

THE TAX LAWYER'S ROLE IN THE WAY THE AMERICAN TAX SYSTEM WORKS

by Mortimer M. Caplin

This was edited from the Erwin N. Griswold Lecture at the annual meeting of the American College of Tax Counsel on January 22, 2005.



In honor of Erwin N. Griswold, I would like to touch on four matters of relevance: Dean Griswold's impact on the tax laws; the role of the U.S. Tax Court; the role of the Internal Revenue Service; and the tax lawyer's role in the American tax system.

My first contact with the dean was in my days as a young law professor at the University of Virginia School of Law—struggling in the classroom using *Griswold, Cases and Materials on Federal Taxation*. Not that the casebook was entirely new to me; for, with the help of the G.I. Bill, I'd become well acquainted

with it at New York University in my post-World War II doctoral efforts. It's hard to believe, but the *Griswold* casebook was the first ever devoted entirely to federal income taxation and it proved a godsend to me as I segued from New York law practice to teaching at U.Va. in the fall of 1950.

Erwin Griswold and I met at law professor gatherings and bar meetings, especially in the early 1950s at American Law Institute sessions in Washington as members of ALL's Tax Advisory Group. We both were hard at work on its comprehensive tax report, which later became part of the

1954 Code. Never did I tell him though that, in using his casebook, my custom was to try a personal touch by distributing mimeographed materials that totally rearranged the order of presentation and reading assignments. Nor did I ever hint that after a year or two, I switched entirely to his major competitor, the more comprehensive *Surrey and Warren*. He probably learned about the switch faster than I thought by skimming through his royalty reports—reports which he undoubtedly scrutinized with great care.

He had graduated from Harvard Law School in 1929, and his first real contact

with tax law was during his five-year stint as a fledgling attorney in the Office of the Solicitor General of the United States. Federal tax rates and tax receipts were at a low point then, and handling tax cases was not the most sought-after assignment. By default, he soon became the office's tax expert, arguing the bulk of its tax cases both in the U.S. Supreme Court and the U.S. Courts of Appeals. I should mention that, just before leaving the solicitor general's office, he was instrumental in the rule change that allowed appeals in tax cases to be made under the general title "Commissioner of Internal Revenue," without the need to specify the name of the incumbent. That's why you see older tax cases bearing the names of particular commissioners. Let me mournfully add: "*Sic transit gloria mundi*"—so passes away the glory of this world!

Erwin Griswold left the solicitor general's office in 1934, to become a Harvard Law School professor for twelve years, and then dean for the next twenty-one. He had a major influence on tens of thousands of law students as well as lawyers throughout the world. As years went by, he reminisced that he found "less exhilaration" in teaching the federal tax course as "the tax law had become far more technical and complicated . . . In the early days, the statute was less than one hundred pages long and the income tax regulations . . . were in a single, rather slight, volume." Oh, for the good old days!

In the fall of 1967, Griswold returned to the solicitor general's office, but this time as *the* Solicitor General of the United States—a position he held for six years. He'd been appointed by President Lyndon B. Johnson, and in 1969, was reappointed by President Richard M. Nixon for a second term. Nixon, however, preferred as his solicitor general a Yale law professor, Robert H. Bork—someone more closely in tune with his philosophy. Griswold's duties ended in June 1973, at the close of the Supreme Court's term, well in time to avoid the heavy lifting of Watergate and the "Saturday Night Massacre." He later said that he would not have followed Solicitor General Bork in carrying out the

President's order to fire Special Watergate Prosecutor Archibald Cox.

Shortly after leaving office, Griswold joined Jones, Day, Reavis & Pogue as a partner and engaged in law practice and bar activities for some twenty years, until his death in 1994, at the age of ninety. Erwin Griswold was honored many times over, not only for his innumerable contributions to the law, but for "his moral courage and intellectual energy . . . meeting the social responsibilities of the profession."

I always suspected that any special feeling the dean may have had for me had roots in my strong backing of his plea for a single federal court of tax appeals—to resolve conflicts and provide "speedier final resolution of tax issues." He observed, "The Supreme Court hates tax cases, and there is often no practical way to resolve such conflicts." He anguished over the practicing bar's opposition to his proposal, convinced that "the real reason is that tax lawyers find it advantageous to have uncertainty and delay"—a preference for forum-shopping, if you will. But in the end, in his 1992 biography, *Ould Fields, New Corne*, he sounded a bit more hopeful: "Eventually, something along the lines proposed will have to come as it makes no sense to have tax cases decided by thirteen different courts of appeals, with no effective guidance on most questions from the Supreme Court."

One Supreme Court member, who'd had hands-on experience in tax administration and well understood weaknesses in our appellate review system, was former Justice Robert H. Jackson. The Court's most informed member on taxation, he had previously served successively as general counsel of the Bureau of Internal Revenue, assistant attorney general in charge of the Tax Division, solicitor general, and then attorney general of the United States. In 1943, in his famous *Dobson* opinion, Justice Jackson made a determined effort to strengthen the Tax Court's status in the decision-making process so as to minimize conflicts and attain a greater degree of uniformity. To

these ends, he laid down a stringent standard in appellate review of Tax Court decisions:

"[W]hen the [appellate] court cannot separate the elements of a decision so as to identify a clear-cut mistake of law, the decision of the Tax Court must stand . . . While its decisions may not be binding precedents for courts dealing with similar problems, uniform administration would be promoted by conforming to them where possible."

The message was straightforward and seemingly clear; but it didn't cover U.S. district court decisions or those of the Court of Federal Claims. Also, other problems were encountered by judges and members of the bar, and dissatisfaction was high. Ultimately, this led to the 1948 statutory reversal of *Dobson* by enactment of the review standard now in the Internal Revenue Code, which requires U.S. courts of appeals to review Tax Court decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." And that's where the situation lies today—save for those still aspiring, as Erwin Griswold did for the rest of his life, for greater uniformity and earlier resolution of conflicts.

Justice Jackson never did change his view about the critical importance of the Tax Court. In his 1952 dissent in *Arrowsmith v. Commissioner*, he underscored this in strikingly poignant fashion, saying: "In spite of the gelding of *Dobson v. Commissioner* . . . by the recent revision of the Judicial Code, . . . I still think the Tax Court is a more competent and steady influence toward a systematic body of tax law than our sporadic omnipotence in a field beset with invisible boomerangs."

Members of the tax bar readily endorse this strong vote of confidence in the role of the Tax Court. As our nationwide tax tribunal for over eighty years, it has served effectively and with distinction as our most important court of original jurisdiction in tax cases.

Today's tax system has its genesis in World War II, when income taxes rapidly expanded from a tax that touched the better-off only to a mass tax that reached out to the workers of America. Revenue collection was turned upside down with Beardsley Rumml's "pay-as-you-go," collection-at-the-source, withholding and estimated quarterly payments, and floods of paper filings. Commissioner Guy Helvering said it couldn't be done. And, in

a nationwide automatic data processing system (ADP), backed by approval of individual account numbers and a master file of taxpayers housed in a central national computer center. The IRS had entered the modern age. This same ADP design, now badly out-of-date, is still in use, albeit patched with additions and alterations. It is the dire need to modernize this forty-four-year-old system, which is the IRS's chief challenge today.

reports of the different oversight committees. To the more sophisticated, the suggestions to Congress appeared more aspirational than realistic.

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fact, the old Bureau of Internal Revenue, with its politically-appointed collectors of internal revenue, was not fully up to the task. Congressional hearings revealed incompetence, political influence and corruption, and directly led to a total overhaul under President Harry Truman's 1952 *Presidential Reorganization Plan*. New district offices and intermediate regional offices replaced the old collectors' offices. Except for the Internal Revenue commissioner and chief counsel, who still require presidential nomination and Senate confirmation, the entire staff was put under civil service. The last step, a year later, was the official name change to the Internal Revenue Service.

The new IRS made remarkable headway in turning itself completely around by the end of the 1950s; and it was not long before it was recognized as one of government's leading agencies. In the early 1960s, new heights were reached through a fortunate confluence of events, strong White House endorsement, and unflagging budgetary support. President John F. Kennedy had a special interest in tax law and tax administration, and almost immediately called on Congress for antiabuse tax legislation and strengthening of tax law enforcement, including Attorney General Robert F. Kennedy's drive against organized crime. Of key importance was the final congressional go-ahead for installing

Starting in the 1970s, the IRS began to encounter its present serious difficulties. A series of complex legislative changes, tightened budgets, an exploding workload and expensive failures to complete its "tax systems modernization" (TSM) project—all contributed to weakened performance and heightened congressional oversight. In 1995 and 1996, Congress created the *National Commission on Restructuring the Internal Revenue Service* "to review the present practices of the IRS, and recommend how to modernize and improve the efficiency and productivity of the IRS, while improving taxpayer services." A year later, the commission issued its report, *"A Vision for a New IRS,"* which led to the enactment of the *Internal Revenue Service Restructuring and Reform Act of 1998* (RRA 98).

The report centered chiefly on governance and managerial changes, including IRS modernization; a publicly-controlled oversight board; a business-type Commissioner of Internal Revenue; electronic filing and a paperless tax system; taxpayer rights; and—of primary importance—changing the IRS's culture and mission so as to place emphasis on enhanced "customer service" and functioning like "a first rate financial institution." Congress was asked to do its part too, with simplified tax legislation; complexity analyses reports; multiyear budgeting; joint hearings and coordinated

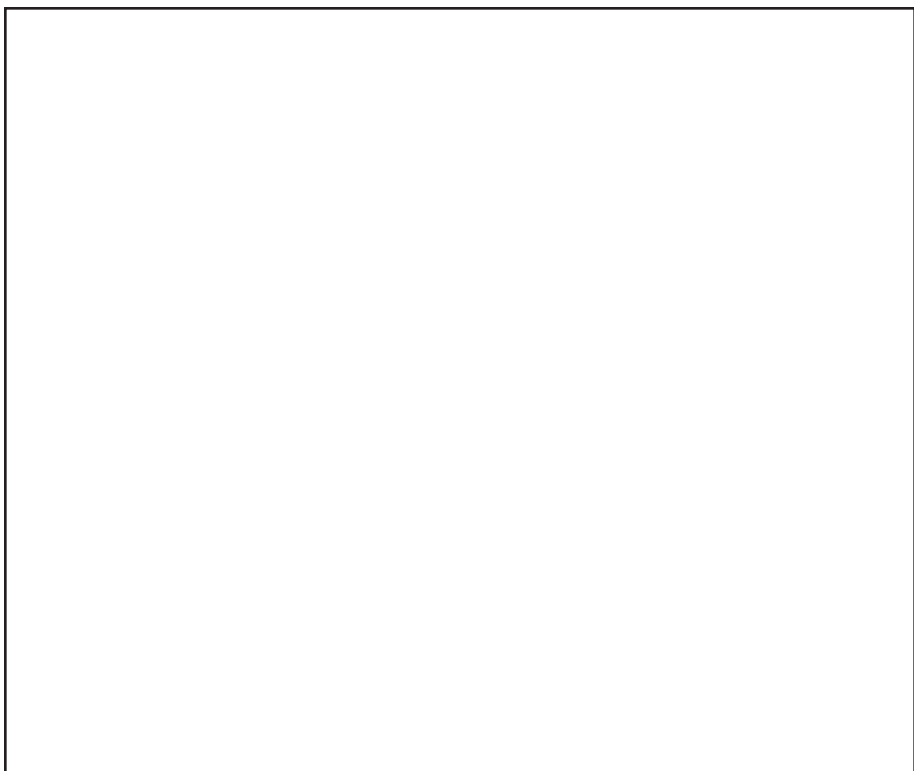
The U.S. House of Representatives largely followed the Commission's recommendations (H.R. 2676). But the legislation found itself pending at a tumultuous time, when the air was filled with words of U.S. Senators who threatened to: "end the IRS as we know it," "tear the IRS out by the roots," "drive a stake in the heart of the corrupt culture at the IRS," and "stop a war on taxpayers." Senator William V. Roth Jr., R-Delaware and chair of the Senate Finance Committee, took over and ran a series of dramatic televised hearings, carefully prepared by his staff, that featured a handful of allegedly abused taxpayers and IRS employees who gave testimony that shocked the nation. Never, at that time, did the IRS have the opportunity to tell its side of the story, nor was the testimony tested for accuracy or placed in proper context. Later, however, after enactment of RRA 98, court proceedings and government reports by the Government Accountability Office and the Treasury Inspector General for Tax Administration (TIGTA) clearly established that much of the testimony was not only misleading, but false. The IRS may have made mistakes, but the mistakes were not malicious or systemic. Numerous corrective news stories began to appear with sharp headlines such as: "IRS Abuse Charges Discredited," "Highly Publicized Horror Story That Led to Curbs on IRS Quietly Unravels," "IRS Watchdog Finds Complaints Unfounded," "Court Is Asked to Block False Complaints against IRS," "Secret GAO Report is Latest to Discredit Roth's IRS Hearings." But, publication came too late; the damage was already done.

Congress, the public and ultimately President William J. Clinton's administration had all been outraged by the Senate's testimony and, almost overnight, sweeping support was given to Senator Roth's proposed highly stringent treatment of the IRS. His Senate version added some one-hundred new provisions to the House bill. Some are praiseworthy and reasonably

protective of taxpayer rights, but others step over the line, unduly micromanaging the IRS's daily operations and laying the groundwork for serious delaying tactics by taxpayers and damage to the administrative process. In the end, the legislation was adopted by an overwhelming vote. One of the most criticized provisions is the "Ten Deadly Sins" sanction in section 1203 of RRA 98. This peremptory discharge procedure, which directs the IRS commissioner to terminate an employee for any one of certain specified violations, is deeply disturbing to IRS personnel. Some hesitate to enforce the tax law because of possible unfair exposure to complaints by disgruntled taxpayers. Both Commissioner Mark W. Everson and former Commissioner Charles O. Rossotti have noted this erratic impact and have requested modification. In my mind, there is little doubt that section 1203 should be totally repealed.

Commissioner Rossotti very ably captained the transition to the new culture. But, with Congress's continuing emphasis on the "customer service" aspect of tax administration, it was not until his last years that the word "enforcement" began to trickle out, along with warnings of the "continuing deterioration" and "dangerous downward trend in the tax system." This shift in emphasis was quickly hastened by new Commissioner Mark Everson, who early announced: "At the IRS our working equation is service *plus* enforcement equals compliance." He underscores repeatedly the significant "diminution of resources;" the continuing fall in collection and notices to nonfilers; the *36 percent drop* in enforcement personnel since 1996; and, since 1998, the audit rate drop of *57 percent*.

Perhaps, of even greater importance, is the negative impact this weakened enforcement has had on compliance and self-assessment. Commissioner Everson often quotes President Kennedy's admonition: "Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others." Indeed, the annual tax gap continues to grow. Last reported as a \$311 billion tax loss each year—from underreporting, nonpayment and non-filing—new find-



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ings of a major increase are anticipated in the IRS study now under way.

With the United States facing repeated annual deficits and a burgeoning national debt, the commissioner recently confessed: “The IRS, frankly speaking, needs to bring in more money to the Treasury.”

Recent congressional and IRS investigations, however, have identified an alarming spread of extremely questionable practices, some approaching outright fraud, by a number of previously well-regarded tax practitioners.

The White House confirmed this by supporting a 2005 budget increase that would have allocated to enforcement alone an increase of 11 percent. This was not to be. In the recent cutback in the increase, House Majority Leader Tom DeLay, R-Texas, commented: “I don’t shed any tears for the IRS. Our priority as far as the IRS is concerned is to put them out of business.” So much for the looming crisis in meeting the revenue needs of our democracy!

The IRS’s final 2005 appropriation reflected barely a one percent increase—an overall grant of \$10.3 billion, almost \$400 million below the President’s request. This tight squeeze tells clearly why the IRS went along with outsourcing to private debt-collection agencies, the collection of certain delinquent tax accounts. The statutory authorization to pay outsiders up to 25 percent of tax debts collected is technically “off-book” and through this backdoor financing, the IRS’s appropriations takes no direct hit.

This then is the very serious state of affairs confronting those directly concerned with the fair and balanced administration of our tax law.

The proper functioning of our tax system is largely dependent upon the quality and responsible involvement of well-trained tax practitioners—primarily tax lawyers and tax accountants. Well over half the public seeks their help for tax advice and return preparation. They inquire, time and again,

about the “rules of the road,” what’s right and what’s wrong, what’s lawful and what’s not. The integrity and standards of these tax professionals serve as the nation’s guideposts, with direct impact on taxpayer compliance and the self-assessment concept itself. The significance of their good-faith practices cannot be overstated.

Recent congressional and IRS investigations, however, have identified an alarming spread of extremely questionable practices, some approaching outright fraud, by a number of previously well-regarded tax practitioners. The Senate Finance Committee has zeroed in directly on practitioners as a whole, emphasizing the “important role tax advisors play in our tax system.” Chairman Charles Grassley, R-Iowa, caustically observed: “At the heart of every abusive tax shelter is a tax lawyer or accountant.” In full agreement, Senator Max Baucus, D-Montana, the committee’s ranking minority member, added: “Let’s stop these unsavory practices in their tracks by restoring integrity and professionalism in the practitioner community.” In their follow-up letter to Treasury Secretary John N. Snow, they called for reinvigoration of the IRS’s Office of Professional Responsibility (OPR), for its proper funding, and for extension of the authority of its new head, Cono Namorato. Much has happened since—legislatively and administratively.

Taking the lead, the *American Jobs Creation Act of 2004* greatly enhances the OPR’s effectiveness through a series of new provisions that expand Circular 230’s reach by confirming authority to impose standards on tax-shelter opinion writers; clarifying authority to “censure” practitioners, as well as to suspend or disbar them; granting authority, for the first time, to impose monetary penalties on individual practitioners, as well as on

employers or entities for which they act; and granting injunction authority, for the first time, to prevent recurrence of Circular 230 violations.

In turn, publication of the Department of the Treasury’s long-awaited Circular 230 amendments on tax-shelter opinion writing puts the OPR’s momentum in high gear. The official release advises that these “final regulations provide best practices for all tax advisors, mandatory requirements for written advice that presents a greater potential for concern, and minimum standards for other advice.” No doubt is left, however, that the amendments’ underlying intent is to “promote ethical practice,” “improve ethical standards,” and “restore and maintain public confidence in tax professionals.” Highlighted, too, is the caution that “one of the IRS’s top four enforcement goals” is “[e]nsuring that attorneys, accountants and other tax practitioners adhere to professional standards and follow the law.”

This is a harsh estimate of tax practitioners in general. As members of the profession of tax lawyers, it is difficult to ignore our collective responsibility to respond. What do we do about it? Certainly, the tax bar has not been asleep. The American Bar Association’s Tax Section and the American Institute of Certified Public Accountants separately have been working on standards of practice for over forty years and each has published a series of guiding principles, which continue as works in progress. The question remains, however, of whether the tax bar has probed deeply enough.

Have we been willing to grapple with more subtle, more difficult issues? Have we articulated what we regard as “best practices” for tax lawyers, keeping in mind that Circular 230 applies to a broad range of “practitioners”? Tax lawyers are clearly distinguishable from other “practitioners” and, indeed, from lawyers in general. And it seems fair to ask: Which practices are acceptable to the *tax bar*, and which are not? At what point does the *tax bar* regard tax advice or tax practice as crossing the line? As “too aggressive”? As “things that are not done”?

These questions, of course, transcend the current concern with tax shelters only. It may not be long, in my view, before we will be asked to revisit a broader issue: “Whether, in a system that requires each taxpayer to self-assess the taxes that are legally due, a tax lawyer can properly advise a client that he or she may take an undisclosed tax return position absent the lawyer’s good faith belief that the position is ‘more likely than not’ correct.” In considering the issue, some twenty years ago, ABA Formal Opinion 85-352 crafted as a more flexible answer the “realistic possibility of success” test, which later became a touchstone used by Congress and the Treasury in assessing certain penalties. In light of unacceptable developments since then, it would seem timely for the entire subject matter to undergo a thorough review.

In his speech on *The Public Influence of the Bar*, Supreme Court Chief Justice Harlan F. Stone addressed the same theme of lawyers’ ethics in relation to the great Wall Street stock market crash. Critical of “clever legal devices,” and critical of lawyers having done “relatively so little to remedy the evils of the investment market,” he observed that “whatever standards of conduct in the performance of its function the Bar consciously adopts must at once be reflected in the character of the world of business and finance.” In his view, “the possibilities of its influence are almost beyond calculation” and he went on to advise, “It is needful that we look beyond the club of the policeman as a civilizing agency to the sanctions of professional standards which condemn the doing of what the law has not yet forbidden.”

The point is: Though we are a long-recognized profession, allowed the privilege of autonomy and essentially self-regulation, no insurmountable barriers exist to prevent encroachment on this privilege, or even its end, if our practices or standards are regarded as inadequate or unrealistic. Today, we already see a gradual erosion flowing from a series of new governmental rules—by Congress, for example through the Internal Revenue Code or legislation such as Sarbanes-Oxley, or by the Securities and Exchange Commission or Public Company Accounting Oversight Board, or by Treasury through Circular 230 or other regulations.

Our profession of tax lawyers must take the initiative and become more intently involved—more proactive and not simply defensive. Problems need to be identified and solutions developed by ourselves, and where necessary, recommended for implementation by the bar in general or by appropriate governmental bodies. We cannot wait for others to compel answers. Nor can we move at the pace of the ALI project that required thirteen years to complete a two-volume *Restatement of the Law Governing Lawyers*. Ours would naturally be more immediate in time and focus, and might well look to the leadership of the ABA Section on Taxation, this organization, the American College of Tax Counsel, or some other concerned and qualified group.

As tax lawyers, we face many different responsibilities daily—to our clients, to the profession, to the public, to ourselves. How we maintain our own self-respect as lawyers, how we desire to be viewed by others, and how we use our special skills

to improve the nation’s revenue-raising system are all questions that cross our minds every day. In this regard, Dean Griswold counseled us to preserve our “independence of view”—separating our representation of clients from our role as public citizens seeking to improve the functioning of government.

The one exemplar he acclaimed is Randolph E. Paul, Treasury’s general counsel and tax policy leader during World War II, whom the Dean refers to as “one of the early giants in the tax field.” Paul asserted this individual independence throughout his entire career, while he developed a remarkable tax practice. In the closing lines of his classic *Taxation in the United States*, he made these seminal observations on “the responsibilities of tax experts”:

“The most I can say is that I do not think surrender needs to be unconditional . . . I know tax advisers who accomplish the double job of ably representing their clients and faithfully working for the tax system taxpayers deserve . . . at another level. I venture the opinion that they lead a more comfortable life than do many of their colleagues. Of one thing I am very sure—that both taxpayers and the government need many more of these independent advisers.”

Tonight, this room is filled with many of these independent, responsible advisers—some surely to become the giants we will salute in the future. I am certain that together we will overcome our present challenge “to restore and maintain public confidence in tax professionals.” At the same time, I have no doubt, too, that we will not fail in our ongoing commitment to better the way in which our nation’s needs for revenue are fulfilled, fairly and honorably. ☺



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