Code relating to crimes and criminal procedure. More recently, numerous bankers and other advisors have also been charged with violations relating to offshore banking activities. Dep't of Justice, *DOJ Highlights Efforts Against Tax Crimes,* 2014 TAX NOTES TODAY 69-28 (Apr. 9, 2014).

21. *See* United States v. Daugerdas, No. S3 09 Cr. 581 (WHP), 2013 WL 3055264 (S.D.N.Y. May 22, 2013) (Jenkens & Gilchrist partners); United States v. Coplan, 703 F.3d 46 (2nd Cir. 2012) (Ernst & Young lawyers and accountants); United States v. Pfaff, 407 Fed. Appx. 506 (2nd Cir. 2010) (Brown & Wood partner); United States v. Stein, 541 F.3d 130 (2nd Cir. 2008), *aff'g*, United States v. Stein, 495 F. Supp. 2d 390 (S.D.N.Y. 2007) (KPMG lawyers and accountants); *see also* Press Release, U.S. Dep't of Justice, Former Jenkens & Gilchrist Attorney Sentenced to 15 Years in Prison for Orchestrating Multibillion Dollar Criminal Tax Fraud Scheme (June 25, 2014), http://www.justice.gov/opa/pr/2014/June/14-tax-671.html; Press Release, U.S. Dep't of Justice, U.S. Att'y S.D.N.Y., Former Jenkens & Gilchrist Attorney Sentenced in Manhattan Federal Court to Eight Years in Prison for Promoting Illegal Tax Shelters That Generated Billions of Dollars in Fraudulent Tax Losses (Mar. 1, 2013), http://www.justice.gov/usao/nys/pressreleases/March13/DonnaGuerinSentencingPR.php; Press Release, U.S. Dep't of Justice, Off. of Affairs, Jenkens & Gilchrist Attorneys, Former BDO Seidman CEO and Deutsche Bank Broker Found Guilty in New York of Multi-Billion Dollar Criminal Tax Fraud Scheme (May 24, 2011), http://www.justice.gov/opa/pr/2011/May/11-tax-676.html; Press Release, U.S. Att'y S.D.N.Y., Three Defendants in Tax Shelter Fraud Trial Sentenced to Prison (Apr. 2, 2009), http://www.justice.gov/archive/usao/nys/pressreleases/April09/larsonetalsentencingpr.pdf [hereinafter Ruble Sentencing Press Release].

using hidden offshore bank accounts.[22] The Department of Justice Tax Division has made offshore non-compliance "[o]ne of [its] top litigation priorities," and further touted on its website that "those who would use secret offshore bank accounts are running out of places to hide."[23] From 2008 through April 2013, the Department of Justice Tax Division charged over "30 banking professionals and 60 account holders . . . resulting in five convictions after trial and 55 guilty pleas, including 2 trial convictions and 16 guilty pleas in the first four months of 2013 alone."[24] Based on the Tax Division's tough talk, it seems likely that the policy of prosecuting professionals will continue.[25] Even after these prosecutions ebb, we can expect that history will repeat itself because tax shelter activity is cyclical.[26]

To prevail in an evasion case, the government must prove the defendant's willfulness beyond a reasonable doubt. To establish willfulness, the government must show that a person accused of a tax crime intentionally violated a known legal duty.[27] Because knowledge of illegality is an element of the government's case, the prosecutor must negate a defendant's claim of ignorance or misunderstanding of the law.[28] A person who subjectively, though erroneously, believed he was complying with the tax laws cannot be criminally sanctioned because such a person is not knowingly violating any known legal duties.[29] The knowledge or understanding of a reasonable person generally is irrelevant except to show that the defendant's subjective beliefs

22. *See* Schumacher, *Magnifying Deterrence*, *supra* note 6, at 524–30 (detailing investigations against the LGT Group, formerly the Liechtenstein Global Trust, and UBS, formerly Union Bank of Switzerland, Switzerland's largest bank).

23. *Offshore Compliance Initiative*, U.S. DEP'T OF JUSTICE, http://www.justice.gov/tax/offshore_compliance_intiative.htm.

24. *Id.* Recent guilty pleas were from Credit Suisse and Wegelin & Co., two Swiss banks, for their role in offshore U.S. tax evasion. Ben Protess & Jessica Silver-Greenberg, *Credit Suisse Pleads Guilty in Felony Case*, N.Y. TIMES, May 19, 2014, http://dealbook.nytimes.com/2014/05/19/credit-suisse-set-to-plead-guilty-in-tax-evasion-case/?_php=true&_type=blogs&_r=0; Halah Touryalai, *Tale of Two Swiss Banks: Why Wegelin Failed and UBS Survived Tax Evasion Charges*, FORBES, Jan. 4, 2013, http://www.forbes.com/sites/halahtouryalai/2013/01/04/tale-of-two-swiss-banks-why-wegelin-failed-and-ubs-survived-tax-evasion-charges/.

25. *See generally* Schumacher, *Magnifying Deterrence*, *supra* note 6, at 543.

26. John Braithwaite, Markets in Vice, Markets in Virtue 17–18 (2005) [hereinafter Braithwaite, Markets in Vice].

27. United States v. Pomponio, 429 U.S. 10, 10–12 (1976).

28. Cheek v. United States, 498 U.S. 192, 201–02 (1991).

29. *See* Dan M. Kahan, Ignorance of Law Is an Excuse—but Only for the Virtuous, 96 MICH. L. REV. 127, 143 (1997) [hereinafter Kahan, Ignorance of the Law Is an Excuse].

are not genuinely held.[30] The mistake of tax law defense and the knowledge of illegality standard are anomalies. Ignorance of the law usually is not an excuse.[31] However, the Supreme Court has said that tax law is special due to the need to protect the average citizen from prosecution because "[t]he proliferation of statutes and regulations . . . made it difficult for the average citizen to know and comprehend the extent of duties and obligations imposed by the tax laws."[32]

The same high standard of willfulness that applies to "average citizens" also applies to tax professionals.[33] This Article critically examines the willfulness standard as it applies to advisors who as regular part of their practices use the Code and Treasury regulations to help their clients evade their tax obligations. One obvious reason to explore the issue is that advisors with tax expertise are far from average citizens. But beyond the advisors' tax expertise, tax advisors are more likely than ordinary citizens to orchestrate transactions that deliberately exploit ambiguity in the law. Tax lawyers and accountants are the engines that drive the proliferation of tax shelter activity.[34] Highly skilled tax professionals structure, market, and implement transactions so complex that even the most sophisticated taxpayers likely cannot fully

30. United States v. Grunewald, 987 F.2d 531, 535–36 (8th Cir. 1993).

31. *Cheek*, 498 U.S. at 203–04 ("[T]he more unreasonable the asserted beliefs and misunderstandings are, the more likely the jury will consider them to be nothing more than simple disagreement with known legal duties imposed by the tax laws and find that the Government has carried its burden of proving knowledge.").

32. *Id.* at 200; *see Bishop*, 412 U.S. at 361 ("In our complex tax system, uncertainty often arises even among taxpayers who earnestly wish to follow the law."); Spies v. United States, 317 U.S. 492, 496 (1943) ("It is not the purpose of the law to penalize frank difference of opinion or innocent errors made despite the exercise of reasonable care."). As Professor Lederman noted, "tax exceptionalism seems to be on the wane, not the rise." Leandra Lederman, (*Un)appealing Deference to the Tax Court*, 63 DUKE L.J. 1835, 1892 (2014); *see also* Mayo Found. for Med. Educ. & Research v. United States, 562 U.S. 44, 55 (2011) ("In the absence of such justification, we are not inclined to carve out an approach to administrative review good for tax law only."); Kristen E. Hickman, *Administering the Tax System We Have*, 63 DUKE L.J. 1717, 1718 (2014) (explaining how the court in *Mayo* "rejected tax exceptionalism from administrative-law requirements and doctrines absent justification").

33. United States v. Regan, 937 F.2d 823, 830 (2nd Cir. 1991) (vacating conviction of defendant, who held himself out as a "tax authority," because the jury was not permitted to assess whether his conduct constituted *Cheek* willfulness).

34. *See* Schumacher, *Magnifying Deterrence*, *supra* note 6, at 545–46 (2014) (describing tax advisors as "enablers"). This is not a recent phenomenon. Justice Harlan Stone noted that the market manipulations of the Great Depression did "not usually occur without the active assistance of some member of our profession." Harlan F. Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 8–9 (1934).

comprehend, much less develop, on their own.[35] Advisors operating at the margin of lawful conduct are far from ordinary citizens who may make innocent mistakes.[36]

This Article proceeds in three parts. Part II sets the stage by briefly describing the willfulness standard that applies in criminal tax cases and by contrasting it with the general rule that ignorance of the law is no excuse. Part II also explains the justifications for treating tax crimes differently.

Part III analyzes the implications of the current willfulness standard specifically as applied to tax advisors. This Part begins by noting the heavy burden that the current standard imposes on the government. Part III also considers the challenges of proving knowledge of illegality when the law is deliberately vague and ambiguous. As explained in this Part, there are reasons for wanting tax law to be schizophrenically both certain to promote tax compliance but also vague and ambiguous to discourage undesired loopholing. Another tension exists between keeping the law vague so that it is responsive to innovative tax evasion conduct deserving of criminal sanction while at the same time it is specific enough to promote principles of legality. Indeterminacy in the law makes it challenging to prove a defendant's knowledge of illegality. Finally, this Part raises the question of whether an advisor can be criminally sanctioned in the absence of established precedent if he actually believes his conduct constitutes evasion based on the extension of existing legal authorities to the transaction at issue. Under current law, an advisor who does not genuinely believe that his conduct is lawful does not qualify for a mistake of law defense. Nonetheless, the government must still establish the defendant's knowledge of illegality. The Supreme Court decided this issue by a plurality of Justices, but the opinion failed to clearly articulate whether uncertainty in the law is evaluated objectively or subjectively, leading to inconsistency in the lower courts.

Part IV draws on the work of Duke University School of Law Professors Samuel Buell and Lisa Kern Griffin on consciousness of wrongdoing.[37] They describe consciousness of wrongdoing as a developing methodology that courts use in cases of novel fraud—cases involving conduct that has not been described in the positive law as fraud but is equivalently

35. Schumacher, *Magnifying Deterrence*, *supra* note 6, at 544 ("Even the most sophisticated taxpayers would not have dreamt up the structures and transactions of these shelters.").

36. *See supra* note 32.

37. Professor Buell explored the consciousness of wrongdoing methodology in Samuel W. Buell, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971 (2006) [hereinafter Buell, *Novel Criminal Fraud*]. Several years later, he and Lisa Kern Griffin co-authored an article entitled *On the Mental State of Consciousness of Wrongdoing*, 75 LAW & CONTEMP. PROBS. 133 (2012) [hereinafter Buell & Griffin, *Consciousness of Wrongdoing*].

blameworthy to fraudulent conduct already so defined.[38] Compared to current law where a defendant's lack of knowledge of illegality may result in acquittal of a tax crime, a defendant's consciousness of wrongdoing or guilty knowledge could be grounds for his guilt under a consciousness of wrongdoing methodology.

When Buell first advocated this consciousness of wrongdoing methodology, he set aside cases of tax evasion. This Part explores whether a consciousness of wrongdoing approach has practical utility as applied to tax evasion by tax advisors. Part IV first situates Buell's work in the context of tax evasion cases against advisors, and then evaluates the suitability of Buell's approach to tax evasion. As discussed in Part IV, the biggest impediment to using advisors' consciousness of wrongdoing as proof of their willfulness is the similarity between legal tax planning or tax minimization and illegal tax evasion. The salient question is whether ex post decision makers, including prosecutors, judges, and juries, can properly distinguish between situations where an advisor is appropriately using ambiguity in the law to his client's advantage or is acting in bad faith. This Part considers the tax planning versus tax evasion issue through the lens of the government's prosecution of advisors in two tax shelter cases. The outcome in those cases suggests that we should be cautious in using an actor's consciousness of wrongdoing to inculpate.

The lack of robust scholarship to date in this area justifies only modest assertions and conclusions. Ultimately, the Article cautiously recommends that consideration be given to broadening the current willfulness standard as it is applied to tax advisors. Further research is necessary, however, before advocating a solution. While Buell's approach would address certain shortcomings of the current willfulness standard, extending it to tax evasion has some drawbacks that need to be explored further in subsequent research.

II. THE WILLFULNESS STANDARD IN CRIMINAL TAX CASES

Ignorance of the law usually is not an excuse, except in tax law and a few other places. As described in this Part, the government must prove the defendant knew that the law imposed upon him some duty that the defendant intentionally violated to establish a defendant's willfulness. To satisfy its burden, the prosecutor must negate the defendant's claimed ignorance or misunderstanding of the law. The Supreme Court has justified this tax exceptionalism, which creates a very heavy burden for the prosecution, because of the need to protect average citizens from being prosecuted for innocent mistakes made due to the complexity of the tax laws.[39]

38. *See generally* Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37.

39. *See infra* Part II.B.

A. Ignorance of the Law Usually is No Excuse

Imbedded in criminal law is the popular maxim that ignorance or mistake of the law is no excuse.[40] Rejecting a defense for not knowing the law traditionally was justified, at least in part, because criminal offenses derived from natural law, which made crimes "definite and knowable."[41] Even if it were unrealistic to expect the public to know what particular acts were criminal offenses, refusing a mistake of law defense was considered essential to sidestep the difficulty of proving knowledge in cases where defendants feigned ignorance.[42] Moreover, eschewing a mistake of law defense was thought to encourage citizens to inform themselves of their legal obligations by penalizing those who claimed to be ignorant of the law.[43]

The scienter requirement that applies to tax crimes conspicuously departs from the "ignorance is no excuse" maxim.[44] The tax evasion statute in section 7201 has been described as the "capstone" of a "hierarchy of tax offenses."[45] Section 7201 makes it a felony for any person to *willfully* attempt

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40. Sharon L. Davies, The Jurisprudence of Willfulness: An Evolving Theory of Excusable Ignorance, 48 DUKE L.J. 341, 343 (1998) [hereinafter Davies, Jurisprudence of Willfulness].

41. *Id.* at 350–52; *Cheek*, 498 U.S. at 199.

42. "Ignorance of the law excuses no man; not that all men know the law, but because 'tis an excuse every man will plead, and no man can tell how to refute him." QUOTABLE LAWYER 133 (David S. Shrager & Elizabeth Frost eds., 1986) (quoting JOHN SELDEN, TABLE-TALK (1869)).

43. Kahan, *Ignorance of the Law Is an Excuse*, *supra* note 29, at 128 (It was thought that the way to promote law-abiding behavior was to make citizens "aware of the content of the law and the consequences of breaking it."). Neither the denial of a mistake of law defense nor the provision of a subjective mistake of law defense promotes a "culture of legal literacy." *See* Davies, *Jurisprudence of Willfulness*, *supra* note 40, at 354–55. Actors in either situation have no incentive to investigate the law. As Dan Kahan recognized, denying a mistake of law defense does not actually encourage citizens to know the law because they can be found criminally liable even if they believed their conduct was legal. Kahan, *Ignorance of the Law Is an Excuse*, *supra* note 29, at 132–35. Even a system with a subjective mistake of law defense fails to promote legal literacy because guilt or innocence does not depend on whether the defendant's understanding is reasonable or not. By contrast, providing a reasonable mistake of law defense would actually encourage citizens to learn the law because their reasonable belief that their conduct was legal could save them from conviction. *See infra* Part IV.B.1.

44. *Cheek*, 498 U.S. at 199 ("The general rule that ignorance of the law or a mistake of law is no defense to criminal prosecution is deeply rooted in the American legal system."); *see* Davies, *Jurisprudence of Willfulness*, *supra* note 40.

45. Sansone v. United States, 380 U.S. 343, 350 (1965) (quoting *Spies*, 317 U.S. at 497).

to evade or defeat any tax imposed by the Code.[46] Though willfully as it applies to tax crimes is not defined in the Code itself, it has been interpreted by the Supreme Court to require the intentional violation of a known legal duty.[47] To establish the defendant's willfulness, the government must prove that "the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty."[48] Because knowledge of illegality is an element of the government's case, the prosecutor must negate a defendant's claim of ignorance or misunderstanding of the law.[49] A person who subjectively, though erroneously, believed he was complying with the tax laws cannot be criminally sanctioned because such a person is not knowingly violating any known legal duties.[50] The knowledge or understanding of a reasonable person generally is irrelevant except to show that the defendant's subjective beliefs are not genuinely held.[51] There is a split in the circuits as to whether a jury may infer knowledge of a particular fact in a tax evasion case where the defendant deliberately disregarded the existence of that fact.[52] The issue is whether a willful blindness standard is consistent

46. I.R.C. § 7201 (emphasis added) (tax evasion is punishable by imprisonment of not more than five years or a fine of not more than $100,000 or $500,000 in the case of corporations, or both). The term "willfully" is used to define other tax crimes, including those in sections 7202–7207, and that term has the same meaning in all tax-related offenses. *See, e.g.*, *Bishop*, 412 U.S. at 361. To prosecute tax evasion, in addition to proving the defendant's willfulness, the government must prove beyond a reasonable doubt that the advisor committed an affirmative act that constituted an attempted evasion of tax, and as a result, the taxpayer-client owed substantially more tax than was reported. *Sansone*, 380 U.S. at 351. The type of conduct that could qualify as an affirmative act includes: "[k]eeping a double set of books, making false entries of alterations, or false invoices or documents, destruction of books or records, concealment of assets or . . . sources of income, handling of one's affairs to avoid making the records usual . . . and any conduct . . . likely . . . to mislead or to conceal." *Spies*, 317 U.S. at 499.

47. *Pomponio*, 429 U.S. at 12.

48. *Cheek*, 498 U.S. at 201.

49. *Id.* at 201–02.

50. *See* Kahan, *Ignorance of Law Is an Excuse*, *supra* note 29, at 143.

51 . *Grunewald*, 987 F.2d at 536.

52. *See* Bucy, *Criminal Tax Fraud*, *supra* note *2*, at 663–64 (discussing the split in the circuits following the Supreme Court's decisions in *Cheek v. United States* and *Ratzlaf v. United States*). *But cf.* United States v. Benjamin, 328 F.2d 854, 863 (2d Cir. 1964):

> In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. Of course, Congress did not mean that any mistake of law or misstatement of fact should subject an attorney or an accountant to criminal liability simply because more

with the knowledge of illegality standard enunciated in *Cheek v. United States*.[53]

There is a considerable difference between the traditional adage and the tax rule. For example, it is a misdemeanor in some states to pass a stopped school bus.[54] A person can be found guilty if the government shows that the defendant passed a stopped school bus, even if the defendant did not know that passing a stopped school bus is a crime. By contrast, for a tax crime to be committed, the defendant must be conscious of both the act and its illegality. Thus, to establish a defendant's willfulness, the government has to show that the defendant intentionally failed to report all her taxable income, the act, and that she knew the Code required the income to be reported, knowledge of illegality.[55]

B. Why Tax is Different

The willfulness standard has had a long legacy dating back to the 1933 Supreme Court decision in *United States v. Murdock*.[56] Murdock was charged with willfully refusing to give testimony and willfully failing to supply information to the Service during an examination of his tax returns.[57] Murdock erroneously believed he could legally refuse to comply with the Service's requests to avoid incriminating himself under state law.[58] He requested the jury be instructed to consider his reasons for failing to comply with the government's requests in determining whether he acted willfully.[59] The trial

> skillful practitioners would not have made them. But Congress equally could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess.

Id.

53. 498 U.S. 192 (1991). See *infra* notes 65–75 and accompanying text for a discussion of *Cheek*; *see also* Susan E. Brune & Laurie Edelstein, *Jury Instructions: Key Topics in Federal White Collar Cases*, 36 CHAMPION 26, 28 (Oct. 2012) ("A willful blindness instruction is inconsistent with the requirement that the government prove that a defendant had actual knowledge that his conduct violated the tax laws.").

54. *See, e.g.*, TENN. CODE ANN. § 55-8-151(a)(5)(B) (West 2014) (it is a Class A misdemeanor for failing to stop when approaching a stopped school bus).

55. *See Cheek*, 498 U.S. at 201.

56. 290 U.S. 389 (1933).

57. *Id.* at 391.

58. *Id.* at 393.

59. *Id.* at 393.

court refused the instruction, and Murdock was convicted.[60] His conviction was reversed on appeal and the Supreme Court affirmed the reversal, reasoning that:

> Congress did not intend that a person, by reason of a bona fide misunderstanding as to his liability for the tax, as to his duty to make a return, or as to the adequacy of the records he maintained, should become a criminal by his mere failure to measure up to the prescribed standard of conduct.[61]

In *United States v. Bishop*,[62] the Court clarified that the term "willfully" has the same meaning in the misdemeanor and the felony sections of the Code. In *United States v. Pomponio*,[63] the Court amplified that willfulness in the criminal tax statutes connotes "a voluntary, intentional violation of a known legal duty." "By requiring the *intentional* violation of a *known* legal duty, the Supreme Court's interpretation of willfulness excludes careless behavior, as well as the taxpayer's resolution of debatable legal issues in his own favor."[64]

Cheek v. United States[65] is the most important decision in the line of cases articulating the willfulness standard and the scope of the mistake of tax law defense. The decision in *Cheek* resolved a circuit split that had developed over the meaning of the term "willfulness" as used in the criminal tax statutes. Until *Cheek* was decided, the Seventh Circuit permitted a defendant to avoid criminal prosecution by a subjective misunderstanding of the law but only if the defendant's interpretation was objectively reasonable.[66] By contrast, other circuits found criminal willfulness negated based on a defendant's subjective understanding of the law whether or not that understanding was objectively reasonable.[67]

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60. *Id.*

61. *Id.* at 396.

62. 412 U.S. 346, 361 (1973).

63. 429 U.S. 10, 12 (1976).

64. BORIS I. BITTKER, MARTIN J. MCMAHON, JR. & LAWRENCE A. ZELANAK, FEDERAL INCOME TAXATION OF INDIVIDUALS, ¶ 50.08[2] (3d ed. 2002) [hereinafter BITTKER ET AL., FEDERAL TAXATION OF INDIVIDUALS].

65. 498 U.S. 192 (1991). *See* Yochum, *Ignorance of the Law*, *supra* note 5 (discussing the misplaced enthusiasm for *Cheek* by defendants seeking a mistake of law defense outside of tax crimes).

66. *Cheek*, 498 U.S. at 197–98 (discussing prior decision in the Seventh Circuit cases).

67. *Id.* at 198–99 (referencing decision from other circuits).

Mr. Cheek was a commercial airline pilot who was part of the tax protestor movement.[68] He stopped paying taxes, asserting that he was not required to file a return or pay income taxes and that his wages were not taxable income.[69] The legal duties at issue in *Cheek*—the obligation of individual wage earners to file returns and pay income tax—were straightforward, well-understood principles. Cheek's assertions were merely frivolous, tax protestor-type arguments, and his belief that his income was not subject to tax was not objectively reasonable given specific Code provisions to the contrary.[70] A jury found him guilty after being instructed to convict if they found Cheek's beliefs to be objectively unreasonable.[71]

The Supreme Court vacated Cheek's conviction, concluding that his good faith belief that he owes no legal duty negates willfulness even if his belief is irrational.[72] The defendant's belief that no legal duty exists or that he or she is acting within the law due to some mistaken interpretation is sufficient to negate willfulness even if that belief is unreasonable because the determination is a subjective one.[73] However, the jury may evaluate the veracity of the defendant's claimed belief by comparing it to what is objectively reasonable.[74] The more outlandish the defendant's claims may make it less likely that the jury would find that the purported claims of ignorance or mistake were genuinely held and more likely to find those claims mere pretext to avoid known legal duties.[75]

Though Congress did not define the term willfulness, its inaction over the years presumptively represents its acquiescence to the Supreme Court's approach.[76] The approach taken by the Court has logical appeal. Since

68. *Id.* at 194–96.

69. *Id.* at 203.

70. I.R.C. §§ 61(a)(1), 6011(a) (taxpayer's duty to file returns).

71. United States v. Cheek, 882 F.2d 1263, 1266 (7th Cir. 1989), *vacated by* 498 U.S. 192 (1991). After the jury sought additional guidance, the district court provided a supplemental instruction that Cheek's claims were not objectively reasonable. *Id.* In some years, Cheek claimed sixty withholding allowances on his Form W-4 and in other years he claimed to be exempt from federal income tax withholding. *Cheek*, 498 U.S. at 194.

72. *Id.* at 203. Cheek ultimately was convicted after retrial. United States v. Cheek, 3 F.3d 1057 (7th Cir. 1993).

73. *Grunewald*, 987 F.2d at 536.

74. *Cheek*, 482 U.S. at 203–04 ("[T]he more unreasonable the asserted beliefs or misunderstandings are, the more likely the jury will consider them to be nothing more than simple disagreement with known legal duties imposed by the tax laws and find that the Government has carried its burden of proving knowledge.").

75. *See* United States v. Burton, 737 F.2d 439, 442–43 (5th Cir. 1984) ("A jury is the ultimate discipline to a silly argument.").

76. Davies, *Jurisprudence of Willfulness*, *supra* note 40, at 411. Davies proposes no departure from the traditional maxim that ignorance or mistake of the law

willfulness requires an intentional violation of a known legal duty, willfulness naturally cannot exist if the defendant was unaware of the pertinent legal duty because one cannot intentionally violate a law without first being aware of it.[77] Likewise, willfulness is negated even if the defendant is aware that a legal duty exists but genuinely, though mistakenly, believes that he or she is complying with it.[78] Under those circumstances, the government would be unable to carry its burden of showing that the defendant's violation of the law is intentional. Even a defendant's irrational belief that no legal duty exists, or that he or she is acting lawfully due to some mistaken interpretation is sufficient to negate willfulness because, under those circumstances, the defendant is unaware of the legal duty or knows of it, but does not intend to violate it.[79]

The Supreme Court has justified this tax exceptionalism because of the need to protect the "average citizen from prosecution for innocent mistakes made due to the complexity of the tax laws."[80] Federal tax law is distinct for a number of reasons. First, the nation's tax laws are voluminous and complex.[81]

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is no excuse absent "plain evidence" in the pertinent statutory text or legislative history. *Id.* at 349. But tax cases, Davies said, should be an exception based on "longstanding congressional acquiescence . . . as well as congressional statements affirming the construction in other contexts." *Id.* at 411. The other statement Davies is referring to is a House committee report accompanying a bill to criminalize failure to pay support for a child living in another state. *Id.* at 406 n.251 (quoting United States v. Williams, 121 F.3d 615, 621 (11th Cir. 1997), which also discusses H.R. REP. NO. 102-771). In it, reference is made to the willfulness standard in tax law and a desire to equate the willfulness standard in the bill to the tax standard, which is described as a "specific intent crime." *Id.*; *see* Mark D. Yochum, *Cheek is Chic. Ignorance of the Law Is an Excuse for Tax Crimes—A Fashion That Does Not Wear Well*, 31 DUQ. L. REV. 249, 252 (1993) (noting there is not a "scintilla of legislative history" for the Court's approach).

77. *Cheek*, 498 U.S. at 202.

78. *Id.* at 201–02.

79. *Id.* at 203.

80. *Cheek*, 498 U.S. at 192, 199–200, 205 (The Court has "interpreted the statutory term 'willfully' as used in the federal criminal tax statutes as carving out an exception to the traditional rule [that ignorance or mistake of the law is no excuse.] This special treatment of criminal tax offenses is largely due to the complexity of the tax laws."); *see Bishop*, 412 U.S. at 360 ("In our complex tax system, uncertainty often arises even among taxpayers who earnestly wish to follow the law."); *Spies*, 317 U.S. at 496 ("It is not the purpose of the law to penalize frank difference of opinion or innocent errors made despite the exercise of reasonable care.").

81. In 2012, the Taxpayer Advocate estimated that the Code alone without considering the Treasury regulations had four million words. NATIONAL TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS, vol. 1, at 6 (2012). Four million words is "nearly as long as seven versions of *War and Peace* or the novel version of *Les Miserables* and just under four times the number of words in all of the Harry Potter books put together." Kelly Phillips Erb, *Tax Code Hits Nearly 4 Million Words,*

Tax laws are also pervasive, touching "most households and most forms of economic behavior."[82] Tax affects taxpayers of all types, from the most sophisticated multi-national corporation to the most unsophisticated individuals who lack both a tax background and legal representation. Equally important, issues of taxability are unmoored from notions of morality.[83] As the Supreme Court has recognized, "moral turpitude is not a touchstone of taxability."[84] Even if the vast majority of taxpayers agree that cheating on their taxes is unacceptable and that they have a civic duty to pay their fair share of taxes, determining the tax consequences of any specific transaction is not simply a matter of morally knowing right from wrong.[85] All of these characteristics create a high risk for ordinary citizens to inadvertently fail to comply with the tax laws even if they otherwise wish to pay all that they legally owe.

Taxpayer Advocate Calls It Too Complicated, FORBES.COM, Jan. 10, 2013, http://www.forbes.com/sites/kellyphillipserb/2013/01/10/tax-code-hits-nearly-4-million-words-taxpayer-advocate-calls-it-too-complicated/. Popular discourse often resorts to the sheer volume of tax law as the reason for its complexity, but more relevant legal authorities rather than less may actually make interpreting the tax law easier. *See* Eric J. Gouvin, *Radical Tax Reform, Municipal Finance, and the Conservative Agenda*, 56 RUTGERS L. REV. 409, 437 (2004). *See generally* Mila Sohoni, *The Idea of "Too Much Law"*, 80 FORDHAM L. REV. 1585 (2012) (cautions against using the heft of the federal law as a meaningful measure in and of itself).

82. Paul B. Stephan III, *Nontaxpayer Litigation of Income Tax Disputes*, 3 YALE L. & POL'Y REV. 73, 90 (1984).

83. *See* Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935) ("Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."); *see also* Edward D. Kleinbard, *Corporate Tax Shelters and Corporate Tax Management*, 51 TAX. EXEC. 235, 247 (1999) ("there is no natural law of corporate taxation"); Donald Arthur Winslow, *Tax Penalties—"They Shoot Dogs, Don't They?"*, 43 FLA. L. REV. 811, 859 (1991) ("Tax offenses . . . do not draw naturally the reprobation of the populace.").

84. Commissioner v. Wilcox, 327 U.S. 404, 408 (1946), *overruled on other grounds by* James v. United States, 366 U.S. 213 (1961).

85. *See* I.R.S. OVERSIGHT BD., 2014 TAXPAYER ATTITUDE SURVEY 3, 8, 20, http://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20Taxpayer%20Attitude%20Survey%202014.pdf. Eighty-six percent of survey participants reported that it was not at all acceptable to cheat on their income taxes. Ninety-four percent of them agreed it is every American's civic duty to pay their fair share of taxes. Ninety-two percent of respondents said personal integrity is the main factor that influences whether they honestly report and pay their taxes.

III. IMPLICATIONS OF THE CURRENT WILLFULNESS STANDARD

This Part analyzes the implications of the current willfulness standard specifically as applied to tax advisors. It begins by noting the heavy burden that the current standard imposes on the government. This Part next considers the challenges of proving knowledge of illegality where the law is deliberately vague. It discusses reasons for wanting tax law to be schizophrenically both certain to promote tax compliance, but also ambiguous and vague to discourage undesired loopholing. Another tension exists between keeping the law vague so as to be responsive to innovative tax evasion conduct deserving of criminal sanction while at the same time making it specific enough to promote principles of legality. Finally, this Part raises the question of whether an advisor can be criminally sanctioned in the absence of established precedent if he actually believes his conduct constitutes evasion based on the extension of existing legal authorities to the transaction at issue.

A. Heavy Burden

The current knowledge of illegality standard imposes a heavy burden on the prosecution that "renders the criminal sanction ineffective for all but a few cases."[86] That coupled with a culture that values tax minimization and zealous advocacy encourages advisors to engage in, and even rationalize, marginal conduct.[87] Lawyers who pursue "zeal at the margin" game the system by strategically interpreting the law.[88] That kind of behavior is harmful because it undermines our voluntary compliance system.[89] The harm is even more pronounced when tax advisors are involved because it makes "average taxpayers feel like chumps."[90]

86. Michael J. Graetz & Louis L. Wilde, *The Economics of Tax Compliance: Fact and Fantasy*, 38 NAT'L TAX J. 355, 358 (1985) [hereinafter Graetz & Wilde, *Economics of Tax Compliance*].

87. *See* DAVID LUBAN, *The Adversary System Excuse*, in LEGAL ETHICS AND HUMAN DIGNITY 19, 26 (2007); *see also* Katherine R. Kruse, *Beyond Cardboard Clients in Legal Ethics*, 23 GEO. J. LEGAL ETHICS 103, 111 (2010) [hereinafter Kruse, *Beyond Cardboard Clients*].

88. *See* Kruse, *Beyond Cardboard Clients*, *supra* note 87, at 109 (summarizing David Luban's "zeal at the margin" interpretation).

89. *See* Dep't of Treasury, The Problem of Corporate Tax Shelters: Discussion, Analysis and Legislative Proposals 3 (1999), http://www.treasury.gov/resource-center/tax-policy/documents/ctswhite.pdf.

90. *Corporate Tax Shelters: Looking Under the Roof: Hearing Before the S. Finance Comm.*, 107th Cong. 1 (statement of the Chairman, Sen. Max Baucus) ("These tax shelters could do serious harm. They clearly undermine public confidence in the tax system. They make average taxpayers feel like chumps; we have to pay more because the big guys are paying less.").

B. Effect of Indeterminacy in Tax Law

As the law currently exists, the willfulness standard imposes a high burden on the government who must show a defendant accused of a tax crime actually knew his acts were illegal. But issues of taxability cannot always be delineated as clearly right or wrong for a host of reasons. First, while some tax issues are limited to two possible outcomes that require the taxpayer to predict which outcome is more likely to be correct, in other cases, there are more than two possible characterizations.[91] Second, errors may be made in interpreting the existing legal authorities or in legal reasoning in the absence of relevant authority. Third, and most conspicuously, despite the predominance of rules that delineate prohibited or permitted conduct with specificity, tax law also encompasses hazier standards such as various judicial anti-abuse doctrines.[92]

As an initial matter, the uncertainty of common law anti-abuse doctrines should not be overstated.[93] The purpose of anti-abuse doctrines is to ensure that the tax results of transactions are consistent with the purposes underlying the statutory and regulatory provisions.[94] The underlying purpose of tax provisions can usually be discerned, and tax practitioners usually can determine whether the purported tax consequences of a transaction are consistent with the intent of Congress.[95] Tax advisors routinely interpret uncertain Code and regulatory provisions and are accustomed to evaluating the applicability of common law anti-abuse doctrines.[96] Furthermore,

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91. Robert P. Rothman, *Tax Opinion Practice*, 64 TAX LAW. 301, 314–15 (2011) (discussing more likely than not tax opinions as potentially involving binary issues and non-binary issues) [hereinafter Rothman, *Tax Opinion Practice*].

92. *See* Richard J. Kovach, *Bright Lines, Facts and Circumstances Tests, and Complexity in Federal Taxation*, 46 SYRACUSE L. REV. 1287, 1288–1300 (1996) (describing the Code and Treasury regulations as a "complex and curious blend of 'bright line' rules and vague standards") [hereinafter Kovach, *Bright Lines in Taxation*].

93. See Michael L. Schler, Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and A Reply to Professor Weisbach, 55 TAX L. REV. 325, 381 (2002) [hereinafter Schler, Ten More Truths About Tax Shelters]; Peter C. Canellos, A Tax Practitioner's Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters, 54 SMU L. REV. 47, 56 (2001) (tax practitioners "are as comfortable with 'standards' as they are with 'rules'") [hereinafter Canellos, A Tax Practitioner's Perspective].

94. Schler, *Ten More Truths About Tax Shelters*, *supra* note 93, at 380.

95. *Id.* at 381–84.

96. *See id.* at 381–82; Joshua D. Blank & Nancy Staudt, *Corporate Shams*, 87 N.Y.U. L. REV. 1641, 1658 (2012) (transactional tax lawyers spend a lot of time trying to predict ex ante how a court will view a transaction) [hereinafter Blank & Staudt, *Corporate Shams*].

empirical data shows, contrary to conventional wisdom, that the application of judicial anti-abuse standards is not wholly inconsistent or erratic, but instead follows a predictable pattern.[97]

Yet, the potential for judicial anti-abuse standards to cause indeterminacy in the law must be acknowledged. The legal duties in many of the tax shelter cases emanated from the economic substance doctrine. Although the economic substance doctrine has become well established, its legitimacy has been criticized because courts conceived of it apart from any statutory authority.[98] Also, some take issue with the doctrine's development over the years. The Supreme Court's last significant economic substance case was *Frank Lyon v. United States* in 1978.[99] Since the *Frank Lyon* decision, the economic substance doctrine has developed in the circuit courts.[100] Professor Andy Grewal has criticized the lower courts' development of the economic substance doctrine as a "free-floating test" that overlays the entire Code.[101] Grewal sees that approach as inconsistent with Supreme Court precedent, which he says invokes economic substance principles "only to the extent that the applicable statute makes those principles relevant."[102]

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97. Based on empirical evidence, Blank and Staudt have concluded that it is possible to predict when the Supreme Court will apply judicial anti-abuse standards. Blank & Staudt, *Corporate Shams*, *supra* note 96, at 1646–47; *see* Schler, *Ten More Truths About Tax Shelters*, *supra* note 93, at 346 (noting that judicial decisions are more than "mere coin tossing").

98. Congress's codification of the economic substance doctrine in 2010 overcomes this argument. *See infra* note 114. Because the economic substance doctrine was being applied in criminal cases at the time of its enactment and nothing in the text limits its application to particular types of cases, Congress implicitly intended for the provision to apply in criminal cases. *See* Charlene D. Luke, *The Relevance Games: Congress's Choices for Economic Substance Gamemakers*, 66 TAX LAW. 551, 554 (Codification at a minimum should mean that Congress endorses "the precodification trajectory of the doctrine, particularly in terms of the types of transactions that were being litigated.") [hereinafter Luke, *Relevance Games*].

99. *The Economic Substance Doctrine*, TAX MGMT. PORT. (BNA) 508-2nd, at II (2015) (citing Frank Lyon v. United States, 435 U.S. 561 (1978)).

100. *See* Luke, *Relevance Games*, *supra* note 98, at 552–53 (describing the development of the economic substance doctrine as "early Supreme Court cases laying the groundwork and lower courts ultimately structuring the more formal elements of the doctrine").

101. Amandeep S. Grewal, *Economic Substance and the Supreme Court*, 116 TAX NOTES 969, 970 (Sept. 11, 2007).

102. *See id.* at 978; *see also* Daugerdas Sentencing Memorandum, United States v. Daugerdas, 2013 WL 3055264, No. 09 Cr.581-001 (S.D.N.Y. May 22, 2013), Exhibit C—Jasper L. Cummings, Letter (June 9, 2014) (on file with the author) [hereinafter Daugerdas Sentencing Memorandum]. Cummings contends that the economic substance doctrine as a general anti-abuse standard was coming together in the late 1990s and early 2000s, which was during the peak of the tax shelter boom.

Others call into question anti-abuse standards like the economic substance doctrine given the move towards textualism, a method of statutory construction that uses the language of the provision to derive its meaning while steering clear of the statute's purpose or legislative intent.[103] There has been lively scholarly debate as to the proper method of statutory interpretation.[104] Textualists eschew congressional intent in favor of the literal letter of the law.[105] Intentionalists would argue not only must the letter of the law be met, but the purpose Congress intended.[106]

Beyond these conceptual difficulties, the economic substance doctrine was imprecisely defined. Different circuits applied different formulations of the test; some courts used a conjunctive analysis that required a transaction to have both a business purpose, which is a subjective inquiry, and economic substance, which is an objective inquiry, while other courts employed a disjunctive analysis that validated a transaction if either business purpose or economic substance existed.[107] Still other courts employed a unitary analysis that identified economic substance and business purpose merely as two factors to consider.[108] Courts defined the objective prong differently. Some courts required a change in the taxpayer's economic position after the transaction as

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Thus, it would be difficult for practitioners to accurately predict whether the Service could successfully raise the economic substance doctrine. *Id.* Before then, economic substance was used "as a matter of common law fact finding to determine whether what happened was the event that the code intended to tax in a certain way." *Id.* (referring to Frank Lyon Co. v. United States, 435 U.S. 561 (1978)).

103. See, e.g., Allen D. Madison, The Tension Between Textualism and Substance-over-Form Doctrines in Tax Law, 43 SANTA CLARA L. REV. 699, 749–50 (2003).

104. *See, e.g.*, Andre L. Smith, *The Deliberative Stylings of Leading Tax Scholars*, 61 TAX LAW. 1 (2007) (examines several leading scholars' theories).

105. Noöl B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 20 (2004).

106. *Id.*

107. *Compare* Coltec Indus., Inc. v. United States, 454 F.3d 1340, 1355 (Fed. Cir. 2006) (applying a conjunctive test requiring objective and subjective inquiries), *and* Pasternak v. Commissioner, 990 F.2d 893, 898 (6th Cir. 1993), *with* Horn v. Commissioner, 968 F.2d 1229, 1237 (D.C. Cir. 1992) (applying a disjunctive test requiring either an objective or subjective inquiry), *and* Rice's Toyota World, Inc. v. Commissioner, 752 F.2d 89, 91 (4th Cir. 1985).

108. *See, e.g.*, ACM P'ship v. Commissioner, 157 F3d 231, 247 (3d Cir. 1998) (The objective economic substance prong and the subjective business purpose prong "do not constitute discrete prongs of a 'rigid two-step analysis,' but rather represent related factors both of which inform the analysis of whether the transaction had sufficient substance, apart from its tax consequences, to be respected for tax purposes."); James v. Commissioner, 899 F.2d 905, 908–09 (10th Cir. 1990) (applying a factor-based approach).

compared to before.[109] A more narrow approach adopted by other courts focused on the taxpayer's expected profits from the transaction.[110] Given these definitional uncertainties, it should come as no surprise that the economic substance doctrine commonly is perceived to be inconsistent and unpredictable.[111] It has been the subject of criticism for being unprincipled and results-oriented.[112] Practitioners and scholars have lamented its inconsistent application.[113] Although the economic substance doctrine was codified in 2010, ambiguity remains in the two-prong conjunctive definition adopted in the statute.[114] Moreover, Congress left it up to the courts to determine when the doctrine applies based on existing common law.[115]

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109. *See* William W. Chip, *The Economic Substance Doctrine*, TAX MGMT. PORT. (BNA), 508-2nd, at V.B.4. (2015).

110. *Id.*

111. *See* Petitioner's Brief, at 9, WFC Holdings Corp. v. United States, 134 S. Ct. 2724 (2014) (No. 13-1037), 2014 WL 2120358 ("[The Supreme Court] has not addressed the economic substance doctrine in more than 35 years. In that time . . . the doctrine has metastasized in certain circuits into a broad and unprincipled 'smell test.'"); *see also* J. COMM. ON TAX'N, JCX-18-10, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE "RECONCILIATION ACT OF 2010," AS AMENDED, IN COMBINATION WITH THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT," at n.303–12 (Mar. 21, 2010) [hereinafter J. COMM. ON TAX'N].

112. *See, e.g.*, *ACM P'ship*, 157 F.3d at 265 ("I can't help but suspect that the majority's conclusion [that a transaction lacks economic substance] . . . is, in its essence, something akin to a 'smell test.'") (McKee, J., dissenting).

113. *See, e.g.*, Leandra Lederman, *W(h)ither Economic Substance*?, 95 IOWA L. REV. 389, 391 (2010) (recommending abandonment of the economic substance doctrine and noting its inconsistent application by the courts); Yoram Keinan, *The Many Faces of the Economic Substance's Two-Prong Test: Time for Reconciliation,* 1 N.Y.U. J. L. & BUS. 371, 375 (2005) (noting the inconsistent interpretation and controversial application of the economic substance doctrine).

114. I.R.C. § 7701(o), added by the Health Care and Reconciliation Act of 2010, Pub. L. 111-152, § 1409, 124 Stat. 1029 (2010). Section 7701(o)(1) adopts the following two-prong conjunction definition:

> In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if— (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

I.R.C. § 7701(o)(1).

115. I.R.C. § 7701(o)(5)(C) ("The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if

The criminal prosecutions of practitioners for opining on transactions found to lack economic substance was astonishing to many because courts determine compliance with doctrines like economic substance only after transactions have closed.[116] Uncertainty in the law would seem to be especially problematic in a criminal case to the extent defendants do not have advance warning as to what conduct is criminal.[117] The principle of legality, which is embodied in the phrase "*nullum crimen, nulla poena sine lege*," or "no crime nor punishment without legislation," means that criminal sanctions should not be brought absent specific and clear legislation.[118] Under the void for vagueness doctrine, a statute is constitutionally vague when "men of common intelligence must necessarily guess at its meaning and differ as to its application."[119] The relevant inquiry "is whether the statute, either standing alone or as construed, made it reasonably clear . . . that the defendant's conduct was criminal."[120] "[L]iability . . . may be imposed . . . only if, 'in the light of pre-existing law the unlawfulness [under the Constitution is] apparent[.]'"[121]

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this subsection had never been enacted."). The Service issued a directive to its auditors setting forth a four-step facts and circumstances analysis to be employed to determine whether to impose the economic substance doctrine. I.R.S., LB&I-4-0711-015, GUIDANCE FOR EXAMINERS AND MANAGERS ON THE CODIFIED ECONOMIC SUBSTANCE DOCTRINE AND RELATED PENALTIES (July 15, 2011), http://www.irs.gov/Businesses/Guidance-for-Examiners-and-Managers-on-the-Codified-Economic-Substance-Doctrine-and-Related-Penalties (impacting I.R.M. 20.1.1, 20.1.5.). This framework is useful for determining the scope of the economic substance doctrine although the directive expressly states that it "is not an official pronouncement of law, and cannot be used, cited, or relied upon as such." *Id.* Approval by the appropriate district field office is required before imposing the economic substance doctrine. I.R.S., LMSB-4-0910-024, CODIFICATION OF ECONOMIC SUBSTANCE DOCTRINE AND PENALTIES (Sept. 14, 2010), http://www.irs.gov/Businesses/Codification-of-Economic-Substance-Doctrine-and-Related-Penalties.

116. Blank & Staudt, *Corporate Shams*, *supra* note 96, at 1650; Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 VA. TAX REV. 339, 363 (2005) [hereinafter Logue, *Tax Law Uncertainty*]. Before the codification of the economic substance doctrine in section 7701(o) in 2010, matters were even more complicated because judges were also left to determine the content of the law, not just its scope.

117. *See infra* Part III.D.

118. Paul H. Robinson, *Fair Notice and Fair Adjudication: Two Kinds of Legality*, 154 U. PA. L. REV. 335, 336 (2005). *See generally* Jerome Hall, *Nulla Poena Sine Lege*, 47 YALE L.J. 165 (1937). Uncertainty in the law also raises issues regarding the ability of the law to deter criminal conduct.

119. Connally v. Gen. Constr. Co., 269 U.S. 385, 391 (1926).

120. United States v. Lanier, 520 U.S. 259, 267 (1997).

121. *Id.* at 272.

C. Desire for Schizophrenic Law

There are good reasons for wanting tax law to be schizophrenically both certain and ambiguous. Certainty in the tax law promotes compliance, but ambiguity helps deter undesired loopholing.[122] A tax system composed predominately of detailed rules is essential to predictably guide taxpayers' voluntary compliance.[123] However, too much specificity may encourage creative tax advisors and taxpayers to find loopholes in the literal language of the Code and Treasury regulations that are inconsistent with the intent of Congress or Treasury.[124] Responding to such circumvention ex ante is impractical to the extent it would require Congress to identify every imaginable instance of evasion and to continuously enact new legislation in response to unintended abuse, which would encourage further loopholing.[125] Deliberately vague standards such as economic substance can be used ex post to prevent this sort of literalism, which is essential to the proper administration of the tax system.[126] Judicial anti-abuse doctrines, by their very design, are less precise than statutory and regulatory rules. Whereas rules are advantageous because they provide relative certainty, standards are useful because they give courts flexibility ex post to determine the "content of the law and apply it to the facts at hand."[127]

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122. The term "loopholing" is borrowed from Dan Kahan. *See* Kahan, *Ignorance of the Law Is an* Excuse, supra note 29.

123. *See* I.R.C. § 6151(a) ("when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, pay such tax to the internal revenue officer with whom the return is filed").

124. Professor Martin Ginsberg famously noted, "The tax bar is the repository of the greatest ingenuity in America, and given the chance, those people will do you in." Jeffery L. Yablon, *As Certain as Death—Quotations About Taxes*, 2010 TAX NOTES TODAY 72-9 (Apr. 15, 2010); *see* Samuel W. Buell, *Good Faith and Law Evasion*, 58 UCLA L. REV. 611, 612 (2011) (referring to acts of evasion as "costly games of regulatory cat-and-mouse") [hereinafter Buell, *Good Faith and Law Evasion*].

125. Buell, *Good Faith and Law Evasion*, *supra* note 124, at 614.

126. Logue, *Tax Law Uncertainty*, *supra* note 116, at 363–68 (distinguishing between rules and standards); J. COMM. ON TAX'N, JCS-02-05 OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES (Jan. 27, 2005); *see* Blank & Staudt, *Corporate Shams*, *supra* note 96, at 1650–52 (generally describing the most well-known anti-abuse standards).

127. Logue, *Tax Law Uncertainty*, *supra* note 116, at 363. As Logue notes, with rules, adjudicators need only apply the law to the facts, but need not determine the content of the law. *Id.*; *see* J. COMM. ON TAX'N, *supra* note 111, at 142 (Recognizing that "[a]lthough these [judicial anti-abuse] doctrines serve an important role in the administration of the tax system, they can be seen as at odds with an objective, 'rule-based' system of taxation.").

D. Clash Between Principles of Legality and Novel Tax Evasion

If only conduct already defined as illegal could be sanctioned, the law "would be frozen to its preexisting limits and barred from adaptation."[128] Ambiguity and vagueness in the law make it flexible and adaptable to innovative, evolving conduct deserving of criminal sanction.[129] However, that flexibility conflicts with the desire for certainty in the law to promote principles of legality.[130] Defendants cannot form the requisite intent necessary for conviction to the extent ambiguity in judicially created anti-abuse doctrines precludes defendants from knowing the law because willfulness requires the "intentional violation of a known legal duty."[131] However, requiring the government to prove a defendant was conscious not only of his actions, but also of their illegality can be an obstacle to prosecution in cases where the conduct at issue has not been defined previously by the courts or regulators as tax evasion, where the law is deliberately vague, and where too much precision in the law is both impractical and unwise.[132] Under those circumstances, defendants may lack adequate ex ante notice of the scope of illegal conduct.

E. Objective Versus Subjective Uncertainty

This discussion raises the question of whether an advisor can be criminally sanctioned in the absence of established precedent if he actually believes his conduct constitutes evasion based on the extension of existing legal authorities to the transaction at issue.[133] The *Cheek* holding that a

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128. *Id.* at 2029; *see* Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37, at 149 ("a requirement that the object of an actor's awareness be preexisting positive law would prevent flexibility and evolution in [the] line drawing process" between lawful and unlawful conduct in cases where the conduct is not uniformly lawful or unlawful).

129. Buell, *Novel Criminal Fraud*, *supra* note 37, at 1973–74.

130. *Id.* at 1980–82.

131. Petition for a Writ of Certiorari, at 7, *Pfaff*, 407 Fed. Appx. at 509, 2011 WL 688724, at *7 (quoting *Cheek*, 498 U.S. at 201).

132. *See* Graetz & Wilde, *Economics of Tax Compliance*, *supra* note 86, at 358 ("Proving that a tax understatement of tax was characterized by the requisite knowledge and deliberate behavior is an extremely difficult matter and, in practice, renders the criminal sanction ineffective for all but a very few cases.").

133. *See* Brief for Petitioner, at 104, United States v. Pfaff, 407 Fed. Appx. 506 (2nd Cir. 2010) (No. 09-1702-cr(L)), 2010 WL 8939963, at *104 (conceding on appeal that there was sufficient evidence for the jury to conclude that they subjectively believed they acted unlawfully but argued that objective reasonableness negated willfulness regardless of their subjective belief); *see also* W. Curtis Elliott, Jr., *CA-9*

defendant does not act willfully if he subjectively believed he acted lawfully does not reach this question.[134] *Cheek* involved objectively certain law that the defendant claimed he misunderstood. What about cases involving objectively uncertain law and a defendant who believed he acted unlawfully?[135]

The Supreme Court grappled with this issue in *James v. United States*.[136] The defendant was convicted of tax evasion in a bench trial for not reporting and paying tax on embezzled funds, despite an existing Supreme Court case, *Commissioner v. Wilcox*, holding that embezzled funds were not included in gross income.[137] The Seventh Circuit affirmed the defendant's conviction by relying on *Rutkin v. United States*, which the Court handed down a few years after *Wilcox*. The Court in Rutkin held that extorted money is taxable income to the extortionist.[138] The Supreme Court granted certiorari in *James* due to the apparent conflict with *Wilcox*.

Six Justices voted to overturn *Wilcox*, concluding that embezzled funds are included in taxable income, but the Court nonetheless set aside the defendant's conviction.[139] However, the Justices disagreed about the role of the defendant's subjective intent in assessing uncertainty in the law. Three Justices ordered the indictment dismissed because willfulness could not be established, apparently as a matter of law, "so long as the statute contained the gloss placed upon it by *Wilcox* at the time the crime was committed."[140] For these Justices, the law was too uncertain without regard to the defendant's subjective belief due to *Wilcox* and *Rutkin* both being on the books at the time of the defendant's conduct. The other three Justices who agreed that *Wilcox* should be overturned thought that willfulness should be negated only if the defendant subjectively relied on the uncertainty in the law.[141]

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in Dahlstrom Analyzes Effect of Tax Law Uncertainty on Criminal Prosecutions, 62 J. TAX'N 150, 151–52 (1985).

134. *See supra* Part II.B. for a discussion of *Cheek*.

135. Of course, we do not know in any quantitative sense how certain a defendant has to believe that his conduct is unlawful to be considered willful though the tax penalty opinion standards may help in that regard. *See infra* Part IV.B.1.

136. 366 U.S. 213 (1961).

137. United States v. James, 273 F.2d 5, 6 (7th Cir. 1959) (ruling contrary to Commissioner v. Wilcox, 66 S.Ct. 546 (1946)), *rev'd* 366 U.S. 213 (1961).

138. *Id.* at 6–7.

139. Justices Warren, Brennan, Stewart, Harlan, Frankfurter, and Clark agreed to overturn *Wilcox*. Justices Black, Douglas, and Whittaker dissented on this point, believing that *Wilcox* was still good law. *James*, 366 U.S. at 241–58. All the Justices except Clark agreed to overturn the defendant's conviction.

140. *Id.* at 213–22.

141. Two of these Justices believed the defendant should be given a new trial to show the extent to which he relied on *Wilcox*. *Id.* at 241–48 (Harlan and Frankfurter, JJ., concurring in part and dissenting in part). Justice Clark believed the defendant's conviction should have been upheld, either because *Wilcox* was not good

The Supreme Court's failure to clearly articulate whether uncertainty in the law is evaluated objectively or subjectively has led to inconsistency in the lower courts.[142] Some courts indicate that when the law is vague or highly debatable, a defendant lacks the requisite intent to violate it regardless of whether the defendant actually knew of the uncertainty.[143] Other courts have upheld convictions despite some uncertainty in the law unless the defendant relied on the uncertainty.[144]

For example, in *United States v. Critzer*,[145] the Fourth Circuit reversed the defendant's conviction for tax evasion, holding that a defendant cannot be said to have acted willfully when the law regarding taxability is uncertain. The court went even further by concluding the defendant's actual belief was irrelevant because "[e]ven if she had consulted the law and sought to guide herself accordingly, she could have had no certainty as to what the law required."[146] In reaching its decision in *Critzer*, the Fourth Circuit characterized the Supreme Court's *James* decision as a majority of the Justices holding that uncertainty as to taxability negates willfulness as a matter of law regardless of the defendant's actual misunderstanding.[147]

In *United States v. Mallas*,[148] two defendants were convicted of tax evasion for promoting transactions that purportedly permitted the deductibility of advance minimum royalty payments for coal-mining enterprises. The

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law at the time of the defendant's conduct or because there was no proof that the defendant relied on *Wilcox*. *Id.* at 241 (Clark, J., concurring in part and dissenting in part).

142. BITTKER ET AL., FEDERAL TAXATION OF INDIVIDUALS, *supra* note 64, at ¶ 50.08[1]; *see* Colleen S. Yamaguchi, *Uncertainty in the Law: An Uncertain Defense in Criminal Tax Prosecutions*, 39 TAX LAW. 387 (1986) [hereinafter Yamaguchi, *Uncertain Defense*]. Yamaguchi takes issue with the decisions that permit a reasonable mistake of law defense in cases where the law is unsettled despite the defendant's subjective intent. She is concerned that creative tax advisors could be acquitted by presenting "a plausible interpretation of the law at trial even though that interpretation did not guide them at the time of their alleged illegal actions." *Id.* at 403.

143. BITTKER ET AL., FEDERAL TAXATION OF INDIVIDUALS, *supra* note 64, at ¶ 50.08[1].

144. *Id.*

145. 498 F.2d 1160, 1162 (4th Cir. 1974).

146. *Id.*

147. *Id.* at 1163 n.5. The *Critzer* court counted the plurality in *James* plus Justices Douglas and Black. Justices Douglas and Black concurred with the plurality that the defendant's conviction should be overturned, but they dissented as well because they would have reaffirmed *Wilcox*. In their partial concurrence and partial dissent, Justices Douglas and Black questioned the prospective application of the plurality's decision to make embezzled funds taxable due to issues of constitutional vagueness. *James*, 366 U.S. at 224.

148. 762 F.2d 361 (4th Cir. 1985).

government disallowed the deductions, claiming that the transactions were impermissible tax shelters.[149] The Fourth Circuit reversed the convictions, holding that the government's theory of the case was "too tenuous," and that both sides offered "plausible support for their positions."[150] Quoting its earlier decision in *Critzer*, the Fourth Circuit reiterated "where the law is vague or highly debatable, a defendant—actually or imputedly [sic]—lacks the requisite intent to violate it."[151] The defendants' convictions were reversed despite evidence that they "may have known that they were violating the law,"[152] which would seem to support the conclusion that a defendant's subjective belief as to the illegality of his own conduct is not relevant to the determination of willfulness.

The Fifth Circuit also addressed the issue in *United States v. Garber*.[153] Garber was convicted for tax evasion for willfully failing to report as income amounts she received for selling her blood plasma, which was quite valuable because her blood had a rare antibody.[154] On appeal, the defendant asserted the district court erred when it refused to admit her expert's testimony.[155] The district court kept out that evidence, ruling it irrelevant because there was no showing that Garber had actually relied on the expert's opinion.[156] The Fifth Circuit, on rehearing en banc, reversed Garber's conviction.[157] It held that willfulness cannot exist as a matter of law if the law is uncertain regardless of whether the defendant was actually aware of the conflict in the law even in the face of evidence that the defendant subjectively believed she was acting unlawfully.[158] Not long after, however, the Fifth Circuit in *United States v. Daly*[159] limited *Garber* to cases "where the level of uncertainty approached legal vagueness," and held that uncertainty in the law is irrelevant for defendants who acted in bad faith.

The Seventh Circuit found that uncertainty in the law negated willfulness. For example, in *United States v. Harris*,[160] two sisters were convicted of tax crimes for failing to report as income over $500,000 received

149. *Id.* at 362.
150. *Id.* at 364.
151. *Id.* at 363.
152. Yamaguchi, *Uncertain Defense*, *supra* note 142, at 394 (citing Brief for Appellee).
153. 607 F.2d 92 (5th Cir. 1979).
154. *Id.* at 94.
155. *Id.* at 96.
156. *Id.*
157. *Id.* at 100.
158. *Id.*
159. 756 F.2d 1076, 1083 (5th Cir. 1985) (citing *Burton*, 737 F.2d at 443–44).
160. 942 F.2d 1125, 1127 (7th Cir. 1991).

from a wealthy widower. Taxability turned on whether the amounts received by the sisters, who were also the widower's mistresses, were income or gifts.[161] The Seventh Circuit held "willfulness is impossible as a matter of law" regardless of the defendant's actual intent if the obligation to pay tax is sufficiently in doubt due to uncertainty in the prevailing tax law.[162]

The Ninth Circuit in *United States v. Dahlstrom*[163] held that willfulness was insufficient as a matter of law despite evidence the defendants, who were tax shelter promoters, subjectively believed they were committing tax evasion because, at the time of the transactions, no authority existed as to the relevant tax treatment. A jury convicted the defendants for violating section 7206(2), which makes it a felony for any person to willfully prepare or help to prepare a materially false document relating to any federal tax matter.[164] The government contended that the defendants knew the transactions they were promoting violated the economic substance doctrine.[165] The Ninth Circuit reversed the convictions, finding no intentional violation of section 7602(2) because the law was not addressed by "clearly relevant precedent" and was "highly debatable."[166] The defendants were not sanctioned despite their conduct included the use of fictitious names, false employer identification numbers, and altered social security numbers.[167]

By contrast, several months before the Ninth Circuit's decision in *Dahlstrom*, the Second Circuit in *United States v. Ingredient Technology Corp.*[168] held that uncertainty in the law cannot negate willfulness as a matter of law because willfulness requires evidence regarding the defendant's state of mind. Ingredient Technology Corp. and its former president were convicted of, among other things, filing false corporate tax returns.[169] The corporation was in the sugar refining and sales business.[170] As prices for raw sugar began to escalate, the corporation switched to the last-in-first-out (LIFO) method to account for its inventory.[171] In periods of escalating prices for raw materials, the LIFO method results in a higher cost of goods sold, and thus, lower taxable income because the LIFO method treats the most recently acquired inventory

161. *Id*.
162. *Id*. at 1132.
163. 713 F.2d 1423 (9th Cir. 1983). The Ninth Circuit later clarified that its holding in *Dahlstrom* is limited to cases where the pertinent law is unconstitutionally vague. United States v. Solomon, 825 F.2d 1292 (9th Cir. 1987).
164. *Dahlstrom*, 713 F.2d at 1426.
165. *Id.* at 1427.
166. *Id.* at 1428.
167. *Id.* at 1430 (Goodwin, J. dissenting).
168. 698 F.2d 88, 97 (2d Cir. 1983).
169. *Id.* at 89–90.
170. *Id.* at 90.
171. *Id.*

as sold first.[172] The Second Circuit found the corporation's taxable income to be improperly understated because the corporation had a prearranged obligation to resell to the purported seller the sugar it claimed to have purchased as inventory.[173] The defendants argued the law was too uncertain to support their convictions.[174] However, the Second Circuit concluded that willfulness existed since the defendants knew their conduct was wrongful.[175] The defendants were concealing information and lying to their external auditors and outside legal counsel.[176] That kind of conduct evidences the defendants' knowledge of wrongdoing.[177] In so holding, the Second Circuit distinguished the Fifth Circuit's decision in *Garber* because the defendant there testified she subjectively believed the amounts at issue were not taxable, and thus, her conduct was lawful.[178]

Requiring acquittal in cases where there is an objectively reasonable argument that the defendant's conduct is legal seems justified at first blush to prevent sanctioning defendants for "frank difference[s] of opinion."[179] It is, however, troublesome to permit a defendant to avoid prosecution when he actually believes his conduct is illegal regardless of whether the law could reasonably be interpreted to support the defendant's tax advice. An advisor who subjectively believed his conduct was unlawful acts in bad faith even if his actions arguably may be supported by a reasonable reading of the relevant legal authorities. The subjective willfulness standard is intended to protect innocent taxpayers who mistakenly believe their conduct is lawful.[180] But an advisor who subjectively believes he is advising a taxpayer to act illegally is not mistaken or confused. Instead, he is a deliberate violator who is attempting to intentionally exploit a supposed ambiguity in the law.[181] Defendants acting in such a manner are not earnestly trying to comply with the law. Instead, they

172. *Id.*
173. *Id.* at 94–95.
174. *Id.* at 96.
175. *Id.*
176. *Id.*
177. *Id.*
178. *Id.* at 97. The court in *Garber*, however, also said that the "government presented persuasive evidence showing that the defendant knowingly and willfully evaded her taxes." *Garber*, 607 F.2d at 100.
179. *Spies*, 317 U.S. at 496 ("It is not the purpose of the law to penalize frank difference of opinion . . . .").
180. *Cheek*, 498 U.S. at 200.
181. *See Bishop*, 412 U.S. at 361 (The Court's interpretation of willfulness implements "the pervasive intent of Congress to construct penalties that separate the purposeful tax violator from the well-meaning, but easily confused, mass of taxpayers.").

are trying to evade the spirit of the law without suffering sanction.[182] In fact, those who research the law to identify and exploit legal ambiguity while believing what they are doing is illegal are even more culpable because those persons have sought out ways to evade the law, but escape criminal sanction.[183] We should inquire into an advisor's subjective understanding of the law. Otherwise, a crafty advisor could put forth a plausible explanation of the law after the fact to justify his conduct even though that reasoning played no part in his conduct.[184]

This discussion, though not intended to be an exhaustive analysis, does demonstrate the confusion that exists in weighing as part of the willfulness analysis the import of a defendant's subjective belief that his conduct is unlawful.

IV. REVISING THE WILLFULNESS STANDARD

This Part first situates Buell's consciousness of wrongdoing work in the context of tax evasion cases against advisors, and then evaluates the suitability of Buell's approach to tax evasion. While Buell's approach would address certain shortcomings of the current willfulness standard, extending it to tax evasion has some drawbacks, which are described more fully below.

A. Using Bad Faith to Inculpate

To locate fault in cases involving conduct not previously defined as fraud by the statutes or cases, but just as blameworthy, Professor Buell has proposed using an actor's consciousness of wrongdoing as a substitute for the actor's mental state.[185] The actor's consciousness of wrongdoing would be determined ex post by examining what Buell calls the actor's "badges of guilt," which would include things such as deception or misrepresentations used to conceal his conduct.[186] The inquiry ex post is not whether the defendant knew his conduct was illegal. Rather, a defendant could be found guilty, assuming the other elements of the crime charged were satisfied, if he knew, at the time

182. William B. Barker, *The Ideology of Tax Avoidance*, 40 LOY. U. CHI. L.J. 229, 247 (2009) ("Sophisticated tax planners who intentionally game the system hardly fit into this category of 'the well-meaning, but easily confused, mass of taxpayers."') [hereinafter Barker, *Ideology of Tax Avoidance*].

183. Buell, *Good Faith and Law Evasion*, *supra* note 124, at 626 (such an advisor "arguably conform[ed] to the letter of the law but [did] so in a bad faith effort to undermine the law").

184. *See* Yamaguchi, *Uncertain Defense*, *supra* note 142, at 402–03.

185. Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37, at 133; *see* Buell, *Novel Criminal Fraud*, *supra* note 37.

186. Buell, *Novel Criminal Fraud*, *supra* note 37, at 1996.

of his actions, that his conduct was contrary to prevailing legal or professional norms, for example.[187] Thus, the "consciousness of wrongdoing" concept describes a "broader categor[y] that can accommodate illegality[,] but need not be so limited."[188] Compared to current law where a tax advisor's lack of knowledge of illegality may result in acquittal of a tax crime, a defendant's "consciousness of wrongdoing" or guilty knowledge could be grounds for his guilt pursuant to the methodology advocated by Buell.[189]

The salient question under Buell's approach is whether the defendant knew at the time he acted that "his conduct would be viewed by others as objectively wrongful."[190] This question has both subjective and objective components.[191] The subjective component asks whether the defendant acted in ways that demonstrate he knew what he was doing was wrongful—in other words, whether there are badges of guilt.[192] To ensure the defendant is not sanctioned for something that is not wrongful, the objective component evaluates whether what the defendant did would be viewed as objectively wrongful—for example, by violating professional or ethical norms.[193] The idea is that a person who deviates from customary norms is blameworthy.[194]

B. Suitability of Buell's Approach to Tax Evasion

When Buell advocated the consciousness of wrongdoing model, he set aside cases of tax evasion, questioning "[w]hether tax-related activities are so normatively distinct that they do not belong at all in analysis of the problem of novel fraud."[195] His approach is appealing in tax evasion for a number of reasons. First, consciousness of wrongdoing can operate as a sorting mechanism for prosecutors and judges by separating those deserving of punishment from those who are not.[196] Consciousness of wrongdoing could also serve as a line-drawing device to distinguish between acceptable tax planning conduct and illegal tax evasion conduct. In other words, an actor's awareness that his conduct is contrary to shared norms provides a means to disentangle tax avoidance from tax evasion.[197]

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187. Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37, at 144.
188. *Id.* at 149.
189. *Id.* at 135.
190. Buell, *Novel Criminal Fraud*, *supra* note 37, at 1999.
191. Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37, at 143.
192. *Id.* at 143–44.
193. *Id.*
194. Buell, *Novel Criminal Fraud*, *supra* note 37, at 1985.
195. *Id.* at 2003 n.86.
196. *Id.* at 1980–82, 1984.
197. Buell and Griffin use the term "entanglement" to describe situations where a defendant is engaged in "a class of activities . . . that are quite welcome[.]"

Additionally, consciousness of wrongdoing provides a way to cope with issues of notice and the legality principle. A person who does not have fair warning ex ante that her conduct may be punished criminally cannot be punished ex post.[198] But the person who was aware that her conduct was wrongful received notice in the sense that she had the opportunity to consider the "normative significance of her conduct" and refrain from it had she wished.[199] A defendant's consciousness of wrongdoing compensates for ambiguity in the law to the extent that the defendant's guilty acts prove that the defendant knew what he did was wrong on some level.[200]

Wrongdoers could be sanctioned under Buell's approach while permitting ambiguity in the law. Under current law, an advisor who, at the time of his conduct, did not actually believe he was acting lawfully does not qualify for a mistake of tax law defense.[201] Acting despite a belief that one is violating the law is the crux of willfulness, at least as that term is ordinarily or naturally understood. Nonetheless, a defendant's bad faith belief alone does not establish willfulness within the meaning of tax crime statutes. Rather, to satisfy its burden of proof, the government must show "the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty."[202] *Cheek v. United States*[203] provides a good illustration of this point. Although the Supreme Court vacated Cheek's conviction, he was convicted after retrial because evidence of his discussions with lawyers as well as earlier tax litigation he participated in belied his stated belief that he thought he was acting lawfully.[204] The jury simply did not believe him when he said he thought he was acting lawfully.[205] Though the

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Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37, at 138. As an example, they note "[a]dversarial behavior is generally welcome; only some of it should be treated as unwelcome obstruction of justice." *Id.*

198. *See supra* Part III.D.

199. Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37, at 140; *see* Ronald H. Jensen, *Reflections on* United States v. Leona Helmsley*: Should "Impossibility" be a Defense to Attempted Income Tax Evasion?*, 12 VA. TAX REV. 335, 376 (1993) [hereinafter Jensen, *Impossibility Defense*].

200. Similarly, the existing willfulness requirement counteracts ambiguity in the law at least to some extent because the jury must find that the defendant violated a known legal duty. *See, e.g.*, Screws v. United States, 325 U.S. 91, 104 (1945) ("One who does act with such specific intent is aware that what he does is precisely that which the statute forbids. He is under no necessity of guessing whether the statute applies to him . . . ."); United States v. Ragen, 314 U.S. 513, 524 (1942) ("A mind intent upon willful evasion is inconsistent with surprised innocence.").

201. *See supra* note 50 and accompanying text.

202. *Cheek*, 498 U.S. at 201.

203. *See supra* note 48 and accompanying text.

204. *Cheek*, 3 F.3d at 1057.

205. *Cheek*, 498 U.S. at 202.

government still had to prove Cheek's knowledge of illegality, it was easily proven in that case because the legal obligation to file returns and pay income tax and the application of the facts to the law were not debatable.[206] That task, however, can be much more difficult in cases where the pertinent law is less clear-cut and where actors deliberately maneuver around complex statutory and regulatory authorities, as well as judicial anti-abuse doctrines. Using a defendant's subjective belief that he acted wrongfully (rather than illegally) as a basis for imposing liability would render meaningless arguments from advisors who use ambiguity in the law to raise plausible interpretations to justify their wrongful conduct.

The incorporation of both objective and subjective components makes Buell's methodology superior to the current approach. The current approach imposes a heavy burden on the government by requiring proof of the defendant's knowledge of illegality. Moreover, the subjective mistake of law defense encourages defendants to feign ignorance of the law. Integrating an objective component helps to rein in defendants who feign ignorance although an objective component by itself risks sanctioning actors who made innocent mistakes. Including a subjective component guards against overbreadth.

But a subjective component alone is insufficient and can create perverse results. Civil liability may not be imposed for objectively reasonable conduct.[207] Thus, an advisor whose conduct is consistent with a reasonable, though erroneous, interpretation of the law can avoid the civil tax preparer penalty. However, a defendant may be criminally liable for an objectively reasonable position if the defendant subjectively believed his conduct was unreasonable under the current willfulness standard.[208] The reasonableness of an advisor's belief is irrelevant to the determination of criminal willfulness except to show the defendant's subjective beliefs are not genuinely held.[209] It would be illogical for the same conduct to escape civil liability, but to result in liability under the more demanding standard of criminal willfulness.

Buell's proposal would help to avoid this perverse result. Under Buell's approach, a defendant's subjective belief is a necessary, though not

206. *See supra* note 70 and accompanying text.

207. *See, e.g.*, I.R.C. § 6694(a)(2)(C) (no tax preparer penalty for giving advice with respect to a tax shelter transaction or a reportable transaction if "it is reasonable to believe that the position would more likely than not be sustained on its merits").

208. *See supra* Part III.E.

209. *Grunewald*, 987 F.2d at 536; *Cheek*, 482 U.S. at 203–04 ("[T]he more unreasonable the asserted beliefs and misunderstandings are, the more likely the jury will consider them to be nothing more than simple disagreement with known legal duties imposed by the tax laws and find that the Government has carried its burden of proving knowledge.").

sufficient, condition to imposing criminal liability.[210] Rather, a defendant's subjective bad faith would support a finding of willfulness only if the defendant's interpretation of the law is also objectively unreasonable.[211]

1. Evaluating Objective Component

To avoid sanctioning a defendant for conduct that is not actually wrongful, Buell posits that only objectively wrongful conduct is deserving of sanction.[212] As will be discussed below, objective standards and prevailing norms exist in tax law that may be suitable to satisfy the objective component.

Two standards come to mind against which objective wrongfulness in tax evasion cases could be measured. First, tax advisors are accustomed to performing an objective evaluation of the legal authorities when writing penalty protection tax opinions.[213] Every time an advisor writes a tax opinion, he or she must assess the strength of the available legal authorities to declare an overall level of confidence as to the purported tax consequences using a quantifiable grading convention generally understood among practitioners.[214]

The second set of objective standards exists in Circular 230, which governs practice by individuals who represent taxpayers before the Service. Pursuant to Circular 230, practitioners who provide written tax advice are required to:

> (i) Base the written advice on reasonable factual and legal assumptions (including assumptions as to future events);
> (ii) Reasonably consider all relevant facts and circumstances that the practitioner knows or reasonably should know;

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210. *See* Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 70 n.20 (2007) (In finding no willful violation of Fair Credit Reporting Act notice obligation because company's reading of the statute was objectively reasonable, the Court noted that "it would defy history and current thinking to treat a defendant who merely adopts one such [reasonable] interpretation as a knowing or reckless violator.").

211. *See supra* Part IV.A.

212. *See supra* note 191 and accompanying text.

213. Tax opinions that rely on unreasonable legal assumptions provide no penalty protection. I.R.C. § 6664(d)(4)(B)(iii)(I) (the reasonable cause and good faith exception to a reportable transaction understatement under section 6662A); Reg. § 1.6664-4(c)(1)(ii) (reliance on opinion to satisfy reasonable cause and good faith exception to section 6662 penalties).

214. *See* Rothman, *Tax Opinion Practice*, *supra* note 91, at 311–27 (describing the range of confidence levels that have a "common understanding among practitioners"); *see also* Randolph E. Paul, *The Responsibilities of the Tax Adviser*, 63 HARV. L. REV. 377, 379 (1950) (describing a tax advisor's role as "systematized prediction") [hereinafter Paul, *Responsibilities of the Tax Adviser*].

> (iii) Use reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter;
> (iv) Not rely upon representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance on them would be unreasonable;
> (v) Relate applicable law and authorities to facts; and
> (vi) Not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.[215]

In evaluating compliance with these principles, the government "will apply a reasonable practitioner standard, considering all facts and circumstances."[216]

Conduct failing to conform to these prevailing norms could satisfy the objective prong under Buell's consciousness of wrongdoing methodology.[217] For example, failing to conduct adequate due diligence to uncover false client or third-party representations that the defendant knew or should have known were incorrect would violate Circular 230, and thus, would satisfy the objective prong of Buell's methodology.[218] By contrast, an advisor

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215. Circular 230 §§ 10.37(a)(2)(i)–(vi), 10.37(a)(3) (A representation is unreasonable "if the practitioner knows or reasonably should know that one or more representations or assumptions on which any representation is based are incorrect, incomplete, or inconsistent."). Treasury replaced the much-maligned covered opinion rules after acknowledging that the covered opinion rules did not "necessarily increase the quality tax advice." T.D. 9668 2014–27 I.R.B. 1 (new standards are effective for written advice given after June 12, 2014).

216. Circular 230 § 10.37(c)(1). A heightened standard of review applies to opinions that will be used or referred to by someone other than the practitioner to promote, market, or recommend a transaction with a significant purpose of tax avoidance or evasion. Circular 230 § 10.37(c)(2).

217. The idea is that a reasonable person would conform his conduct to prevailing norms, such as Circular 230 (a person who fails to conform acts unreasonably); *see* OLIVER WENDELL HOLMES, JR., THE COMMON LAW 51; *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 8 (1998) ("The traditional and appropriate activities of a lawyer in representing a client in accordance with the requirements of the applicable lawyer code are relevant factors for the tribunal in assessing the propriety of the lawyer's conduct under the criminal law.").

218. Imposing criminal sanctions for inadequate due diligence is not unprecedented. *See, e.g.*, *Benjamin*, 328 F.2d at 860–63; United States v. Schaefer, 299 F.2d 625, 629–32 (7th Cir. 1962); Stone v. United States, 113 F.2d 70, 75 (6th Cir. 1940) (permitting willful blindness instruction where defendants sold securities using a prospectus containing false statements whose falsity would have been uncovered had the defendants conducted adequate due diligence).

presumably could not be criminally sanctioned for such a failure because no criminal penalties may be imposed for violating Circular 230 under the current willfulness standard.[219]

Making objective unreasonableness a part of the prosecution's case may actually encourage tax advisors to attain the level of knowledge of an objective, reasonable tax advisor, which may dissuade advisors' over-confidence and hyper-aggressiveness.[220] Moreover, such an approach could encourage advisors to comply with their Circular 230 obligations when delivering tax advice. In short, the threat of criminal sanction could encourage advisors to navigate a customary course of conduct. Those who knowingly operate at the margins risk crossing the line between acceptable and illegal conduct whereas those who are unaware that they are in the margins would not merit punishment.[221] Encouraging a more restrained approach is consistent with practitioners' duty to the tax system, which is generally acknowledged, though not universally accepted.[222]

> It would be insulting an honorable profession to suppose that a certified public accountant may take the representations of a corporation official as to companies it proposes to acquire, combine their balance sheets without any investigation as to the arrangements for their acquisition or suitable provision reflecting payment of the purchase price, and justify the meaningless result simply by an applique of two Latin words, [*pro forma*].

Benjamin, 328 F.2d at 861.

219. Circular 230 § 10.50 (sanctions for violating Circular 230). Although Congress authorized Treasury to regulate practitioners in 31 U.S.C. § 330, the scope of sanctions is limited to censure, suspension, disbarment, and monetary penalties. *See id.*, *see also* 31 U.S.C. § 330 (2015)

220. *Id.*

221. *See* Boyce Motor Lines, Inc. v. United States, 342 U.S. 337, 340 (1952) ("Nor is it unfair to require that one who deliberately goes perilously close to an area of proscribed conduct shall take the risk that he may cross the line."); *see also* Buell, *Novel Criminal Fraud*, *supra* note 37, at 1986 n.30; Schler, *Ten More Truths About Tax Shelters*, *supra* note 93, at 383. In discussing a general anti-avoidance rule (GAAR) as a necessary, but not sufficient solution, Schler recognizes that a GAAR may be overinclusive and shut down winning transactions that are very tax motivated; nonetheless, the benefit of deterring losing transactions is worth the cost of discouraging aggressive transactions close to the line.

222. *See generally* Richard Lavoie, *Am I My Brother's Keeper? A Tax Law Perspective on the Challenge of Balancing Gatekeeping Obligations and Zealous Advocacy in the Legal Profession*, 44 LOY. U. CHI. L.J. 813, 828–29 (2013) (advocating tax lawyers as gatekeepers of the tax system); Rachelle Y. Holmes, *The Tax Lawyer as Gatekeeper*, 49 U. LOUISVILLE L. REV. 185 (2010). *But see* Camilla E. Watson, *Tax Lawyers, Ethical Obligations, and the Duty to the System*, 47 U. KAN. L. REV. 847, 851 (1999) (finding no duty to the tax system beyond the applicable rules

Admittedly, both the penalty protection opinion standards and the Circular 230 tax advice standards carry their own interpretative baggage because both revolve around a nebulous reasonable person. Nonetheless, the Code and the Treasury regulations are structured around core concepts that tax specialists understand.[223] As Joseph Isenbergh notes:

> [P]erennial questions includ[ing] the nature of income, the tax benefit principle, annual accounting, recovery of capital, realization, claim of right, the timing of income and deductions, and . . . . [other] basic notions will survive as long as income remains the basis of our tax system. An understanding of these notions . . . makes up the indispensable knowledge and intuition of tax lawyers.[224]

Experienced practitioners develop and hone a certain tax intuition tied to these core principles to help them discern suspect transactions whose predicted tax consequences are often confirmed by the Code and regulations.[225]

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of professional conduct); Camilla E. Watson, *Legislating Morality: The Duty to the Tax System Reconsidered*, 51 U. KAN. L. REV. 1197, 1236–37 (2003) [hereinafter Watson, *Legislating Morality*] (reconsidering her earlier conclusion that tax practitioners owed no separate duty to the tax system, she remains concerned that even if there is such a duty, there are no standards to adequately guide practitioners as compared to a mere ideological duty to the system).

223. *See* Schler, *Ten More Truths About Tax Shelters*, *supra* note 93, at 333 (The "Code and regulations do have an overall structure representing their underlying intent. Moreover, to a large extent this intent can be determined in the context of particular fact patterns.").

224. Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859, 862 (1982) [hereinafter Isenbergh, *Musings on Form*]; *see* ROSTAIN & REGAN, CONFIDENCE GAMES, *supra* note 11, at 60 (Tax lawyers' judgment is informed by, among other things, "an understanding of at least a general set of basic principles that animated the Internal Revenue Code.").

225. Commentators have described this concept in various ways. *See, e.g.*, Michael Hatfield, *Legal Ethics and Federal Taxes, 1945-1965: Patriotism, Duties, and Advice*, 12 FLA. TAX REV. 1, 34 (2012) (discussing the tax lawyer's "reliable predictive intuition" and a "reliable clairvoyance"); Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 NOTRE DAME L. REV. 1727, 1769 (2007) ("A savvy tax theoretician can intuit her way to many results under the I.R.C."); Isenbergh, *Musings on Form*, *supra* note 224, at 883 (acknowledging that lawyers have developed "an exquisite set of intuitions about what kinds of transactions the courts 'like' and 'don't like'"); Paul, *Responsibilities of the Tax Adviser*, *supra* note 213, at 379 ("[The tax practitioner's] thinking must be precise, but he must think, as

Contrary to conventional wisdom, experienced tax practitioners are able to distinguish between legitimate transactions and abusive ones.[226] Tax practitioners can readily distinguish between artificial transactions initiated solely for tax reasons and real business transactions that are structured to achieve tax efficiencies.[227] "Good tax lawyers know when they are pushing hard at the edge of the envelope."[228]

The vast majority of advisors resisted the economic lure of tax shelter work, which reinforces the notion that tax practitioners can and do distinguish between advice landing within the fairway and advice in the trees. To be clear, however, tax lawyers and accountants played a significant role in the latest bout of tax shelters.[229] Nevertheless, they represented a very small percentage

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the Chinese express it, 'with his profound intestines.' In short, he must have the gift of controlled intuition.").

226. Barker, *Ideology of Tax Avoidance*, *supra* note 182, at 230 (quoting BRAITHWAITE, MARKETS IN VICE 126) ("[E]xperienced tax professionals can usually readily distinguish tax shelters from real transactions . . . ."); Canellos, *A Practitioner's Perspective*, *supra* note 93, at 51 ("[E]xperienced tax professionals can usually readily distinguish tax shelters from real transactions."); Hollis L. Hyans & Amy F. Nogid, *How Can Advisors Provide Useful Opinion Letters in the Absence of Uniform Statutory Rules and Uniform Application of Common Law Doctrines?*, 11 ST. & LOC. TAX LAW. SYMPOSIUM 109, 119 (2006) (citing Joseph Bankman, *State Tax Shelters and State Taxation of Capital*, ST. & LOC. TAX LAW. SYMPOSIUM 141, 145 (2006)) (comparing aggressive tax shelters "to rodents running across the dining room in broad daylight").

227. Schler, *Ten More Truths About Tax Shelters*, *supra* note 93, at 332–34; Randolph E. Paul, *The Lawyer as a Tax Adviser*, 25 ROCKY MTN. L. REV. 412, 413 (1952) ("[A tax practitioner] knows that he should not have even an advisory part in any transaction involving methods of tax evasion which plainly cross the line of legality.").

228. Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 SMU L. REV. 131, 136 (2001).

229. In denying a taxpayer's motion to compel production of all Son-of-Boss tax opinions that the Service had collected as well as a list of the names and addresses of all law firms and accounting firms known by the service to have issued Son-of-Boss Tax opinions, the Tax Court indicated that those firms constituted "only a small subset of tax advisers." 3K Inv. Partners v. Commissioner, 133 T.C. 112, 116 n.6 (2009). The taxpayer was attempting to bolster its reasonable cause and good faith defense in the hopes of avoiding civil tax penalties. The taxpayer argued that:

> The availability of a large number of law firms and accounting firms issuing tax opinion letters determining that so-called "Son of Boss" transactions * * * would produce the tax results as reported by Petitioner on its subject tax return would bolster Petitioner's position that it had reasonable cause and that Petitioner acted in good faith.

of all tax advisors.[230] Advisors exercised restraint despite the promise of substantial professional fees in an essentially unregulated market with little downside risk.[231] Most advisors were not swayed despite competitive pressures accompanying a modern-day law practice that focus attention to the bottom line and achieving the client's and lawyer's own interests even if at the expense of the public interest.[232]

At a time where the benefits from participating in abusive tax shelters outweighed the costs, an overwhelming majority of tax advisors were unwilling to undertake tax shelter work. Social scientists use the term "informational cascade" to describe situations where "it is optimal for an individual, having observed the actions of those ahead of him, to follow the behavior of the preceding individual without regard to his own information."[233] Nor did a reputational cascade result, despite the involvement of professionals from white-shoe firms.[234] A reputational cascade is similar to an informational cascade in that a person follows another's behavior even if inconsistent with his or her own information because the follower assumes the

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Id. at 116. Further, petitioner hoped to show that it had reasonable cause for the position taken on its return "'based upon the general consensus of national law firms across the country that were issuing tax opinion letters that were taking the same position as the Petitioner . . . .'" *Id.* The Tax Court "reject[ed] any suggestion that the requested information . . . shows any 'general consensus' of tax advisers regarding Son–of–BOSS transactions." *Id.* at n.6.

230. *Id.*

231. *See generally* ROSTAIN & REGAN, CONFIDENCE GAMES, *supra* note 11, at 57 (explaining of the factors contributing towards an optimal environment for abuse).

232. Russell G. Pearce & Eli Ward, *Rethinking Lawyer Regulation: How a Relational Approach Would Improve Professional Rules and Roles*, 2012 MICH. ST. L. REV. 513, 516–17 (2012) (noting a shift in law firm culture to one rooted in autonomous self-interest); Christine Pedigo Bartholomew & Johanna Oreskovic, *Normalizing Trepidation and Anxiety*, 48 DUQ. L. REV. 349, 363 (2010) (describing the evolution of law firms in the last thirty years to "a more competitive, bottom-line business environment").

233. Sushil Bikhchandani, David Hirshleifer, & Ivo Welch, A Theory of Fads, Fashion, Custom, and Cultural Change as Informational Cascades, 100 J. POL. ECON. 992, 992, 994 (1992); see April Mara Barton, Application of Cascade Theory to Online Systems: A Study of Email and Google Cascades, 10 MINN. J. L. SCI. & TECH. 473, 476–77 (2009) (describing an informational cascade as "a situation in which every subsequent actor, based on the observations of others before him, makes the same choice as the others, independent of his own intuition") [hereinafter Barton, Cascade Theory].

234. William Safire, *On Language; Gimme the Ol' White Shoe*, N.Y. TIMES, Nov. 9, 1997, http://www.nytimes.com/1997/11/09/magazine/on-language-gimme-the-ol-white-shoe.html (describing a white-shoe firm as an elite firm of pedigreed professionals with a reputation for being cautious and conservative).

leader is correct based on the leader's reputation.[235] This was not a situation where advisors were jumping off the proverbial bridge because everyone else was doing it. No herd mentality developed because the non-participants likely were unwilling to allow the behavior of others to override their own assessment that the transactions were improper.[236]

Admittedly, these illustrations are unsettling to the extent they describe a cultural ideology more than a discrete set of duties.[237] Nonetheless, these examples show that there are norms that exist to guide and shape advisors' behavior. The salient question is whether deviation from those norms warrants criminal sanction.

2. Evaluating Subjective Component

The subjective component of Buell's approach examines the defendant's conduct to infer whether he knew he was acting wrongfully.[238] Buell recognized that defendants, through careful planning, could conceivably act deliberately to avoid creating badges of guilt in the first place.[239] But perhaps the biggest impediment to using advisors' badges of guilt as proof that they willfully helped clients evade their taxes is the apparent similarity between legal tax planning or tax minimization and illegal tax evasion.[240] The right to engage in tax planning is firmly ingrained in our tax system.[241] As the Supreme Court recognized, "[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by

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235. Barton, *Cascade Theory*, *supra* note 233, at 479–81.

236. Timur Kuran & Cass R. Sunstein, *Availability Cascades and Risk Regulation*, 51 STAN. L. REV. 683, 686 (1999) ("Those with considerable private information may remain unswayed.").

237. *See* Watson, *Legislating Morality*, *supra* note 222.

238. *See supra* note 191.

239. Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37, at 142–43.

240. Tax planning and tax minimization are used interchangeably in this Article to refer to non-criminal conduct intended to minimize taxes, whether successful or not (in which case civil tax penalties may be imposed), whereas tax evasion refers to criminal conduct.

241. Whether tax planning has social utility is beyond the scope of this Article. *See* Daniel N. Shaviro, *Evaluating the Social Costs of Corporate Tax Shelters*, 55 TAX L. REV. 445, 451 (2002) (taxpayers are incentivized to overinvest in tax planning); Schler, *Ten More Truths About Tax Shelters*, *supra* note 93, at 384–87 (not all tax planning is bad); David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 222 (2002) ("[T]ax planning . . . produces nothing of value."); Bruce Kayle, *The Tax Adviser's Privilege in Transactional Matters: A Synopsis and a Suggestion*, 54 TAX LAW. 509, 551 (2001) ("[I]t is rather difficult to articulate what may be the social interest in tax minimization.").

means which the law permits, cannot be doubted."[242] Because tax minimization is legal, inferring an actor's consciousness of wrongdoing from his conduct could be problematic. A jury might wrongly conclude an actor's tax planning conduct is evidence of the actor's consciousness of wrongdoing, which would result in false positives—the sanctioning of advisors who are undeserving of punishment. One important question is whether ex post decision makers can properly distinguish between situations where an advisor appropriately uses ambiguity in the law to his client's advantage or inappropriately acts in bad faith. On the one hand, can lines realistically be drawn between good lawyering, which often is justified by the zealous advocacy model, and criminal lawyering on the other?[243]

Tax planning and tax evasion share many common characteristics. Tax planning connotes affirmative, deliberate structuring and planning of transactions to achieve certain tax consequences. But so too does tax evasion. Both minimization and evasion involve intentionality to get around tax laws. Both evasion and minimization result in the reduction of taxes, which reduces the fisc.[244] Despite these similarities, tax planning or tax minimization is

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242. Gregory v. Helvering, 293 U.S. 465, 469 (1935). The Second Circuit in *United States v. Ingredient Tech. Corp.*, 698 F.2d 88, 94 (2d Cir. 1983), insightfully noted that invoking the oft-cited:

> [M]axim that a person is entitled to arrange his taxes so as to pay only that which is due . . . . tells us nothing about what must ultimately be rendered unto the I.R.S. any more than Socrates solved the thorny problems of justice by defining it to require that we give every person his due.

Id.

243. *See generally* Bruce A. Green, *The Criminal Regulation of Lawyers*, 67 FORDHAM L. REV. 327 (1998) (the construct of "good lawyering" versus "criminal lawyering"). MODEL RULES OF PROF'L CONDUCT Preamble [9] (a basic underlying principle is a "lawyer's obligation zealously to protect and pursue a client's legitimate interests, within the bounds of the law."). Transactional lawyers are not immune from the systemic pressures of an adversarial legal system. Dennis J. Ventry, Jr., ABA Comm. on Ethics & Prof'l Responsibility, *Lowering the Bar: ABA Formal Op. 85-352*, 112 TAX NOTES 69, 70 (July 7, 1985) (identifying the Service as an adversarial party vis-à-vis tax advisors and adopting "litigation and controversy norms to define the tax lawyer's responsibilities"). The ABA Tax Section concluded that Formal Opinion 85-352 should apply to lawyers rendering tax opinions "in the course of structuring transactions" to the extent "tax return positions would be involved." Paul J. Sax et al., *Report of the Special Task Force on Formal Opinion 85-352*, 39 TAX LAW. 635, 636 (1986).

244. STUART P. GREEN, LYING, CHEATING, AND STEALING: A MORAL THEORY OF WHITE-COLLAR CRIME 245 (Oxford Univ. Press 2006). A separate question exists as to whether evasion and minimization both erode the integrity of the

generally acceptable, but tax evasion is not.[245] The real difference between evasion and minimization "is the thickness of a prison wall."[246] If unsuccessful, tax minimization may result in civil penalties. Tax evasion, however, may result in criminal penalties. The government in the tax shelter prosecutions viewed the advisors' conduct as far beyond "the bounds of legitimate tax planning" and a "flagrant disregard of the law."[247] By contrast, the advisors saw themselves as aggressive advocates for their clients' interests.[248] To resolve this quandary, ex post decision makers have to be able to ascertain when good lawyering has crossed the line to criminal lawyering.

It is fair to assume that most practitioners are not wringing their hands over whether they or their clients could go to jail as a result of the practitioners' tax advice. Instead, tax advisors worry more about whether the transaction works—essentially, the chances that the Service would respect the transaction, taking for granted that it is examined.[249] Advisors writing tax opinions also must concern themselves with the potential for exposing the client to civil tax penalties if the Service successfully challenges the transaction.

Although practitioners generally recognize tax evasion is illegal while tax minimization is akin to zealous advocacy, the majority has limited concern for tax evasion.[250] Viewing tax compliance as a continuum stretching from legitimate planning on one end to illegal tax evasion on the other end, a

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tax system. Tax planning or minimization signals to taxpayers that sophisticated taxpayers who have the resources to hire sophisticated tax counsel get different tax treatment than those who do not. *See supra* note 90.

245. *Gregory*, 293 U.S. at 469 ("The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."); *Gregory*, 69 F.2d at 810 ("Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.").

246. *See* Matthew Bishop, *The Mystery of the Vanishing Taxpayer*, THE ECONOMIST (Jan. 27, 2000), http://www.economist.com/node/276945 (quoting former British chancellor Denis Healey). The quote obviously refers to the fact that minimization involves civil liability and evasion involves criminal liability, but the quote also alludes to the thin line between the two.

247. Press Release, U.S. Att'y S.D.N.Y., Four Individuals Charged in Criminal Tax Fraud Related to Ernst & Young Tax Shelters (May 30, 2007), at 4, http://graphics8.nytimes.com/packages/pdf/business/30shelter_
statement.pdf [hereinafter Press Release, Four EY Individuals Charged].

248. *See* Daugerdas Sentencing Memorandum *supra* note 102, at 24 ("He simply used the complexity of the Code against its own creators.").

249. Circular 230 § 10.37(a)(2)(vi) (prohibiting practitioners from taking into account the audit lottery when giving written advice).

250. Mark A. Turner, Build an Awareness of Unlawful Tax Evasion to Ensure Avoidance, 81 PRAC. TAX STRATEGIES 230, 230 (2008).

transaction's place on the continuum depends on the aggressiveness of the transaction.[251] Where an advisor draws the line depends in part on the availability of legal authority addressing the situation, the advisor's and the client's tolerance for risk, and for some advisors, the risk of detection by the Service.[252] Most tax advisors likely apply something akin to a "smell test" that presumes the line between legal tax planning and illegal tax evasion can be sensed even if it cannot readily be defined.

This subpart considers the tax planning versus tax evasion issue through the lens of the government's prosecution of three Ernst & Young lawyers and one accountant in *United States v. Coplan* and the prosecution of certain KPMG professionals in *United States v. Stein.*[253] These prosecutions provide a glimpse into the ability of ex post decision makers to effectively distinguish between legal tax planning conduct and illegal tax evasion conduct.

The government indicted eighteen KPMG partners and employees along with R.J. Ruble, a tax partner at the law firm of Brown & Wood.[254] The bulk of the indictment in the KPMG litigation was dismissed due to the government's interference with the firm's advancement of legal fees, which

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251. Logue, *Tax Law Uncertainty*, *supra* note 116, at 359–60 n.34 (quoting DANIEL N. SHAVIRO, CORPORATE TAX SHELTERS IN A GLOBAL ECONOMY: WHY THEY ARE A PROBLEM AND WHAT WE CAN DO ABOUT IT 25 (2004)). In distinguishing aggressive tax planning and tax evasion, Shaviro states:

> Aggressive paper shuffling to minimize tax liability is not identical to cheating if its [sic] being impermissible under the existing state of the law is not clear-cut. But there is an issue of degree here, and a slippery slope. Taking self-interested but reasonable reporting positions slides over into taking positions that are more and more unlikely to be sustained and, therefore, deliberately kept secret, converting the entire enterprise into one of playing the "audit lottery" rather than taking a position that one believes is actually reasonable under the law. At a certain point, although it is hard to say exactly where, aggressive planning merges into outright cheating. Even before that point is reached, the former starts to have many of the same bad effects on general compliance as the latter.

Id.

252. *See* Kovach, *Bright Lines in Taxation*, *supra* note 92, at 1311–12.

253. *Coplan*, 703 F.3d at 53; United States v. Stein, 488 F. Supp. 2d 350, 352 (S.D.N.Y. 2007).

254. Brief for Defendant-Appellant Raymond J. Ruble, at 3, *Pfaff*, 407 Fed. Appx. 506 (No. 09-1702-cr(L)), 2009 WL 8044178 (C.A.2), at *3 [hereinafter Brief for Defendant-Appellant Ruble]; *KPMG to Pay $456 Million for Criminal Violations*, IR-2005-83, IRS (Aug. 29, 2005), http://www.irs.gov/uac/KPMG-to-Pay-$456-Million-for-Criminal-Violations.

the Second Circuit said amounted to state action to deprive the defendants of their Sixth Amendment right to counsel.[255] However, the dismissal did not affect the prosecution of Ruble or three KPMG employees who had left the firm before the indictments were handed down, because none were entitled to fee advancement from the firm, and thus, the prohibited government action would not have affected their ability to defend themselves.[256] Ruble was indicted on forty-three counts of tax evasion, and ultimately was convicted by a jury on ten counts of tax evasion for issuing opinions on the so-called BLIPS tax shelter, which he helped KPMG design.[257] Eventually, Ruble was sentenced to six and a half years in prison.[258] Two of the other three defendants also drew guilty verdicts, resulting in a ninety-seven-month prison sentence and a $3 million fine for one and a 121-month sentence and a $6 million fine for the other.[259]

All three defendants appealed their case to the Second Circuit. The Second Circuit gave the appeal short shrift. It first issued a summary order.[260] On motion for rehearing, it issued an unreported summary order.[261] The Second Circuit swiftly dismissed the defendants' argument that there was insufficient evidence to support their convictions.[262]

In the other case, *United States v. Coplan*, four Ernst & Young defendants were charged with tax evasion under section 7201 for promoting tax shelter transactions to clients.[263] Following a ten-week trial, a New York

255. *Stein*, 541 F.3d at 135; Brief for Defendant-Appellant Ruble, *supra* note 254; *KMPG to Pay*, *supra* note 254.

256. *Stein*, 495 F. Supp. 2d at 425–27. Two of the other three defendants whose cases were not dismissed drew guilty verdicts. Pfaff received a ninety-seven-month prison sentence and a $3 million fine and Larson received a 121-month sentence and a $6 million fine. Ruble Sentencing Press Release, *supra* note 21. The third former KPMG employee was acquitted. Lynnley Browning, *3 Convicted in KPMG Tax Shelter Case*, N.Y. TIMES (Dec. 17, 2008), http://www.nytimes.com/2008/12/18/business/18kpmg.html?_r=0 [hereinafter *3 KPMG Convicted*].

257. Brief for Defendant-Appellant Ruble's, *supra* note 254, *3–4. BLIPS is an acronym for "Bond Linked Issue Premium Structure." Swartz v. KPMG LLP, 476 F.3d 756, 758 (9th Cir. 2007).

258. Ruble Sentencing Press Release, *supra* note 21.

259. *Id.* The third former KPMG employee was acquitted. 3 KPMG *Convicted*, *supra* note 256.

260. United States v. Ruble, Nos. 09-1702-cr(L), 09-1707-cr(CON), 09-1790-cr(CON), 2010 WL 3374102 (2nd. Cir. Aug. 7, 2010), *amended and superseded by* United State v. Pfaff, 407 Fed. Appx. 506 (2d Cir. 2010).

261. *Pfaff*, 407 Fed. Appx. at 506.

262. *Id.* at 508–09.

263. Press Release, Four EY Individuals Charged, *supra* note 247. All of the defendants were also charged with conspiracy under 18 U.S.C. section 371, and

jury found all four defendants guilty on all counts.[264] The defendants were eventually sentenced to serve prison terms ranging from twenty months to three years, and to pay fines of between $75,000 and $100,000.[265] All four defendants appealed their convictions to the Second Circuit.[266] By contrast to its terse handling of the KPMG appeal, a three-judge panel copiously parsed the facts and in a seventy-three page, split opinion, affirmed the convictions of two defendants, but overturned the convictions of two others due to a lack of evidence proving the requisite criminal intent.[267]

The government characterized its position in *Coplan* as follows:

> [T]he co-conspirators understood that if the IRS were to detect their use of these tax shelters, and learn the true facts and circumstances surrounding the design, marketing and implementation of the shelters, the IRS would aggressively challenge the claimed tax benefits. In that event, the IRS would seek to collect the unpaid taxes plus interest, and might also seek to impose substantial penalties upon the clients. Accordingly, the conspirators undertook to prevent the IRS from: a) detecting their clients' use of these shelters; b) understanding how the transactions operated to produce the tax results reported by the clients; c) learning that the shelters were marketed as cookie-cutter products that would eliminate, reduce[,] or defer large tax liabilities; d) learning that the clients were not seeking profit-making investment opportunities, but were instead seeking huge tax benefits; and e) learning that, from the outset, all the clients intended to complete a pre-planned series of steps that had been designed

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certain of the defendants also were charged with making false statements to the Service under 18 U.S.C. section 1001 and obstructing the Service under section 7212. *Id.*

264. Press Release, U.S. Att'y S.D.N.Y., Two Former Ernst & Young Partners Sentenced in Manhattan Federal Court for Their Roles in Criminal Tax Shelters (Jan. 21, 2010), http://www.justice.gov/archive/usao/nys/pressreleases/January10/coplannissenbaumsentencingpr.pd.

265. Press Release, U.S. Att'y S.D.N.Y., Two Additional Ernst & Young Partners Sentenced in Manhattan Federal Court (Jan. 22, 2010), http://www.justice.gov/archive/usao/nys/pressreleases/January10/shapirovaughn sentencingpr.pdf.

266. *Coplan*, 703 F.3d at 46.

267. *Id.* at 96. The other two defendants did not challenge the sufficiency of the evidence. *Id.* at 62 n.19. The fact that the convictions were overturned meant that the Second Circuit concluded that no "rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt." *Id.* at 62 (quoting Jackson v. Virginia, 443 U.S. 307, 319 (1979)).

> by the conspirators to lead to the specific tax benefits sought by the clients.[268]

The government found blameworthy the following conduct in the *Coplan* case: (1) encouraging firm personnel to collect promotional materials from clients to impede those materials from getting into the hands of the Service; (2) advising clients to download foreign currency trading materials and to engage in additional trading activity to strengthen their tax positions; and (3) editing internal correspondence, transaction documents, and tax opinions to put the transactions in the best possible light and to deemphasize potentially negative information.[269]

i. Document Management

The Second Circuit concluded that encouraging firm personnel to collect promotional materials from clients to prevent those materials from getting into the hands of the Service did not justify criminal sanction in the absence of deceit or dishonesty.[270] Undertaking acts that merely make the Service's job harder are not criminal.[271] To carry out its examination responsibilities, the Service has broad authority "[t]o examine any books, papers, records or any other data which may be relevant or material . . . ."[272] Typically, the Service obtains information through statutorily mandated disclosures, information document requests during audit, and the summons process.[273] Absent a specific statutory mandate or request from the

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268. Press Release, Four EY Individuals, *supra* note 246.

269. *Coplan*, 703 F.3d at 64–65.

270. *See id.* at 88; *see also* ROSTAIN & REGAN, CONFIDENCE GAMES, *supra* note 11, at 36 (noting that because taxpayers have no general disclosure obligation, they have "an opportunity to submit returns that reflect an interpretation of facts that best promote their interests without alerting the government to facts that may undermine that interpretation"). The government in *United States v. Stein* also accused KPMG of trying to hide the true nature of the transactions from the Service by not permitting clients to keep copies of PowerPoint presentations, which would show the pre-arranged nature of the transactions. Superseding Indictment, at 17, United States v. Stein, 488 F. Supp. 2d 350 (S.D.N.Y. 2007) (No. S1 05 Cr. 888 (LAK)), 2005 WL 4168176, at ¶36.h [hereinafter Superseding Indictment].

271. *See* United States v. Scott, 37 F.3d 1564, 1575 (10th Cir. 1994) (to convict defendant for conspiracy to defraud the United States pursuant to 18 U.S.C. section 371, defendant's acts to obstruct the government must be deceitful or dishonest.); *see also* United States v. Caldwell, 989 F.2d 1056, 1061 (9th Cir. 1993).

272. I.R.C. § 7602(a)(1).

273. *See, e.g.*, I.R.C. § 7602 (the Service's summons power); Reg. § 1.6011-4(b) (reportable transactions); HEATHER C. MULROY, I.R.S., LB&I-04-0214-004, UPDATED GUIDANCE FOR EXAMINERS ON INFORMATION DOCUMENT REQUESTS

government, advisors are not obligated to disclose information or turn over materials.[274]

ii. Encouraging Legitimate Activities to Strengthen Tax Position

Some advisors suggested that clients engage in otherwise legal activities such as additional foreign currency trading.[275] The government characterized such advice as criminal because the advisors took affirmative steps to disguise the "true nature" of the transactions to avoid detection by the Service.[276] However, the defendants would say they were simply creating favorable atmospherics to maximize the likelihood that the intended tax consequences would be achieved.[277] Nevertheless, the government would accuse the advisors of "window dressing" unlawful transactions to try to create the appearance of an investment non-tax business purpose through the use of cosmetic trading.[278]

Though the recommended trading was contrived rather than essential and was added merely to make the transactions look more legitimate, the Second Circuit did not find this activity to be culpable, noting that there was no dispute "that the substance of the advice advocated lawful trading activity."[279] This holding is not entirely convincing because the advisor's intent was to conceal the real purpose of the transaction.[280]

However, even assuming this kind of behavior could be characterized as a badge of guilt under Buell's proposal, it is unclear whether the advisor's behavior would be seen as objectively wrongful. It is not unusual for advisors to take steps to increase the odds that the Service will respect the transaction,

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ENFORCEMENT PROCESS (Feb. 28, 2014), http://www.irs.gov/Businesses/Large-Business-and-International-Directive-on-Information-Document-Requests-Enforcement-Process (last updated Feb. 19, 2015); Circular 230 § 10.20(a)(1) ("A practitioner must, on a proper and lawful request by a duly authorized officer or employee of the [Service], promptly submit records or information in any matter before the [Service] unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.").

274. *See* United States v. Murphy, 809 F.2d 1427, 1431–32 (9th Cir. 1987) (Failure to disclose absent a legal duty is not unlawful.); *see also* Barker, *Ideology of Tax Avoidance*, *supra* note 182, at 245.

275. *Coplan*, 703 F.3d at 64.

276. *Id.* at 58; Press Release, Four EY Individuals Charged, *supra* note 247.

277. Philip Kotler, *Atmospherics as a Marketing Tool*, 49 J. OF RETAILING 48, 48–50 (1973) (Philip Kotler coined the term "atmospherics," which he defined as the "conscious designing of space to create certain effects in buyers.").

278. *See* ROSTAIN & REGAN, CONFIDENCE GAMES, *supra* note 11, at 206.

279. *Coplan*, 703 F.3d at 65.

280. *See* Spies, 317 U.S. at 499.

whether by minimizing potentially negative aspects of the transaction or clarifying, highlighting, and making more understandable potentially positive aspects of the transaction. Recommending clients engage in or refrain from certain activities to put a transaction in the best possible light is part and parcel of legitimate tax planning. Criminalizing this type of behavior potentially criminalizes legal advocacy, particularly when what is being recommended is legal and is actually implemented rather than merely a sham. What the government complained of goes to the core of what transactional tax professionals do. Before a tax return is even filed or litigation is ever commenced, tax advisors may structure transactions to meet their clients' business or personal objectives in a tax-efficient manner.[281] So long as taxpayers continue to have the right to minimize their taxes and the U.S. legal system encourages gamesmanship by skillful lawyers, tax planning advisors will continue to shape the facts to minimize tax liability.

iii. Wordsmithing

One example of wordsmithing the government objected to was edits to an internal memorandum to deemphasize the expected early termination of a swap contract. The original draft of the memo provided: "At the appropriate time during the swap period, GP will terminate the swaps with the bank."[282] One of the defendants recommended that the document be revised to read, "Swap terminates."[283] The court found this conduct acceptable because it more accurately aligned the description of the contract terms in the memo with the actual terms in the contract, which permitted, but did not require, either party to terminate the contract before the maturity date.[284] It made little difference to the court that it was expected that every swap would terminate early to achieve the desired tax consequences and in fact all were terminated early.[285] In this way, the court seemed to elevate form over substance by ignoring edits that concealed from the Service the pre-wired nature of the transaction.

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281. *See generally* Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227 (2010) (describing transactional lawyers as "regulatory arbitrageurs" who manipulate deal structures to, among other things, avoid taxes); Logue, *Tax Law Uncertainty*, *supra* note 116, at 360 n.35 ("[T]ax planning is when a taxpayer wants to engage in a transaction primarily for nontax business reasons, but wishes to structure the transaction so as to minimize its tax liability consistent with the tax laws—or consistent with how Congress intended the tax laws to be applied.").

282. *Coplan*, 703 F.3d at 65 n.22 (quoting the original draft of the CDS Action Plan).

283. *Id.*

284. *Id.* at 65.

285. The court acknowledged that the change "clearly deemphasized the prevailing expectation of early termination." *Id.*

Nonetheless, the statements made were not inaccurate; there literally was no dishonesty or misrepresentation in the change that was made.

iv. Failure to Register Transactions As Tax Shelters

In *United States v. Stein*,[286] the government criticized KPMG for failing to register the transactions as tax shelters. KPMG essentially weighed the "lucrative fees" the firm stood to collect against the monetary penalties for failure to file and made a "business decision" to not register the transactions.[287] Holding advisors criminally liable would seem to present a notice problem because the penalty for failing to register a tax shelter consisted of monetary fines.[288]

Despite this anecdotal evidence, distinguishing legal tax minimization from illegal tax evasion is not as mysterious as the decision in *Coplan* and the conventional wisdom suggests.[289] When all is said and done, the distinction between legal tax minimization and illegal tax evasion is the difference between "genuine business activities and tax planning for its own sake."[290] Legitimate tax planning changes the form of real transactions proposed by clients to achieve better tax results.[291] Legitimate tax planners genuinely believe no tax liability arises because they avoided otherwise applicable legal duties by engineering around them. By contrast, tax evaders know tax liability is underreported, but deploy illegitimate means such as deception, falsification, or intentional misrepresentation to hide the truth.[292] In short, an evader knows tax liability is not properly reported, but uses deception or concealment to suggest otherwise. Advisors who were indicted acted like sales people by directly soliciting clients and initiating tax shelter transactions.[293] Under those circumstances, the relevant business purpose had to be identified

286. 488 F. Supp. 2d 350, 354 (S.D.N.Y. 2007).

287. Superseding Indictment, *supra* note 270, at ¶56.

288. Former Reg. 301.6707-1T, removed by T.D. 9686, 2014-34 I.R.B. 3820.

289. Logue, *Tax Law Uncertainty*, *supra* note 116, at 353 (The distinction between minimization and evasion "is, to tax experts, notoriously fuzzy."); Watson, *Legislating Morality*, *supra* note 222, at 1217.

290. Rostain, *Sheltering Lawyers*, *supra* note 9, at 119.

291. *See* Canellos, *A Tax Practitioner's Perspective*, *supra* note 93, at 52, 54–55.

292. I.R.M. 9.1.3.3.2.1. "One who avoids tax does not conceal or misrepresent. He[] shapes events to reduce or eliminate tax liability and, upon the happening of the events, makes a complete disclosure. Evasion, on the other hand, involves deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events or make things seem other than they are." *Id.*

293. *See* Canellos, *A Tax Practitioner's Perspective*, *supra* note 93, at 52, 54–55.

as part of, or after, the solicitation process.[294] The realty was that the complexity of the transactions made them inaccessible for many clients, who could not formulate a business purpose on their own.[295]

Nonetheless, since the *Coplan* defendants were indicted by the government and convicted by a jury before the Second Circuit reversed the convictions of two of the four defendants on appeal raises serious concerns about the ability of ex post decision makers to adequately distinguish between legal tax planning conduct and illegal tax evasion conduct. *Coplan* reinforces the fact that not all deception constitutes evasion.[296] Even behavior concealing the true essence of a transaction may be acceptable if there is no misrepresentation or falsification. This issue highlights the importance of properly instructing the jury that conduct impeding the ability of the Service to do its job is not, in and of itself, unlawful. Rather, the impeding conduct must be accomplished by deceitful or dishonest means.[297]

3. Conflating Badges of Guilt and Affirmative Act

To prosecute tax evasion, in addition to proving the defendant's willfulness, the government must prove beyond a reasonable doubt that the advisor committed an affirmative act constituting an attempted evasion of tax, which results in the taxpayer-client owing substantially more tax than was reported.[298] Substituting an actor's consciousness of wrongdoing for willfulness would seem to conflate the willfulness and affirmative act elements. An affirmative act of evasion is "any conduct, the likely effect of which would be to mislead or to conceal."[299] Conduct that may qualify as an affirmative act includes: "keeping a double set of books, making false entries of alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, [and] handling of one's affairs to avoid making the records usual in transactions of the kind . . . ."[300] In the tax shelter context, affirmative acts of evasion may include "the preparation of fraudulent supporting documents, the creation of financial entities and the implement[ation] of tax shelter transactions through those entities, and the concealment of the tax shelters from regulators."[301] Even

294. See generally id.
295. ROSTAIN & REGAN, CONFIDENCE GAMES, *supra* note 11, at 203.
296. Buell & Griffin, *Consciousness of Wrongdoing*, *supra* note 37, at 139.
297. *See supra* note 271.
298. *Sansone*, 380 U.S. at 351; *Spies*, 317 U.S. at 499.
299. *Spies*, 317 U.S. at 499.
300. *Id.*
301. United States v. Stein, 429 F. Supp. 2d 633, 644 (S.D.N.Y. 2006).

lawful activities "can serve as an 'affirmative act' . . . if it is done with the intent to evade income tax."[302]

4. No Tax Due Defense

In addition to establishing willfulness, the government must prove the existence of a tax deficiency to convict a defendant of tax evasion.[303] Therefore, the government may still have to wrestle with vagueness and ambiguity to the extent a transaction's purported tax benefits are disallowed due to one or more anti-abuse standards such as the economic substance doctrine.[304]

V. CONCLUSION

This Article makes the case that the current willfulness standard, which requires proof of a tax advisor's knowledge of illegality and requires the government to negate a defendant's claim of ignorance or misunderstanding of the law even if irrational, is not well-suited for tax evasion prosecutions of tax experts for the tax evasion they help their clients commit. This Article offers a potential alternative drawing from the work of Professor Samuel Buell. Buell's "consciousness of wrongdoing" work proposes the substitution of an actor's "badges of guilt" for the actor's mental state. An actor whose conduct demonstrates that he knew, at the time he acted, his conduct was wrongful could be found to have acted willfully if that conduct was also wrongful based on some objective measure, such as professional or ethical norms. The incorporation of both objective and subjective components makes Buell's methodology superior to the current approach. While Buell's approach would address certain shortcomings of the current willfulness standard, extending it to tax evasion has some drawbacks that need to be and should be explored further in subsequent research.

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302. United States v. Valenti, 121 F.3d 327, 333 (7th Cir. 1997) (quoting United States v. Jungles, 903 F.2d 468, 474 (7th Cir. 1990) (extensive use of cash and non-use of a bank account can be affirmative acts though such conduct is not criminal in and of itself)).

303. *Sansone*, 380 U.S. at 351; *see* Gurpreet Bal, *Bringing It All Back Home: Boulware and the Unfortunate Demise of the Miller Rule*, 5 HASTINGS BUS. L.J. 367, 369 (2009) ("[T]he lack of an actual tax deficiency is a form of legal impossibility defense.").

304. *See* Jensen, *Impossibility Defense*, *supra* note 199, at 395 (taking issue with the *Sansone* requirement that the government prove the existence of a tax deficiency to the extent that a defendant could be acquitted because "unrelated and unclaimed deductions eliminate the tax deficiency resulting from his wrongful acts").