5-1-1999

Tax Lawyers, Ethical Obligations, and the Duty to the System

Watson

University of Georgia School of Law, camillaw@uga.edu

Repository Citation
Watson, Tax Lawyers, Ethical Obligations, and the Duty to the System (1999), Available at: https://digitalcommons.law.uga.edu/fac_artchop/840

This Article is brought to you for free and open access by the Faculty Scholarship at Digital Commons @ Georgia Law. It has been accepted for inclusion in Scholarly Works by an authorized administrator of Digital Commons @ Georgia Law. Please share how you have benefited from this access. For more information, please contact tstriepe@uga.edu.
ARTICLE

Tax Lawyers, Ethical Obligations, and the Duty to the System

Camilla E. Watson*

I. INTRODUCTION

Perhaps the most elusive area of law is that of legal ethics. While the term itself is easy to define,¹ the subject all but defies codification² because ethics, or morals (the terms are interchangeable), cannot be encapsulated by or in law. This is because law, in general, contains its own standard of validity on which there is usually clear societal consensus. For example, murder, rape, and theft are morally repugnant universally. Hence, punishment for any of these offenses does not impinge upon religious or individual autonomy because there is no ethical freedom to choose whether or not to engage in the conduct that would constitute the offense.³

* Professor of Law, University of Georgia, School of Law. B.A., Converse College; J.D., University of Mississippi; LL.M. (in taxation), New York University. A version of this Article was presented at the Conference on Professionalism at the University of Kansas School of Law on April 2-3, 1998. I thank Dean Michael H. Hoeflich for inviting me to participate in this conference. I am grateful to Leigh W. Bauer, Walter Hellerstein, Edward D. Spurgeon, and Alan Watson for their helpful comments on an earlier draft of this Article.

1. Black's Law Dictionary defines it as “[t]hat branch of moral science which treats of the duties which a member of the legal profession owes to the public, to the court, to his professional brethren, and to his client.” BLACK'S LAW DICTIONARY 894 (6th ed. 1990). A related term is "professional responsibility," which refers to the rules of conduct that govern the legal profession. See id. at 1210. Note, however, that the term “legal ethics” is a misnomer because law and ethics have different foundations, and thus are different species of the same genus. See infra text accompanying notes 4-5.

2. For a general criticism of the codification of professional ethics, see Steven R. Salbu, Law and Conformity, Ethics and Conflict: The Trouble with Law-Based Conceptions of Ethics, 68 IND. L.J. 101 (1992); see also DANIEL R. COQUILLETTE, LAWYERS AND FUNDAMENTAL MORAL RESPONSIBILITY, at xv (1995) (“The most important problems often cannot be solved by a simple or standardized process, at least not by individuals who value their moral characters.”).

3. See Salbu, supra note 2, at 103-06 (discussing the fallacies of codes of professional ethics). Of course, on occasion there may be some laws that may not have clear societal consensus because many people may regard the law as immoral. In general, however, law rests on a foundation of clear societal consensus.
Rules of ethics, however, rest on a very different foundation. They may be either absolute, like law, or motivational (determined by the motivation of the actor), or consequential (judged by their foreseeable consequences). But in some cases there may be no single correct answer, or clear societal consensus, to a controversial and complex ethical question. Thus, canonizing an ethical rule addressing the particular problem deprives the individual of ethical autonomy and imposes an element of coercion that may not be justified in every case.

The very nature of a lawyer's representation and protection of a client means that the lawyer is likely to be faced with continually conflicting decisions as to what must be done to act legally and in accordance with the rules of professional ethics, while continuing to act morally. The lawyer qua lawyer is almost always acting as an agent for another, usually in an undertaking that is critical to the client. When confronted with an issue in which the rules of professional ethics conflict with the lawyer's personal morality, the primary question is whose interest should prevail—the lawyer's or the client's?

Most ethical dilemmas faced by practicing lawyers involve conflicts between a lawyer's duty of zealous representation of a client, and the duty of truthfulness and fairness to a party other than the client. The extent of the problem is illustrated in the preamble to the Model Rules of Professional Conduct (Model Rules), which states that "[v]irtually all difficult ethical problems arise from the conflict between a lawyer's responsibilities to clients, to the legal system and to the lawyer's own interest in remaining an upright person while earning a satisfactory living." The problem is especially pronounced in the area of tax

---

4. See id. at 104-05 & n.16 ("The canonization of controversial ethical questions is a usurpation of individual autonomy, and therefore insupportable."). The structure of the ABA Model Code of Professional Responsibility, which preceded the current Model Rules of Professional Responsibility, was particularly unfortunate because it contained separately delineated Canons, Ethical Considerations, and Disciplinary Rules. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY (1997). Thus, the moral distance between the ethical considerations and the demands of the law was lengthened.

5. The Model Rules of Professional Conduct, as amended, replaced the Model Code of Professional Responsibility, which included disciplinary rules under which a lawyer could be subject to sanction by the state bar. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-101, 1-102 (1983). The Model Rules, on the other hand, contain legally enforceable sanctions under which a lawyer can be punished by a court for substantive offenses such as legal malpractice. See MODEL RULES OF PROFESSIONAL CONDUCT preamble (1997). For a discussion of the history of the ethical standards of the legal profession and some limitations of these standards, see N. Lee Cooper & Stephen F. Humphreys, Beyond the Rules: Lawyer Image and the Scope of Professionalism, 26 CUMB. L. REV. 923, 925-31 (1996).

6. MODEL RULES OF PROFESSIONAL CONDUCT preamble (1997). For a criticism of this statement, see Richard L. Abel, Why Does the ABA Promulgate Ethical Rules?, 59 TEX. L. REV. 639, 670-72 (1981). The term "legal system," as it is used in the preamble to the Model Rules,
practice, in which various rules of ethics collide in force because of the nature of the practice, which differs in two important respects from other types of law practice.

First, tax practice is a multi-profession practice of lawyers and nonlawyers, such as accountants and enrolled agents; hence, the need for uniform standards of professional responsibility other than those of the variously represented professional organizations. This need is met by Circular 230, a set of Treasury Department regulations that specifically governs practice before the Internal Revenue Service (IRS), and by the civil penalty provisions of the Internal Revenue Code (the Code). In addition, tax lawyers are subject to the ethics rules of the United States Tax Court, as well as the rules of professional ethics of the state bar associations of the jurisdictions to which they are admitted to practice. This Article maintains that the additional ethics rules to which tax lawyers refers generally to the legal profession, encompassing the court system as well as the individual members of the profession and the organized bar. See Model Rules of Professional Conduct preamble (1997).

A lawyer is both a professional, as a member of the legal profession, and a private citizen, as a member of society. As an individual lawyer and officer of the legal system, the lawyer has a duty not to engage in criminal or fraudulent conduct. See id. Rule 8.4. She must be candid with a tribunal, and truthful and fair in dealing with others, including adversaries. See id. Rules 3.3, 3.4, 4.1. As a member of the bar, the lawyer should strive to strengthen legal education through support of the Continuing Legal Education program, should engage in pro bono practice to provide legal services to the poor, and should aid the bar in maintaining its independence through self-regulation. See id. Rule 6.1. Thus, the lawyer should conform her conduct in accordance with the bar’s ethical rules and should report violations of these rules. See id. Rule 8.3. As a member of society, the lawyer owes a duty to society to conform to the requirements of the law, and to seek to improve the law and the administration and quality of justice. See id. preamble.

7. Certified Public Accountants are automatically admitted to practice before the IRS. See 31 C.F.R. § 10.3(b) (1998). Other professionals may enroll to be admitted to practice, and, in some cases, the IRS may permit enrollment to a limited extent. See id. § 10.3(d), (e) (permitting enrolled actuaries, those admitted temporarily while being considered for enrollment to practice, and those acting pro se or representing a related party to practice). But see id. § 10.3(f), (g) (prohibiting practice before the IRS by federal and state government officers and employees).

There has been considerable controversy over the issue of accountants, particularly the “Big Five” accounting firms, engaging in the unauthorized practice of law. See John Gibeaut, Squeeze Play, 84 A.B.A. J. Feb. 1998, at 42, 42 (discussing accountants’ encroachment in the legal market). In the United States Tax Court, attorneys in good standing may be admitted to practice. See Tax Court Rules of Practice, Rule 200(a)(2), 17 Stand. Fed. Tax Rep. (CCH) ¶ 42,360 (1999). A taxpayer may appear before the court pro se, and with the permission of the court, an officer of a corporation may appear on behalf of the corporation. See 31 C.F.R. § 10.7. Other applicants must pass a written examination. See id. §§ 10.3(e), 10.5(c).


lawyers are subject create added ethical conflicts, and that the problems likely to be encountered by tax lawyers have not been dissected thoroughly enough for these conflicts to be meaningfully resolved.

Second, tax practice differs from other types of law practice in that the opposing party is always the government, which through its agency, the IRS,\(^\text{11}\) assumes a variety of roles with respect to the lawyer. For instance, it assumes a regulatory role both in promulgating and enforcing ethical standards for those professionals practicing before it, and in processing and examining returns of taxpayers. Moreover, it assumes a police role in enforcing the revenue laws to ensure that taxpayers and their representatives conform not only to the requirements of the Internal Revenue laws, but also to the government's own ethical standards. Finally, it assumes a quasi-judicial role in issuing rulings in response to taxpayers' requests for guidance in particular situations, in hearing taxpayer appeals from assertions of deficiencies, and in deciding claims for refund. In all of these roles, according to the American Bar Association (ABA), the relationship between the IRS on the one hand, and the lawyer and client on the other hand, is adversarial or potentially adversarial.\(^\text{12}\) Thus, the IRS is not considered a tribunal to which the lawyer would otherwise owe a special duty of candor under the Model Rules.\(^\text{13}\)

Several commentators have noted, however, that, in addition to the more specific duties to obey the Internal Revenue laws and regulations, and to conform one's conduct to the government's ethical standards, tax lawyers have a general duty to "protect the revenue,"\(^\text{14}\) "to contribute to improvement of the tax laws and their administration,"\(^\text{15}\) and ensure that the tax system is "functioning honestly, fairly and smoothly."\(^\text{16}\) Thus, lawyers advising clients in tax matters must balance the immediate demands of their clients against "the public's interest in a sound tax system which operates in accord with policy judgments reached through a democratic process."\(^\text{17}\)

---

11. The same applies, of course, to state tax practice in which the adversary is always the state department of revenue and its agents.
When one considers the various roles of the government and the various duties tax lawyers ostensibly owe to society, the government, the legal profession in general, as well as the client in particular, the essential question is what happens when these duties conflict? The purpose of this Article is not to resolve this question definitively, but to place it in perspective with the thesis that there is no discrete duty owed by the lawyer *qua* lawyer either to society or to the tax system. Instead, as a private citizen and a member of society, the lawyer has the same duty that is imposed upon every person: to obey and uphold the law. As a professional, the lawyer has a duty to behave as a moral, upstanding person, adhering to the rules of professional responsibility while representing the client to the best of her ability. Finally, as a member of the legal profession, the lawyer has a duty to act in the best interests of the profession as a whole. If the lawyer adheres to these duties, there should be no separate duty owed either to the tax system or to society.

In defining the duty owed by the lawyer, as a member of the legal profession, to the government, this Article begins in Part II with the pivotal issue of the relationship between the tax lawyer and the government. It is this relationship that defines the lawyer’s duty in her role as a return preparer to disclose to the government return positions that do not have a realistic possibility of being sustained on the merits, determined either administratively or judicially. Such disclosure is required under both the civil penalty provisions of the Code and the ethics rules of Circular 230. In contrast, under the Model Rules, no such duty of disclosure is owed because of the ABA’s position that the IRS is not a tribunal, since the relationship between the taxpayer or attorney and the IRS is considered adversarial. The ABA has been strongly criticized for this position, but this Article concludes that while the supporting rationale of the ABA’s position is flawed, it yields a feasible result.

---

18. See, e.g., *Model Rules of Professional Conduct* Rule 8.1 (1997) (stating that a lawyer must not knowingly make a false statement of material fact on application for admission to the bar or in connection with a disciplinary matter), Rule 8.3 (stating that a lawyer should report professional misconduct), Rule 8.4 (stating that a lawyer should not engage in misconduct).


The duty of disclosure raises several thorny problems for tax practitioners. Chief among them is what happens if the lawyer determines that a position taken on a tax return lacks a realistic possibility of success, and thus should be disclosed in accordance with the government's rules and regulations, but the client refuses to disclose. This Article also examines the lawyer's duty of disclosure when an IRS agent makes a mistake in the client's favor. Does the lawyer's duty of candor under Circular 230 and fairness to an opposing party under the Model Rules trump the duty of confidentiality to the client, or vice versa?

Although this Article addresses ethical issues from the perspective of the tax lawyer, the civil and criminal penalty provisions of the Code, as well as the provisions of Circular 230, can apply to lawyers who do not specialize in tax law, who never prepare returns for clients, and who have few, if any, professional dealings with the IRS. This can happen in two general ways: (1) a lawyer may be considered a return preparer under the Code, even though the lawyer does not physically prepare a return, if the lawyer or one of her employees renders advice for compensation that constitutes a substantial portion of a return; 22 and (2) a client can put a lawyer at risk if the client has committed tax fraud and the lawyer's advice might assist in furthering the fraud. Tax fraud raises a number of problems for the lawyer which this Article examines in the latter section of Part II.

Parts III and IV examine the antithesis of the duty of disclosure—the duty of confidentiality. In Part III, the Article focuses on practitioner privilege—both the attorney-client privilege and the newly enacted accountant-client or tax advisor privilege. Part IV discusses the government's duty not to disclose return information and problems that have arisen from the government's interpretation of that duty.

---

22. See I.R.C. § 7701(a)(36) (1994). For a definition of substantiality, see Treas. Reg. § 301.7701-15(b) (as amended in 1980). Only one individual per firm is treated as a preparer. See id. 1.6694-1(b). That person is usually the signing preparer—the person who signs the return or refund claim as the preparer. If no one in the firm signed as the preparer, one individual will be liable, nonetheless, as a nonsigning preparer. See id. This is usually the individual with "overall supervisory responsibility for the advice given." Treas. Reg. § 1.6694-1(b) (as amended in 1992). Because liability is limited to one person per firm, the person who is liable may not rely on the advice of another person in the same firm in order to establish a reasonable cause and good faith defense. See id. § 1.6994-2(a)(2). Thus, the defense is not available to those who rely on the advice of another member of the same firm. See Treas. Reg. § 1.6694-3 (1991).
II. The Nature of the Ethical Relationship Between the Tax Lawyer and the Government

A. The View of the ABA

Under the Model Rules, a lawyer has a duty to disclose to a tribunal adverse controlling authority that has not been disclosed by the opposing party. Thus, the lawyer has an ethical duty to disclose weaknesses in the client’s case to a tribunal if the opposing party does not do so. With respect to third parties, the lawyer has a duty to be fair and truthful, and to refrain from assisting a client’s crime or fraud, but otherwise there is no duty of disclosure under the Model Rules. In fact, the lawyer owes the client a duty of confidentiality and cannot disclose weaknesses to third parties without the client’s approval.

The ABA has stated in two formal opinions that the IRS is considered neither a “true tribunal” nor a “quasi-judicial institution” because of its lack of impartiality. Instead, the IRS is considered an adversary to whom the lawyer owes no greater duty than is owed to any other adversarial party. The first formal opinion, issued in 1965, disposes of the issue somewhat glibly with the rationale that the IRS, while “obviously intending to be fair, ... is not designed and does not purport to be unprejudiced and unbiased in the judicial sense.” Twenty years later, the ABA concluded in the second formal opinion that lawyers have no obligation to disclose an aggressive return position to the IRS because the filing of such a return could realistically be regarded as the “first step in a process that may result in an adversary relationship between the client and the IRS.”

Critics have argued forcefully that the ABA’s position is wrong because it fails to consider the various roles of a tax lawyer, the three most general being advisor, advocate, and return preparer. In the roles of advisor and return preparer, very little of the tax lawyer’s practice

---

25. See id. Rule 1.6. According to the ABA commentary on Model Rule 1.6, “[t]he observance of the ethical obligation of a lawyer to hold inviolate confidential information of the client not only facilitates the full development of facts essential to proper representation of the client but also encourages people to seek early legal assistance.” Id. cmt. 2.
29. See Falk, supra note 21, at 645-46 (discussing the various roles of tax lawyers). Note that Falk delineates several types of advisors: return advisor, tax planning advisor, and tax shelter advisor. See id. In fact, the roles of advisor and return preparer may overlap because the lawyer may advise a client on a return position. See id.
involves adversarial interaction with the government. In fact, there may be very little direct interaction with the government at all.\textsuperscript{30} This is what was intended under the voluntary compliance system of federal taxation.\textsuperscript{31} Indeed, the purpose of a return is to fulfill the taxpayer's legal obligation of disclosure, reporting, and self-assessment.\textsuperscript{32} Because relatively few returns are audited,\textsuperscript{33} the filing of a return cannot realistically be regarded as the first step in an adversarial proceeding.\textsuperscript{34} Even the ABA has admitted informally that until the taxpayer is audited, there is no

\begin{itemize}
  \item[30.] See id. at 657 ("Much federal tax practice does not involve appearances before the Service.").
  \item[31.] See id. at 647.
  \item[32.] See id. at 647-48 (discussing criticism of the ABA Tax Section's position that the filing of a return is the start of an adversarial process). Perhaps, in response to this criticism, the ABA appointed a special task force that issued a report interpreting Formal Opinion 85-352. This report attempted to soften the ABA's position:
  \begin{quote}
  The Opinion does not state that the general ethical guidelines governing advocacy in litigation are determinative, or suggest that tax returns are adversarial proceedings. To the contrary, a tax return initially serves a disclosure, reporting, and self-assessment function. It is the citizen's report to the government of his or her relevant activities for the year. The Opinion says that because some returns, particularly aggressive ones, may result in an adversary relationship, there is a place for consideration of the ethical considerations regarding advocacy. Thus, the Opinion blends the ethical guidelines governing advocacy with those applicable to advising, from which the new ethical standard is derived.
  
  \end{quote}
  \item[33.] The chances of being audited by the IRS continue to decline. In 1995 and 1996, only 1.67\% of individual income tax returns were audited. See Tom Herman, A Special Summary and Forecast of Federal and State Tax Developments, WALL ST. J., Aug. 12, 1998, at A1. In 1997, the percentage declined to 1.27\%. See id. For the 1998 fiscal year (ending September 30, 1998), the projected percentage was 1.09\%. See id. It should be noted, however, that the 1 to 1.6\% audit rate translates into around 1.9 million returns. See MARTIN KAPLAN & NAOMI WEISS, WHAT THE IRS DOES NOT WANT YOU TO KNOW 47 (5th ed. 1999). When the number of audited returns is considered, the audit risk becomes more daunting.
  
  In recently enacted legislation, Congress shifted the burden of proof to the IRS in civil court proceedings. See I.R.C. § 7491 (West Supp. 1999). One commentator postulates that there will be even fewer audits as a result of this legislation because the shift in the burden of proof probably will mean "more intrusive audits, increased use of the summons power, and more expansive discovery in litigation." Leandra Lederman, Unforeseen Consequences of the Burden of Proof Shift, 80 TAX NOTES 379, 382 (1998).
  \item[34.] See Matthew C. Ames, Formal Opinion 352: Professional Integrity and the Tax Audit Lottery, 1 GEO. J. LEGAL ETHICS 411, 414 n.29 (1987) (discussing the position of the ABA's Tax Section that the filing of a tax return should not be regarded as the start of an adversarial proceeding because (1) so few returns are audited that, in general, returns are rarely "subjected to adversarial review," and (2) it is merely the taxpayer's report to the government of financial transactions for that period, and regarding it as anything else undermines the self-assessment system).
\end{itemize}
adversarial relationship. But even if the client is audited, the relationship between the client (and, by extension, the lawyer) and the IRS is not necessarily adversarial, because the revenue agent is obligated to deal fairly with the taxpayer. It is only in the event that the IRS and the taxpayer disagree over a return position, or if the IRS suspects fraud, or if the revenue agent violates the IRS audit standards that the relationship becomes adversarial. Thus, it cannot be said that the nature of the relationship between the lawyer and the government is always adversarial; neither can it be said realistically that the relationship is generally adversarial. In fact, in comparatively few cases is there an adversarial relationship between the taxpayer (or his lawyer) and the IRS. Thus, the governing ethical standard should not be determined by the unusual case.

Critics further argue that the ABA’s position encourages the playing of the audit lottery, undermines the voluntary compliance system, and is thus detrimental both to society and to the legal profession. Most of these critics also admit that the lawyer’s duties are derivative of the client’s duties, and that the lawyer should not inject extraneous moralism into tax advice. Yet, tax law is extremely complex and subject to frequent change. There may be times when the resolution of a particular issue is not crystal clear and the lawyer may be called upon to make a decision that will involve an exercise of her independent judgment. Should the lawyer be required to disclose to the government weaknesses in her client’s position? Or does the duty of confidentiality control?

Critics aside, if we assume for the moment that the ABA had concluded that the IRS was not an adversarial party, and that it was a tribunal to which the special duty of disclosure applied, this would have created several problems for lawyers engaged in tax practice. First, as the ABA notes, the government does have a stake in the outcome of the

35. See Falk, supra note 21, at 644 n.4, 647 n.14 (discussing a proposed revision to Formal Opinion 314); see also Task Force Report, supra note 32, at 640 (reporting that the ABA Task Force backed away from the adversarial position). But see Steven C. Todrys, NYSBA Opposes Burden of Proof Shift, 79 TAX NOTES 125, 125 (1998) (stating that the result of the burden of proof shift under I.R.C. § 7491 is likely to be “more intrusive IRS audit procedures,” which will introduce an adversarial tone, or heighten the existing adversarial nature of the audit process “if the IRS concludes that numerous interviews of potential third-party witnesses are necessary to develop its affirmative case in the event of litigation”).

36. See Falk, supra note 21, at 647 & n.16.

37. See id. at 647-49; Handelman, supra note 21, at 93-94.

38. See Handelman, supra note 21, at 89 (“While the legal expertise provided may expand the client’s awareness of opportunities and constraints, the taxpayer’s rights and duties are neither expanded nor contracted by retaining a lawyer.”); James P. Holden, Constraining Aggressive Return Advice: A Commentary, 9 VA. TAX REV. 771, 772-73 (1990) (agreeing on this issue and replying in general to Professor Handelman).

controversy, and therefore is not as impartial as a judge would be.\footnote{See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 314 (1965).}

Second, occasions clearly arise in which the lawyer and the government are adversaries, such as in a court proceeding. There are other occasions, however, in which it may be difficult to determine whether the taxpayer or his lawyer-representative and the IRS are adversaries. For example, it may not always be clear at the outset whether an audit is routine, or whether it constitutes the beginning of a criminal investigation, which would herald the advent of an adversarial relationship between the taxpayer and his lawyer on the one side and the government on the other side. If the duty of disclosure is applied broadly, it would be difficult to effectively advise and represent a client who has committed tax fraud.\footnote{But see infra notes 163-65 and accompanying text (discussing duty of lawyer to be truthful in dealings with the government).}

At the very least, it would drive a wedge between the lawyer and her client if the lawyer is obligated to disclose the fraud to the government.

Third, because tax practice is a mixed-profession practice, it would mean that lawyers would be held to a higher ethical standard than other tax practitioners who are not subject to an additional disclosure requirement.\footnote{Although the Model Rules are merely a guide and thus do not control the conduct of practicing lawyers, they have been adopted in some form by most states, and they have been adopted in their entirety by the United States Tax Court. See Tax Court Rules of Procedure, Rule 201(a), 17 Stand. Fed. Tax Rep. (CCH) ¶ 42,361 (1999).}

Fourth, while the government may not be the formidable opponent it might at first blush appear to be\footnote{Indeed, the IRS has been referred to as a "paper tiger, not a leviathan the taxpayer should defeat by cunning." Falk, supra note 21, at 648.} (for instance, it is a well-known fact that the government lacks the resources to audit more than a small percentage of returns), nevertheless, it is not a helpless opponent either. The government brings considerable pressure to bear in influencing legislation when it perceives weaknesses in the laws, and the government uses these laws, as well as its own ethics rules, to ensure that tax practitioners conform to a standard of conduct that it finds acceptable.\footnote{So effective is the government in regulating the professional conduct of tax practitioners that no state bar association has ever disciplined a practitioner or even expressed concern over the conduct of a tax practitioner related to the quality of tax advice. See James P. Holden, Practitioners' Standard of Practice and the Taxpayer's Reporting Position, 20 CAP. U. L. REV. 327, 337 (1991).}

For example, in order to reduce the odds in favor of the taxpayer in the audit lottery, the Code requires both taxpayers and their return preparers to disclose aggressive return positions if these positions are not supported...
by substantial authority and lack a realistic possibility of success.\textsuperscript{45} If the position results in a substantial understatement of tax liability and the taxpayer fails to disclose the position, the IRS can impose a monetary penalty on both the taxpayer and the preparer.\textsuperscript{46} Return preparers may be subject to further disciplinary sanctions under Circular 230.\textsuperscript{47} These penalties and their potential effects are discussed in Part III below.

The preparers' understatement penalty raises a further potential problem if the ABA had concluded that a special disclosure duty was owed to the IRS: what weight should a state bar ethics committee give to an IRS conclusion that a lawyer is subject to the preparer penalty? Would the IRS determination and sanction alone subject the lawyer to discipline by the state ethics committee without further investigation? If so, the lawyer could be penalized for conduct that otherwise may not constitute an ethics violation in that particular jurisdiction;\textsuperscript{48} thus, there would be an ethics violation without fault. If not, and the investigation of the state bar ethics committee concludes that the lawyer did not violate the ethical duty to disclose, the civil preparer penalty would be undermined.

Thus, the position of the ABA, though flawed in its reasoning, perhaps represents a tacit acknowledgment of the problems that would have been raised had the ABA endorsed the government's disclosure requirement. If so, it is unfortunate that it was not more explicit in its reasoning. Instead, as critics have noted, the ABA appears to have

\textsuperscript{45} See I.R.C. §§ 6662 (taxpayer's penalty), 6694 (preparer's penalty) (1994). Section 6662 imposes a 20% penalty on any underpayment of tax liability to which the provision applies. See I.R.C. § 6662. The amount of this penalty is reduced by that portion of the understatement for which the taxpayer can demonstrate either substantial authority (defined under the regulations) or a reasonable basis for the position, provided that the position is adequately disclosed to the IRS. See id. § 6662(a), (d)(2).

\textsuperscript{46} The taxpayer's penalty is 20% of the underpayment (40% in the case of gross valuation overstatements). See id. § 6662(a), (h)(1). The penalty applies to returns that contain a substantial understatement of income tax. See id. § 6662(b)(2). A substantial understatement is defined as the greater of 10% of the tax required to be shown on the return, or $5000. See id. § 6662(d)(1). An understatement is defined as the excess of the amount of tax required to be shown on the return over the amount shown on the return, reduced by (1) the amount of any rebates and (2) the amount of the understatement for which there is either substantial authority or a reasonable basis for the tax treatment, provided that the position was adequately disclosed. See id. § 6662(d)(2).

The preparer's penalty is $250 per return or claim, and $1000 for a reckless or intentional disregard of the rules and regulations. See I.R.C. § 6694(a), (b). This amount is reduced by the portion of the understatement for which there is a realistic possibility of being sustained on the merits, or where the preparer can demonstrate reasonable cause for the understatement and that she acted in good faith. See id.

\textsuperscript{47} See 31 C.F.R. § 10.51(j) (1998) (describing disreputable conduct for which the practitioner may be disbarred or suspended from practice).

\textsuperscript{48} See Holden, supra note 44, at 37 (stating that no jurisdiction has penalized conduct or expressed concern in connection with the rendering of tax advice).
condoned playing the audit lottery, thereby sending the wrong message to the public in general and to the legal profession in particular.\textsuperscript{49}

B. The View of the Government

1. Return Preparers and the Duty to Disclose

ABA Formal Opinion 85-352\textsuperscript{50} applies to lawyers who prepare tax returns or render advice with respect to return positions.\textsuperscript{51} These lawyers, however, are subject to the provisions of Circular 230, as well as the civil penalty provisions of the Code,\textsuperscript{52} both of which conflict with the Formal Opinion on the issue of disclosure of aggressive return positions.

The Opinion permits a lawyer to recommend, without disclosure, return positions for which there is no substantial authority in support of the position, even if the lawyer believes the position probably will not prevail.\textsuperscript{53} The position cannot be frivolous, though, and the lawyer must have a good faith belief that the position is "warranted in existing law or can be supported by a good faith argument for an extension, modification

\textsuperscript{49} See Handelman, \textit{supra} note 21, at 95-96 (noting that failure to disclose an aggressive return position constitutes deception). As another commentator has stated: "By drawing from litigation standards, [Formal] Opinion 85-352 indicates to practitioners that a taxpayer's desire to test the bounds of what is legally permissible is of greater significance than the taxpayer's duty to file a true and correct return." Myron C. Grauer, \textit{What's Wrong With This Picture?: The Tension Between Analytical Premises and Appropriate Standards For Tax Practitioners}, 20 \textit{Cap. U. L. Rev.} 353, 363 (1991).


\textsuperscript{51} According to the Task Force Report, the scope of Formal Opinion 85-352 is to restate the lawyer's duty in advising a client as to positions that can be taken on a tax return. The same principles should apply to all aspects of tax practice to the extent tax return positions would be involved. For example, it should govern the lawyer's duty as to tax advice in the course of structuring transactions that will involve tax return positions, including tax advice in the course of preparing legal documents such as employee benefit trusts, wills, and business buy-sell agreements. However, Opinion 85-352 does not address a lawyer's duty and responsibilities in negotiation and settlement procedures with the Internal Revenue Service, which are the subject of discussion in Opinion 314, and which continue to be governed by Opinion 314. Nor does Opinion 85-352 address the lawyer's duties and responsibilities in tax litigation. \textit{Task Force Report, supra} note 32, at 636.

\textsuperscript{52} See, e.g., I.R.C. §§ 6695(a) (failure to furnish copy of return to taxpayer), 6695(b) (failure to sign return), 6695(c) (failure to show identification numbers), 6700 (promoting abusive tax shelters) (1994). According to two commentators, "the taxpayer and the IRS will remain opponents in an adversary proceeding in which penalties mark the borderline of acceptable taxpayer and tax practitioner behavior." William L. Raby & Burgess J.W. Raby, \textit{Facts Can Control in 'Substantial Authority' Cases}, 80 \textit{TAX NOTES} 1465, 1467 (1998).

The Opinion also requires some "realistic possibility of success if the matter is litigated." The Code contains a corresponding provision under which a civil penalty may be imposed on a return preparer who understates tax liability by recommending a return position that does not have a "realistic possibility of being sustained on its merits."

Violations of the Circular 230 provision that are attributable to willfulness, recklessness, or gross incompetence will subject the practitioner to "suspension or disbarment from practice before the Service." Infractions of the Code will result in a monetary penalty of $250 per return, increasing to $1000 per return for willful, reckless, or intentional understatements. While the amount of the nonwillful,

54. Id.
55. Id.
57. I.R.C. § 6694(a) (1994). An understatement is defined as "any understatement of the net amount payable with respect to any tax imposed . . . or any overstatement of the net amount creditable or refundable with respect to any such tax." Id. § 6694(c). This provision is intended to encompass negligent understatements that had previously been subject to penalty under I.R.C. § 6694. See H.R. 101-239, 101st Cong., 1st Sess. (1989). Note also that the understatement against which the penalty applies is not reduced by the amount of any carryback. See Treas. Reg. § 1.6694-1(c) (1992).
58. 31 C.F.R. § 10.34(b).
59. See I.R.C. § 6694(a); see also supra note 46 (discussing monetary penalties).
60. See I.R.C. § 6694(b). Under prior law, it was determined that a taxpayer could be liable for both the section 6694(a) and the section 6694(b) penalty concurrently if the government met its burden of proof with respect to both provisions. See Judisch v. U.S., 755 F.2d 823, 827-28 (11th Cir. 1985). Under current law, both penalties may apply, but if so, the section 6694(b) penalty is reduced by the amount of any section 6694(a) penalty imposed. See I.R.C. § 6694(b); Treas. Reg. § 1.6694-3(g) (1991).

Note that in a situation in which a new statute directly conflicts with a specific statement in the committee reports, a position in accordance with either the statute or the committee report would satisfy the realistic possibility of success standard, and thus the preparer would be absolved of a section 6694(a) penalty. See Treas. Reg. § 1.6694-3 (1991) (stating that such a position constitutes a disregard of a rule or regulation and must be disclosed in order to avoid the penalty). If the position is contrary to the statute, though, the position would subject the preparer to a section 6694(b) penalty unless it were adequately disclosed. See id.

In order to avoid section 6694(b) penalty, a preparer must prove (1) that no rule or regulation was recklessly or intentionally disregarded, (2) that any position contrary to a regulation represented a good faith challenge to the validity of the regulation, and (3) that disclosure was adequately made. See Treas. Reg. § 1.6694-3(f) (1991). However, a revenue ruling or other IRS announcement does not constitute a rule within the statutory sense, nor does it constitute a regulation, which is promulgated by the Treasury Department under the authority of Congress and thus has the cloak of
nonreckless understatement penalty may seem minor to those who are not representing clients pro bono, the problem is the correlation between the civil penalty and Circular 230. A preparer cannot afford very many of these civil penalties, even if they are the more minor variety, because that may establish a pattern of misconduct that, in turn, may attract the attention of the IRS Director of Practice. This could result in the imposition of more serious sanctions under Circular 230.

In order to be subject to the preparer penalty, the preparer must have known, or reasonably should have known, of the position being taken on the return. The definition of the term “realistic possibility” under both the Code and Circular 230 is consistent with the ABA definition: a one-in-three or greater chance of success on the merits, as determined by the reasonable and well-informed analysis of a person knowledgeable in the law. A revenue ruling merely represents the IRS viewpoint and has no other elevated status.

A preparer is not considered to have acted recklessly or intentionally if there is a realistic possibility of success for the position taken. But when the return position is contrary to a regulation, the position must be taken in good faith and must be disclosed, regardless of whether it has a realistic possibility of success. See Treas. Reg. § 1.6694-3(d) (1991) (stating that no disclosure required for challenge of a revenue ruling but disclosure is required for the challenge of a regulation.)

61. See 31 C.F.R. § 10.51(j). Note that this provision has been criticized on the ground that it is poor policy to impose a standard of professional responsibility in an area that should be left to the civil penalty provisions governing return preparers under the Code. See Handelman, supra note 21, at 84 n.43. The rationale behind the criticism is that the considerations between professional ethics and civil penalties are different. See id.

62. Compare 31 C.F.R. § 10.34(b) (“Only violations . . . that are willful, reckless, or as result of gross incompetence will subject a practitioner to suspension or disbarment from practice before the Service.”), with 31 C.F.R. § 10.51(j) (“A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence.”). Although Congress evidently intended the IRS to use its discretion and not refer these cases automatically to the Director of Practice, see H.R. 101-239, 101st Cong., 1st Sess. (1989), this does not appear to be the current policy of the IRS. See BERNARD WOLFMAN ET AL., ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE 53 (1995) (citing IRS Administration Manual).

tax law. Under both the Code and Circular 230, the taxpayer’s chances in the audit lottery may not be considered in this determination.

Both the civil penalty and the Circular 230 sanction may be avoided if the position is not frivolous (defined as “patently improper”), and is adequately disclosed on the return or claim. Thus a preparer may advise a position that does not have a realistic possibility of success if the position is not frivolous and it is adequately disclosed. Adequate disclosure means that the return or claim must be sufficient to alert the IRS to the position being taken. Thus, the position must be disclosed either on a Form 8275 (Disclosure Statement) attached to the return or on the return itself in accordance with the applicable forms and instructions.

---

64. See Treas. Reg. § 1.6694-2(b)(1) (as amended in 1991); 31 C.F.R. § 10.34(a)(4)(i); ABA Comm. on Ethics and Professional Responsibility, Formal Op. 85-352 (1985). In determining whether a position has a realistic possibility of success, the analysis and authorities considered in determining substantial authority under the taxpayer accuracy-related penalty (section 6662) may also be considered for purposes of the preparer penalty. See infra notes 85-113 and accompanying text. The preparer may not rely, however, on some types of authority regularly relied upon by practitioners, such as tax treatises, legal opinions, legal periodicals, or opinions of other tax professionals. See Treas. Reg. § 1.6662-4(d)(3)(iii) (1991). This means that the preparer may not advise a position that advocates a modification or reversal of existing law without disclosure because the position must be analyzed under the substantial authority standard. See Treas. Reg. § 1.6694-2(b)(1) (as amended in 1991) (containing preparer penalty provision which refers to the substantial authority standard); Treas. Reg. § 1.6662-4(d)(3) (1991) (delineating the substantial authority standard). Thus, the weight of authority supporting the treatment must be objectively substantial in relation to the weight of authorities supporting contrary treatment. See Treas. Reg. § 1.6694-2(b)(1); Treas. Reg. § 1.6662-4(d)(3) (1991); see also Gwen T. Handelman, Caring Reasonably, 20 CAP. U. L. REV. 345, 351 n.29 (1991) (discussing this point).

65. See Treas. Reg. § 1.6694-2(b)(1) (as amended in 1991); 31 C.F.R. § 10.34(a)(4)(i). But the chances of audit may be considered in advising a client of the duty to disclose an aggressive return position. See Holden, supra note 44, at 776 (replying to Professor Handelman).

66. See Treas. Reg. § 1.6694-2(c)(1), (2) (as amended in 1991); 31 C.F.R. § 10.34(a)(4)(ii). This definition also must be read in conjunction with the Model Rules, which provide that for a position to be nonfrivolous, there must be at least a “good faith argument for an extension, modification or a reversal of existing law.” MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.1 (1997).

67. See I.R.C. § 6694(a); 31 C.F.R. § 10.34(a)(1).


69. See Treas. Reg. § 1.6694-2(c)(1).

70. The type of disclosure required varies according to the status of the preparer and the type of penalty being imposed. If the individual is a signing preparer, the disclosure must be made on a Form 8275 Disclosure Statement (or an 8275-R if the position is contrary to a regulation) or on the return itself in accordance with IRS specifications. See Treas. Reg. § 1.6694-2(c)(3) (as amended in 1991); see also Rev. Proc. 97-56, 1997-52 I.R.B. 18 (stating that the disclosure on the return must be made in accordance with all applicable forms and instructions and the monetary amounts must be verifiable). If the position being asserted is contrary to a rule or regulation, so that the penalty under section 6694(b) might apply, disclosure must be made on a disclosure statement (Form 8275 or 8275-R) attached to the return. See Treas. Reg. § 1.6694-3(e) (1991). In addition, the disclosure must be
The imposition of the preparer penalty does not necessarily involve the physical filing of a return or refund claim, nor does it necessarily require the individual to sign the return or claim as a preparer. If an individual renders advice for compensation that constitutes a substantial portion of a return or claim for refund, that individual may be considered a return preparer under the Code and the corresponding regulations.71

An attorney is deemed a return preparer if the attorney furnishes sufficient advice on a specific issue to either the taxpayer or to another preparer, so that completion of the return is "largely a mechanical or clerical matter."72 The information or advice must be directly relevant to the determination of the existence, characterization, or amount of an entry on a return or refund claim,73 and it must relate to a completed, as opposed to a contemplated, transaction.74 For example, if an attorney advises a partnership on the deductibility of expenses, and the attorney prepares the partnership information return to the IRS, as well as the K-1's to the partners in accordance with the advice given, the attorney may unwittingly be considered a return preparer, not only with respect to the partnership but also with respect to the partners.75 Thus, lawyers who

---

72. Treas. Reg. § 301.7701-15(a)(1) (as amended in 1980). The advice must constitute all or a substantial portion of the return or refund claim. Substantiality is defined as length, complexity, amount of tax liability or refund involved in that portion of the return compared to the return as a whole. See id. § 301.7701-15(b)(1).
73. See id. § 301.7701-15(b)(1).
74. See id. § 301.7701-15(a)(2)(i).
75. See Goulding v. United States, 957 F.2d 1420, 1428 (7th Cir. 1992) (holding that payment by partnership was imputed to partners through their capital contributions). Note also that firms that prepare and sell computer programs to tax practitioners or to taxpayers may be considered return preparers if the program goes beyond mere mechanical assistance. See Rev. Rul. 85-187, 1985-2
render tax opinions are susceptible to the preparer penalty for substantial understatement of tax liability if the opinions pertain to matters likely to constitute a substantial portion of a tax return.

The realistic possibility standard also raises several problems for return preparers. First, while some standards are easy to quantify, this one is not. For instance, can one feasibly differentiate between a 10% and a 33.33% chance of success, or between a one-in-three and a one-in-four chance of success? Also, what is the measure of success? The government's predictive standard of requiring a preparer to guess what a court would do has been soundly criticized for exposing the preparer to a potentially serious sanction for what could be a lawful position, albeit one that might lack a realistic possibility of success.

Moreover, what constitutes success in litigation? It could take years before the conclusion of the appellate process. Although the understatement penalty may be imposed regardless of whether a final appeal has been concluded, and should be abated if the preparer ultimately prevails, nevertheless, in the meantime the imposition of the penalty could make the preparer overly risk averse. Also, in determining the possibility of success, the fact that the highest court has rendered a decision contrary to the position taken on the return is not necessarily conclusive of a lack of a realistic possibility of success because even the United States Supreme Court may subsequently reverse itself. Thus, the ABA has taken the view that the realistic possibility of success standard does not mean that the lawyer must necessarily believe that the position will prevail. Although this view has been criticized, it is, nonetheless,
consistent with the one-in-three standard as defined in the regulations. If a position has a one-in-three chance of success, by definition it can have a less than 50 percent chance of success. But the fact that the minimum standard could support a position that has a less than 50 percent chance of success should not be an argument in favor of either the routine application of the minimum standard or its being used to support positions that otherwise have no realistic possibility of success at all. Instead, the flexibility of the standard should be used—as it was intended—to advance positions that the lawyer believes "can be supported by a good faith argument for an extension, modification or reversal of existing law."82

A second problem lies with the amnesty disclosure provision because the taxpayer is permitted to litigate questionable positions in the United States Tax Court prior to payment of the tax liability. While this does not mean that the taxpayer is entitled to play the audit lottery in advancing any colorable claim without some disclosure, the type of disclosure required by the government could constitute an admission against the interest of the client because the purpose of the disclosure is to notify the government that, in the preparer's opinion, the position does not have a realistic possibility of success.83 This could prejudice the client in any subsequent litigation on the merits of the position.84

2. The Taxpayer's Accuracy-Related Understatement Penalty

Another problem raised by the issue of disclosure is that a comparable understatement penalty applies to the taxpayer-client,85 and the interrelationship of that penalty and the preparer penalty may create a conflict of interest between the preparer and her client. The primary problem lies with the standard of disclosure, which may vary between the two penalties.

The taxpayer has three opportunities to avoid the understatement penalty. These opportunities correspond roughly to the preparer's avoidance opportunities. First, the penalty does not apply to taxpayer positions for which there is "substantial authority,"86 as defined under the

81. See Handelman, supra note 21, at 95 (stating that the ABA position "condones deception" and "violates the lawyer's duty of candor").
83. See Handelman, supra note 21, at 98 (arguing that disclosure, in this context, would amount to "a virtual concession on the merits").
84. See id.
85. See I.R.C. § 6662 (1994) (accuracy-related, substantial understatement penalty). Note that the IRS has the burden of proving the liability of an individual taxpayer for the penalty and any additions to tax. See I.R.C. § 7491(c) (West Supp. 1998).
regulations. In general, the substantial authority standard corresponds to the preparer's realistic possibility standard. Because recent cases define substantial authority to include substantial factual evidence, however, such evidence may enable a taxpayer to avoid the substantial understatement penalty even though this evidence alone would not be substantial enough to enable the taxpayer to succeed on the merits. Thus, a taxpayer relying solely on factual evidence may not prevail on the merits, but otherwise may satisfy the substantial authority standard, thereby avoiding the understatement penalty. Because the preparer's standard is based on the success of the merits of the position, there may be a gap between the preparer's standard and the taxpayer's standard.

Second, the penalty does not apply if the taxpayer has a reasonable basis for the position and there is adequate disclosure. As a general rule, the lawyer's duty and the client's duty will be compatible because the lawyer and the client will share a common goal—the avoidance of the understatement penalty. A problem arises, however, when the practitio-

87. See Treas. Reg. § 1.6662-4(d)(2) (1991) (discussing substantial authority standard); see also Raby & Raby, supra note 52, at 1465 (stating that evidentiary authority that is substantial relative to contrary evidence may be sufficient to avoid a substantial understatement penalty, even though such evidence is not sufficient to support the substantive issue that gave rise to the understatement).

88. See Treas. Reg. § 1.6694-2(b)(4)(as amended in 1991); see also Deborah H. Schenk, Conflicts Between the Tax Lawyer and the Client: Vignettes in the Law Office, 20 CAP. U. L. REV. 387, 405 n.68 (1991) (stating that it is unlikely that there were would be substantial authority if the lawyer thought there was not a realistic possibility of success on the merits, and that about the only way this could occur is when there is a difference of opinion between the lawyer and the client as to whether there is substantial authority).

89. See Kluener v. Commissioner, 154 F.3d 630, 638-39 (6th Cir. 1998) (stating that authority includes factual as well as legal authority); Streber v. Commissioner, 138 F.3d 216, 223 (5th Cir. 1998) (stating that the substantial understatement penalty may be avoided by factual evidence that is substantial); see also Osteen v. Commissioner, 62 F.3d 356, 359 (11th Cir. 1995) ("Only if there was a record upon which the Government could obtain a reversal under the clearly erroneous standard could it be argued that from an evidentiary standpoint, there was not substantial authority for the taxpayer's position.").

90. This view is apparently not shared by William and Burgess Raby, who note in their recent article that "[a]s a result of these cases there will be more situations than before when practitioners can in good conscience answer 'no' to the checklist query about whether it will be necessary to file a Form 8275 with the return." Raby & Raby, supra note 52, at 1468. The two standards, however, are different because the practitioner standard is based on a "realistic possibility of being sustained on the merits," whereas the taxpayer's standard, as interpreted by the recent cases, does not look to the merits of the substantive case, but merely to whether or not there is substantial authority sufficient to avoid the understatement penalty. Kluener, 154 F.3d at 637. Thus, an appellate court may review de novo a trial court's evaluation of the law and application of that law to the relevant facts. See id.

91. See I.R.C. § 6662(d)(2)(B)(ii) (1994). An exception applies to tax shelters, for which there is a higher standard. If a position with respect to a tax shelter lacks substantial authority, the understatement penalty applies regardless of disclosure. See id. § 6662(d)(2)(C). Moreover, even if the position has substantial authority, the taxpayer must have reasonably believed that the position was more likely than not proper. See id.
ner determines that disclosure is in her best interest but the client does not wish to disclose. This creates a clear conflict of interest in which the lawyer may no longer be able to represent her client competently.92

If disclosure is not in the client's best interest, the client-taxpayer may be disadvantaged by seeking the advice of a professional. If the taxpayer would not otherwise have had to disclose the position because it satisfies the reasonable basis standard, and the taxpayer chooses not to disclose contrary to the advice of the attorney-advisor, the taxpayer will no longer have a reasonable cause and good faith defense to the understatement penalty because the failure to disclose will be contrary to the advice of the advisor. Moreover, if the taxpayer chooses to litigate the merits of the position in the United States Tax Court and the attorney's opinion that the decision lacked a realistic possibility of success prejudices the taxpayer's case, this in itself could constitute a violation of the Model Rule against conflicts of interest.93

In practice, it is seldom feasible to render an opinion stating that a position has a one-in-three, as opposed to a one-in-four, chance of success.94 In between the sure losers (no reasonable basis) and the sure winners, there is a vast gray area of uncertainty. If the lawyer thinks the undisclosed position falls short of the one-in-three standard but above the reasonable basis standard, can the client feasibly expect unbiased advice from his lawyer? Does the use of a professional preparer, whether a lawyer, accountant, or commercial tax preparation service, automatically subject the client-taxpayer to the higher standard?

Because it is often difficult to determine with any degree of certainty whether the realistic possibility standard has been met, adequate disclosure provides a safe harbor for both the preparer and the taxpayer to avoid the understatement penalty. Thus, even if a preparer thinks the return position is reasonable, she may favor disclosure nonetheless to avoid the understatement penalty. Furthermore, if a preparer has previously been subject to an understatement penalty, she might now be "gun-shy" or overly risk averse and thus inclined to urge disclosure of any questionable position, regardless of whether she believes that it has a realistic possibility of success.95 Such action might not be in the client's best interest because the disclosure is likely to increase the risk

92. See generally Schenck, supra note 88, at 419.
93. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (1997). For a discussion of the application of the attorney-client privilege in this context, see infra text accompanying notes 216-44.
94. See Schenck, supra note 88, at 392 n.24, 405.
95. This is not an idle concern. If the IRS suspects that an individual preparer's noncompliance is widespread, it may recommend "program action" under which the returns all of the preparer's clients may be examined. See WOLFMAN ET AL., supra note 62, at 49 (citing Internal Revenue Audit Manual).
of an audit, and if the taxpayer has to defend the position in court, the cost of the defense could be considerable. Thus, the interests of the client and the attorney-preparer could further conflict.

If so, there are several things to bear in mind. First and foremost, only the client can make the ultimate decision to disclose. If the client does not wish to disclose the position, the lawyer may not ethically continue to recommend disclosure without revealing her own conflict of interest. If the client's position falls into the gray area of uncertainty as to whether there is a one-in-three chance of success, the client's decision not to disclose should not be affected by the preparer's penalty, particularly if the preparer is subject to a higher standard. The lawyer's primary duty is owed to the client. As a return preparer, the lawyer should not put her own interests above the client's, even though the lawyer may feel that she cannot legally or ethically sign the client's return.

If the preparer signs the return, she might find herself subject to an understatement penalty, even though the client is not subject to a comparable penalty. On the one hand, it is both poor policy and patently unfair to subject a preparer to a penalty for recommending a position that the client is legally and ethically entitled to take. On the other hand, the complexities of the tax law make it extremely difficult for the average layperson to determine whether there is a reasonable basis for every position, and often impossible to determine whether there is substantial authority for a return position. Return preparers, therefore, should be held to a higher standard, at least in this case.

In addition to the lawyer's duties to the government that are derivative of the client's duties, the lawyer owes the government a separate duty not to misrepresent a return position as being stronger than the lawyer thinks it is. Because so few returns are audited, this would undermine the self-assessment system. This duty, however, is a legal duty. If the lawyer recommends such a position, she would be violating the Code as well as Circular 230. But if the lawyer thinks the client has a reasonable basis for the position, even though technically there might not be a realistic possibility of success on the merits if the position were litigated, the client is legally and ethically entitled to assert the position without disclosure.

---

96. See I.R.C. § 6662(d)(2)(B)(i) (1994) (stating that the taxpayer understatement penalty may be avoided with substantial authority). The problem is that the authority must be substantial, which is a more stringent standard than the reasonable basis standard. See Treas. Reg. § 1.6662-4(d)(2) (1998). This standard is met if the weight of authority supporting the position is substantial with respect to the weight of authority supporting contrary treatment. See Treas. Reg. § 1.6662-4(d)(3)(i). Most laypersons are not competent to make this determination. For example, most laypersons are clueless as to the weight that should be accorded a proposed regulation as compared to a private letter ruling.
The question then is what is the lawyer’s duty? Clearly, the lawyer may not reveal the position without the client’s consent. The lawyer may then be in a situation in which the client’s position is lawful. Although, the client is legally and ethically entitled to take the position without disclosure, the lawyer is obligated either to reveal the position or refuse to sign the return, provided the lawyer is otherwise the signing preparer under both the Code and Circular 230.

If the lawyer thinks it might be a close question as to whether the position has a realistic possibility of success, and the client will not authorize disclosure after being informed of the possible consequences, the lawyer should then sign the return (if, indeed the lawyer is otherwise the signing preparer). Close questions should generally be resolved in favor of the client, although the lawyer should protect herself by making and retaining copious notes detailing the advice given to the client. If, on the other hand, the lawyer believes that the position is not frivolous but there clearly is no realistic possibility of success on the merits, the lawyer’s advice on the position and her signature on the return without disclosure would constitute a misrepresentation. In this case, the lawyer should not sign the return because she is legally and ethically prohibited from doing so under the Code and Circular 230. Note, however, that the client legally may be entitled to take the position without disclosure, and thus the difference between the standards of the preparer and the standards of the taxpayer-client creates a clear and unresolvable conflict.

The next question, then, is whether the lawyer should continue to represent the client. The answer depends upon whether the understatement penalty creates a normative standard of conduct for taxpayers or whether, as one commentator has stated, it constitutes the price of an exercise of a free choice under the applicable law. As long as the position taken is not frivolous, the lawyer does not necessarily have to withdraw from representation, although the lawyer may not have that choice because the client may no longer wish to have the lawyer represent him. If, however, the client does wish to have the lawyer continue the representa-

---

97. This can occur, for example, when the position presents a novel question of law, or when the position will involve arguing for a change in or modification to the existing law. When all is said and done, the only quantification that the preparer can generally make is a guess as to whether “the position flies or does not fly.” Schenk, supra note 88, at 392-93 n.24.

98. See 31 C.F.R. § 10.34(a)(2) (1998) (stating that the practitioner must advise client of potential penalties for failure to disclose and of opportunities to avoid the penalties).


100. The lawyer, however, may do so if she chooses. See Schenk, supra note 88, at 403-04 n.61 (stating that as long as the withdrawal does not adversely affect the client, both the Model Rules and the Model Code permit the lawyer to withdraw from employment on the ground that she does not approve of the client’s actions).
tion, the lawyer should note that continued representation of the client has become much more complex because the client has demonstrated a willingness to take a risky return position. Therefore, the lawyer may have a greater duty of inquiry if she continues to represent the client. Moreover, if the return position could affect other items on that return, or if it could affect the tax treatment of items in other taxable years, the lawyer's continued representation might compromise the client if the client is audited because the lawyer, if asked directly, would have to reveal the fact that she had advised the client that the position lacked a realistic possibility of success if litigated.

The third opportunity to avoid the substantial understatement penalty is through proof that the position has a reasonable basis and that the taxpayer acted with reasonable cause and in good faith, even though there is no substantial authority for the position and no disclosure was made. According to the regulations, reasonable cause is a facts and circumstances determination to be made on a case-by-case basis. The most important factor is the extent of the taxpayer's effort to assess the proper tax liability. Reliance on the advice of a professional can constitute reasonable cause, provided the taxpayer reasonably relied on the advice.

101. See 31 C.F.R. § 10.34(a)(3) ("[The] practitioner may not ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent, or incomplete.").

102. See infra text accompanying notes 210-15.

103. See I.R.C. § 6664(c) (1994). This was the standard used for negligence under the prior law. See Holden, supra note 44, at 332-34 (discussing whether the accuracy-related penalties establish a normative standard of conduct). Negligence is now an accuracy-related penalty under section 6662(b)(1), subject to the reasonable cause exception under section 6664(c). See I.R.C. §§ 6662(b)(1), 6664(c).

104. See Treas. Reg. § 1.6664-4(b) (as amended in 1995).

105. See id. In judging the extent of the taxpayer's efforts to comply, the IRS will examine the reason for noncompliance, the taxpayer's previous compliance history, and the length of time the taxpayer took to subsequently comply, as well as whether any noncompliance was due to circumstances beyond the taxpayer's control. See INTERNAL REVENUE MANUAL ¶ (20)132.4 (1996) [hereinafter HANDBOOK].

106. See, e.g., United States v. Boyle, 469 U.S. 241, 251 (1985) (stating that good faith reliance on the advice of an attorney is, under certain circumstances, a defense to underpayment of income tax); Betson v. Commissioner, 802 F.2d 365, 372 (9th Cir. 1986) (reversing negligence penalty because court determined that taxpayer had relied in good faith on the advice of an accountant).

There are two minimum prerequisites for reliance on a tax advisor to be considered reasonable cause. First, the advice must be based on all the relevant facts and circumstances and on the law as it relates to those facts and circumstances. See HANDBOOK, supra note 105, ¶ (20)133.54. The taxpayer also must have made full disclosure to the advisor. See id. Second, the advice must be based on reasonable factual or legal assumptions, and the advisor must be competent. See id. Although the Handbook does not so state, the taxpayer also must have followed the advice. See Treas. Reg. § 1.6664-4(b)(1) (as amended in 1995) ("Reliance on . . . professional advice . . . constitutes reasonable cause and good faith if, under all the circumstances, such reliance was..."
The problem, however, is that this defense may jeopardize the advisor, who may find herself subject to a preparer penalty.107

Clearly, the reasonable cause and good faith defense cannot apply to a frivolous position. Therefore, the taxpayer’s accuracy standard is a “reasonable basis” for the position.108 This seems to fall somewhere below the realistic possibility standard (one-in-three chance of success) of the preparer.109 If this is the case, it is yet another conflict between the taxpayer’s and the practitioner’s reporting standards. If the return position passes the lower reasonable basis standard but not the greater realistic possibility standard, the client who relies on the advice of a professional and does not disclose the position would be protected because the advice of the tax advisor would constitute a defense to the penalty. The preparer, however, would have no defense and would be subject to the preparer penalty unless the position is disclosed. Moreover, Circular 230 prohibits the preparer from signing the return without disclosure.110 Thus, the preparer may be subject to a civil penalty under the Code, as well as a sanction from the Director of Practice under Circular 230.111

If the lawyer’s duty to the government is derivative of the client’s duty, why should the lawyer owe a greater ethical duty to the government than the client owes? One reason is that the advisor or return preparer, by virtue of being an expert in tax matters, is held to a higher standard of knowledge than the lay taxpayer in order to preserve the integrity of the self-assessment system. If this were not the case, taxpayers would feel freer than they already do to search with impunity for the advice they want to hear and perhaps the defense that, no matter how spurious the reasonable and the taxpayer acted in good faith.”).

107. See Raby & Raby, supra note 52, at 1465; see also infra note 233 and accompanying text (discussing effect of advice of counsel defense on attorney-client privilege).

108. See Holden, supra note 44, at 332-35 (discussing the rationale behind the standard).

109. See Treas. Reg. § 1.6662-3(b)(3)(ii) (as amended in 1995) (defining reasonable basis as a relatively high standard of tax reporting that is “significantly higher than the not frivolous standard”). The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in Treas. Reg. § 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities and subsequent developments), the return position generally will satisfy the reasonable basis standard, even though it may not satisfy the substantial authority standard as defined in Treas. Reg. § 1.6662-4(d)(2). See Treas. Reg. § 1.6662-4 (as amended in 1995). In addition, the reasonable cause and good faith exception, as set forth in Treas. Reg. § 1.6664-4, may provide relief from the penalty, even if a return position does not satisfy the reasonable basis standard. See Handelman, supra note 21, at 88 n.59 (noting that the “realistic possibility of success” standard is widely regarded as higher than the ‘reasonable basis’ standard”); Holden, supra note 44, at 771-72 (charting the various standards).


111. See I.R.C. § 6694(a); 31 C.F.R. §§ 10.34(b), 10.52.
advice, they nevertheless acted with reasonable cause and in good faith in relying upon the advice of this professional. The IRS would then have to beef up its audit procedures in order to police this type of activity. More resources would have to be allocated to the IRS to increase and train its personnel in order to level the audit lottery playing field. But this would involve greater government intrusion into the lives of the citizens and higher taxes from the citizenry to pay for the intrusion—a politically unfeasible idea.

While the foregoing may suggest that the lawyer has a duty to the revenue system, the lawyer has no such discrete duty. First, the higher standard of the advisor or preparer is imposed upon lawyers and others who prepare returns and are admitted to practice before the IRS. 112 Therefore, lawyers owe no discrete duty to the government, but, rather, they share any duty with other professionals. Second, because the preparer’s standard is set forth in both the Code and Circular 230 with potentially severe penalties for violations, the lawyer owes no separate duty to the government beyond simply to obey the rules. 113

3. Ethical Standards and Mistake

If the taxpayer has made a mistake on a return that has been previously filed, the preparer must advise the taxpayer to disclose the error to the government and also must advise the taxpayer of any penalties that may be imposed for failure to disclose. 114 If the error was innocent and will not affect other taxable years, the preparer has no further obligation. 115 If the error was not innocent, it may constitute tax fraud, which is discussed below. If, however, the error was innocently made but would affect other taxable years, or the mistake was made by the preparer instead of the taxpayer and the taxpayer refuses to permit the preparer to disclose the error, the preparer must withdraw from further representation. Otherwise, the preparer may have participated, or be deemed to have participated, in giving misleading information to the government. This would constitute disreputable conduct under Circular 230, 116 which could subject the preparer to sanctions. 117 In general, a lawyer or preparer is

112. See discussion supra note 7.
113. See 31 C.F.R. § 10.34(a)(2).
114. See id.
115. But see infra text accompanying notes 210-11 (noting that an attorney must be careful in representing the client at an audit).
116. See 31 C.F.R. § 10.51(b) (stating that facts contained in federal tax returns may constitute information, which, if the preparer knows the information to be false or misleading, may subject the preparer to penalty).
117. It also might subject the preparer to other penalties under the Code. See I.R.C. § 6701 (1994) (aiding and abetting); I.R.C. § 7206(2) (1994) (aiding or assisting in a false return).
not permitted ethically to reveal the error to the government without the client’s permission because of the duty of confidentiality owed to the client under lawyers’ rules of professional responsibility.¹¹⁸

A long-standing, unresolved ethical problem arises when an IRS agent makes a mistake in favor of a taxpayer. Does the lawyer have a duty to disclose the error to the IRS or is the lawyer prohibited from disclosing by virtue of the duty of confidentiality? In order to analyze this problem, it is first necessary to determine to whom the lawyer owes the primary duty—the tax system in general, the government in particular, or the client? Then, it is necessary to reduce the problem to its underlying context. The issue arises in connection with four potential mistakes: (1) a math error, (2) a mistake of law, (3) a mistake of fact where the agent misstates the facts, and (4) a mistake of fact where the agent correctly states the facts but misinterprets them. Finally, it is necessary to determine which rules of ethics apply.

a. The Primary Duty

If the lawyer’s primary duty is to “protect the revenue,”¹¹⁹ the answer is simple: the lawyer must always reveal to the government any error that would be adverse to the treasury. Similarly, if the primary duty is owed to the tax system, to ensure that the system is “functioning honestly, fairly and smoothly,”¹²⁰ the lawyer would be obligated to disclose the error because otherwise the taxpayer would profit wrongfully at the expense of the government. This, however, raises an obvious problem. Under the ABA’s view, the government is an adversary and the lawyer is the representative of the client.¹²¹ If the lawyer’s primary duty is to consider the effect on the treasury or the smooth functioning of the tax system or both above all other considerations, the lawyer cannot effectively represent her client in an adversarial proceeding with the government.

If, on the other hand, the lawyer’s primary duty is to the client, the lawyer may not be able to reveal the error without the client’s permission because the duty of confidentiality may control.¹²² This enables the

¹¹⁸. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1997) (stating that a lawyer shall not reveal information relating to the representation of a client unless the client consents). A way around the problem of disclosure is an advance agreement with the client that all material errors relevant to the issues in question (whether audit or administrative appeal) are to be disclosed. See Frederic G. Comel, The Service and the Private Practitioner: Face to Face and Hand in Hand—A Private Practitioner’s View, 11 AM. J. TAX POL’LY 343, 349-50 (1994) (discussing this issue).
¹¹⁹. See supra note 14 and accompanying text.
¹²⁰. See supra note 16 and accompanying text.
¹²¹. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1997).
¹²². See id.
lawyer to function as an effective advocate for the client. The question becomes whether the duty of confidentiality always controls or whether there are instances in which the lawyer can and should reveal the error. If so, must the lawyer first consult with the client? What if the client directs the lawyer not to reveal the error—may (or must) the lawyer do so anyway?

If the failure to reveal the error constitutes fraud or misrepresentation on the part of the lawyer, the lawyer must either persuade the client to allow the error to be revealed, or the lawyer must withdraw from representing the client. The lawyer is ethically required to do so under the Model Rules.123 The Model Rules also require a lawyer to be truthful when dealing with others on a client’s behalf, but the lawyer generally “has no affirmative duty to inform an opposing party of relevant facts.”124 A failure to act, however, may constitute a misrepresentation.125 Thus, the lawyer must balance the duty of confidentiality to the client with the duty of truthfulness and fairness to third parties.

i. Mathematical Error

When the problem of the error is analyzed in more depth, the issues may change and the results may vary. Consider, for instance, a math error. There are several general ways in which such an error may arise. One is in an oral or face-to-face consultation with an IRS agent, as in an office or field audit. There are several reasons why this type of consultation is very different from written correspondence. First, because of the give and take between the parties, it may be much easier for the lawyer’s silence to mislead the agent. If the lawyer has an affirmative duty to correct the agent’s error, her failure to do so may make her a party to the error. If so, this would constitute disreputable conduct that could subject her to sanction under Circular 230126 and perhaps under the

123. See id. Rule 1.2(d) (“A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . . .”); id. Rule 1.16 (a)(1) (stating that the lawyer must withdraw from representation if continued representation would “result in a violation of the rules of professional conduct or other law”). But see infra notes 208-10 and accompanying text (discussing the “noisy withdrawal”).
125. See id.
126. See 31 C.F.R. § 10.51(b) (stating that giving false or misleading information to a Treasury employee is disreputable conduct); 31 C.F.R. § 10.51(j) (defining reckless conduct as “a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances”).
Model Rules as well. Second, because of the nature of an oral or face-to-face consultation, the lawyer may be required to make split-second decisions in which there may be no time to consult with the client. Therefore, the lawyer may have to use her own judgment, taking a variety of factors into account. Third, in connection with a lawyer’s representation of a client before the IRS, it is important that the lawyer gain the trust and respect of the revenue agent. Even if the lawyer’s silence is not egregious enough to subject her to direct sanctions, the agent may think that the lawyer is untrustworthy, and thus, would be less inclined to deal favorably with the lawyer and her clients from that point on. This could jeopardize not only the client in question, but also the lawyer’s other clients as well. Moreover, the agent may think that the lawyer’s silence is suspicious or that she is attempting to conceal information with respect to this particular client. The agent may then decide that a more in-depth audit is warranted. Thus, it is advantageous to all the parties for the lawyer to correct the error, and the lawyer should not need the permission of the client to do so.

This type of error, a mistake of the revenue agent favorable to the taxpayer-client, should not be protected by an ethical duty of confidentiality. It is not information adverse to the client because the client was never legally entitled to benefit from the error. Instead, it should be regarded as information impliedly authorized to be revealed in order to ensure effective representation of this client and other clients.

When the error arises in a written correspondence or on a tax return, the issue is trickier because there is usually ample time to consult with the client. Furthermore, if the examination or negotiations have been reduced to writing, they are likely to be at a more advanced stage than they would be in an oral consultation, leaving the client with more at stake. In general, unless the error is minor enough to be considered a scrivener’s error, the lawyer cannot reveal the error without the client’s

127. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 cmt. (1997) (“A misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false. Misrepresentations can also occur by failure to act.”). If the lawyer’s affirmative duty is great enough, her nonfeasance may result in civil liability under the Code. See I.R.C. § 6701 (1994) (aiding and abetting the understatement of tax liability).
128. Note that the ABA informally takes the position that a mere scrivener’s error is not subject to the duty of confidentiality. See ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1518 (1986) (stating that “scrivener’s error” may be revealed to opponent without client’s consent; if client is consulted and refuses to authorize disclosure, lawyer may be involved in fraud).
129. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(a) (1997) (stating that permission to disclose is implied when necessary to effectively represent the client).
express permission. But mathematical errors may vary in degree and documents may vary in importance. These factors could have a bearing on the lawyer's duty. For example, if at the conclusion of an income tax audit or an administrative appeal the taxpayer and the government are in agreement or partial agreement on the adjustments to be made, there are three general types of forms that the government may use to finalize the agreement.

The first type is the Form 870, which waives the statutory restrictions on the government's ability to assess an income tax deficiency. Form 870 is routinely used at the conclusion of an income tax audit and may also be used at the conclusion of an administrative appeal. Although Form 870 usually signals the final disposition of a case, it does not prevent either party from subsequently contesting previously agreed upon issues. For instance, the government subsequently may assert an additional deficiency and the taxpayer subsequently may file a suit for refund. Thus, except for the waiver of the statutory notice of deficiency, Form 870 does not purport to be a binding agreement between the parties.

Because Form 870 is not binding, the lawyer should have more freedom to reveal any mathematical error of the revenue agent in the underlying agreement without prior consultation with the client because the client will still be vulnerable until the close of the statute of limitations. By revealing the error, the lawyer establishes trust with the agent (a valuable asset) and ultimately provides better protection and representation of the client. Furthermore, because the agreement is not binding, the government may raise the issue of the error at any time.

131. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(a) (stating that a lawyer cannot reveal a client confidence without the permission of the client).

132. Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment, Form 870 (1997). This waiver is authorized by I.R.C. § 6213(d) (1994). After Form 870 is signed by the taxpayer, the government may immediately assess the tax liability without having to send a statutory notice of deficiency and without having to observe the statutory 90-day waiting period. See I.R.C. § 6213(a) (1994) (listing restrictions on assessment and petition to Tax Court). The taxpayer is foreclosed from petitioning the Tax Court to redetermine the deficiency because a statutory notice of deficiency (also called a "90-day letter") is a prerequisite to Tax Court jurisdiction. See id. Another effect of Form 870 is that it stops the running of interest after 30 days from the filing of the waiver unless, within that period, the IRS has issued a notice and demand for payment of the assessed tax liability. See I.R.C. § 6601(c) (1994).

133. A similar form may be used for other tax liabilities. For example, a Form 890 may be used to consent to estate and gift tax assessments without a deficiency notice.

134. See Joyce v. Gentsch, 141 F.2d 891, 895 (6th Cir. 1944) ("The instrument in terms did not even purport to bind the Government."); see also Maloney v. Commissioner, 86 T.C.M. (P-H) 367 (1986) (holding that the Commissioner could issue a notice of deficiency after the Form 870 had been executed because there was no binding closing agreement in effect).
before the expiration of the statute of limitations.135 Thus, neither the agreement nor any subsequent assessment pursuant to the agreement can be considered final until the expiration of the statutory period.

The second type of form commonly used by the IRS is Form 870-AD,136 which finalizes the agreement between the government and the taxpayer at the conclusion of an income tax appeal in which mutual concessions are made in settlement of the case.137 In this type of settlement, both parties typically have relatively strong positions, and there is substantial uncertainty on both sides about the outcome if the case should proceed to court. Understandably, neither the taxpayer nor the government is willing to fully concede the disputed issues. Thus, each party makes concessions based on the relative strength of their position, and a settlement is reached.

Form 870-AD, unlike Form 870, is effective only when it is accepted by the government.138 The taxpayer agrees to the terms of the settlement and waives the statutory limitations on assessment and collection (the statutory notice of deficiency).139 The government also agrees not to reopen the case absent "fraud, malfeasance, concealment, or misrepresentation of a material fact, [or] an important mistake in mathematical calculations."140

What constitutes an "important" mathematical mistake? Because IRS materials do not define the term, it is presumed that the rules of contract (or on occasion, criminal) law apply. If so, the agreement may be voided if the mistake adversely affects the agreement between the parties. Thus, a case may be reopened, even though a small amount of tax liability is at issue, if the amount represents a large percentage of the settlement agreed upon in Form 870-AD. But the term "important mistake" is a subjective one, and thus may be subject to varying interpretations. The

135. The general statute of limitations is three years from the later of the due date of the return or the date the return was actually filed. See I.R.C. § 6501(c) (1994). When a tax liability is paid after the return is filed (or if no return is filed but a liability is paid), the statutory period is two years from the date of payment (for purposes of a refund if no return was filed), if that period is greater than the general three year period. See id. If no return is filed or if there is fraud on a filed return, the statute never runs and the liability can always be assessed. See I.R.C. § 6501(c)(1). If there is a substantial omission of an item of income greater than 25% of the gross income required to be shown on the return, the general statutory period is extended to six years. See I.R.C. § 6501(e).
136. Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment, Form 870-AD (1997). Like the Form 870, the Form 870-AD is authorized by I.R.C. § 6213(d) (1994).
137. Similar forms are used for other types of taxes, such as a Form 890-AD for estate tax appeals.
138. See Form 870-AD (1997) (stating that offer is subject to acceptance by the Commissioner of Internal Revenue, and that until the offer is accepted, it "shall have no force or effect").
139. See id.
140. Id.
lawyer can never be certain of the finality of the settlement agreement if there is a mathematical error. In addition, there is the previously mentioned problem of good faith, fair dealing, and trust between the parties. If the revenue agent thinks the lawyer is untrustworthy, this may jeopardize not only the client in question, but also the lawyer’s other clients in dealing with the IRS. It is, therefore, in the best interest of both the lawyer and the client to reveal the error. As the client’s representative, the attorney should not need the permission of the client to disclose, although it is not clear under the Model Rules that such disclosure is permissible.  

The third type of agreement is the closing agreement, which is a final, binding agreement with respect to the expressly delineated issues in the document. Once a closing agreement has been signed, neither the government nor the taxpayer may reopen the case without a showing of fraud, malfeasance, or misrepresentation of material fact. In the absence of any of these three grounds, a closing agreement remains valid and binding. The attorney, therefore, cannot reveal the mathematical error to the government without the client’s express permission because the revelation would not serve any interest of the client other than the satisfaction of doing the morally correct thing, even though there is no corresponding legal obligation to do so. It is very unlikely that the case will be reopened, and the chances are slim that the attorney’s other clients will be adversely affected in dealings with the IRS. Thus, the attorney’s duty to behave morally must take a back seat to the attorney’s duty to her client because in this situation the client’s interest is paramount to the attorney’s interest. Thus, the morally correct action by the attorney is not permitted under the Model Rules.

ii. Mistake of Law

The second type of general mistake that may arise in dealing with an IRS agent is a mistake of law. This is usually a much more complex problem than the mathematical error because it is not a simple computa-

141. Under Model Rule 1.6, there are very narrow grounds for revealing client confidences without the client’s permission. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1997). But if the lawyer is required to do nothing further with respect to Form 870 or 870-AD, the question remains whether the lawyer’s failure to reveal the error constitutes a misrepresentation. If not, then under the Model Rules, the duty of confidentiality appears to control, and the lawyer may not reveal the error without the client’s express permission. See id. Other than advising the client to permit the lawyer to disclose and advising the client of the consequences of nondisclosure, the lawyer has no further obligation. See id. Conversely, the argument might be made that the disclosure is necessary to effectively carry out the representation of the client. See id. Rule 1.6(a).

142. Such an agreement is expressly authorized under I.R.C. § 7121 (1994).

143. See id. § 7121(b); Treas. Reg. §301.7121-1(c) (1998).
tional error in which the magnitude of the mistake is directly proportional to the likelihood of its being detected. Instead, it is an error that usually reflects on the competence and diligence of the agent. When the error arises in a nonbinding agreement, the case may be reopened at any time provided the statute of limitations is open. Thus, closure occurs only with the passage of time, and until then, neither of the parties should have any firm expectation of finality.

While to some extent the same considerations inherent in the mathematical error also apply to the mistake of law, such as the lack of trust and adverse consequences to the attorney’s other clients, the situation is somewhat different. First, a mistake of law generally tends to be a more serious mistake than a mathematical miscomputation. Second, the ABA considers the government in this context an adversary or potential adversary. As such, the lawyer has no obligation to make the government’s case for it, although the lawyer may not affirm the error or incorporate the error into any document or argument. Instead, the lawyer is the representative of the taxpayer and thus owes a primary duty to the taxpayer.

Conversely, there is the issue of the taxpayer’s wrongful profiting at the expense of the government. The taxpayer is morally not entitled to do this. As a matter of professional ethics, however, the issue of whether to reveal the error should be left to the taxpayer. Thus, the attorney should not reveal the mistake without the client’s permission.

A mistake of law is not one of the factors that allows the settlement agreement (Form 870-AD) to be reopened. However, Form 870-AD, by its terms, is not a binding closing agreement. In the past, courts have had problems distinguishing when the parties are bound by Form 870-AD and when they are not. For instance, there may be legitimate situations in which a taxpayer wishes to reopen the case and disregard Form 870-AD, such as when there has been a retroactive change in the

144. See Maloney v. Commissioner, 86 T.C.M. (CCH) ¶ 86,091 (1986) (stating that the IRS may issue a notice of deficiency when there is no binding agreement).
145. See supra text accompanying notes 23-49.
146. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1(a) (1997); see also Staum Int’l Corp. v. Commissioner, 90 T.C. 315, 325 (1988) (holding that IRS was bound by settlement agreement notwithstanding its unilateral mistake in calculating amount owed by the taxpayer). Of course, the lawyer must not espouse a return position that has no basis in law. This would amount to disreputable conduct under Circular 230. See 31 C.F.R. § 10.51 (1998).
147. See supra text accompanying note 140.
148. See Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment, Form 870-AD (1997).
law. But there are other situations in which taxpayers attempt to gain
an unfair advantage by paying the amount agreed upon and then later
filing a claim for a refund after the statute of limitations has barred
further assessment. In these cases, estoppel may apply to prevent the
taxpayer from reneging on the settlement agreement. On the other
hand, some courts have regarded Form 870-AD as nonbinding and have
allowed taxpayers to file their refund claims.

An attorney cannot be certain, however, that a court will determine that
a settlement agreement is nonbinding. If the agreement can be reopened
at any time, it might be in the client’s best interest to reveal the error
because if the government discovers the error first and reopens the case,
the client may be disadvantaged if the government perceives that it has
not been dealt with fairly. According to the Model Rules, however, the
lawyer cannot disclose the error without the client’s permission.

A closing agreement is statutorily final and binding, and can be
reopened only upon a showing of fraud, malfeasance, or misrepresenta-
tion of a material fact. A mistake of law does not constitute a ground
for reopening the case. The attorney, therefore, may not reveal the error
without express permission from her client because disclosure otherwise
would serve no useful purpose in representing the client and may even
prejudice the client’s interest.

149. See, e.g., Stair v. United States, 516 F.2d 560, 562 (2d Cir. 1975) (referring to intervening
court decision); Guggenheim v. United States, 77 F. Supp. 186, 187 (Ct. Cl. 1948) (referring to retroactive change in the statute).

150. See, e.g., Union Pac. R.R. Co. v. United States, 847 F.2d 1567, 1573 (D.C. Cir. 1988)
(holding that although the Form 870-AD was not binding, equitable estoppel precludes the taxpayer
from challenging its validity); Kretchmar v. United States, 9 Cl. Ct. 191, 198 (1985) (holding that
provided the conditions are met, a Form 870-AD could equitably estop the taxpayer from litigating
a refund claim).

151. See, e.g., Botany Worsted Mills v. United States, 278 U.S. 282, 289 (1929) (concluding that
agreement between taxpayer and IRS that does not satisfy the formalities of a statutory closing
agreement for settlement or compromise is not binding on either party); Aronsohn v. Commissioner,
988 F.2d 454, 457 (3rd Cir. 1993) (upholding lower court ruling that Form 870-AD can constitute
an equitably binding agreement); Flynn v. United States, 786 F.2d 586, 591 (3rd Cir. 1986)
(concluding that a taxpayer, attacking the validity of an agreement, must show that equitable relief
is appropriate).

152. See, e.g., Whitney v. United States, 826 F.2d 896, 898 (9th Cir. 1987); Uinta Livestock
Corp. v. United States, 355 F.2d 761, 765 (10th Cir. 1966); Bennett v. United States, 231 F.2d 465,
467-68 (7th Cir. 1956).

153. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1997) (discussing confidentiality
of information).

154. See supra text accompanying notes 142-43.

155. See supra text accompanying note 143.
iii. Mistake of Fact

When the agent misstates material facts in an oral confrontation, the lawyer has a duty to correct the agent because otherwise her silence would be deliberately misleading.156 For the same reasons discussed above in connection with the mathematical error in the face-to-face consultation, the lawyer should not need the permission of her client to reveal this error.

When, however, the agent misinterprets correctly stated facts, the situation is trickier. If the lawyer chooses not to disclose the error, her silence may be considered deliberately misleading, although her conduct could technically fall within the permissible limits of both Circular 230 and the Model Rules.157 If the lawyer's silence could be considered a misrepresentation of material fact, she has an affirmative duty under the Model Rules and Circular 230 to reveal the error and she should not need the permission of the client to do so.158

If the misrepresentation could not be considered material, the question is whether the lawyer should reveal the error anyway. If the mistake affects the finality of the agreement, the lawyer should reveal the error and she should not need the express permission of the client to do so. Instead, this should be regarded as the type of information which the lawyer has implied permission from the client to disclose in order to effectively represent the client.159

If the mistake is not material and the finality of the agreement is not affected, the lawyer probably should disclose, even without the prior express permission of the client, for the same reason—this should fall under the auspices of implied consent because of the important consideration of establishing trust with the revenue agent in order to effectively represent this client as well as other clients with matters pending, or potentially pending, before the IRS.

156. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 (discussing truthfulness in dealing with third parties); 31 C.F.R. § 10.51(b) (1998) (stating that participating in the giving of false or misleading information to a Treasury officer or employee constitutes disreputable conduct).

157. Under the Model Rules, if the misinterpretation is not material, the lawyer has no ethical duty to correct the agent. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1. Under Circular 230, the lawyer is not giving misleading information. See 31 C.F.R. § 10.51(b). The question is whether the lawyer can be regarded as participating in the giving of misleading information. If the facts are correctly stated, it is certainly arguable that the lawyer has no further duty under Circular 230. See id. (stating grounds for disreputable conduct).

158. See supra note 157. Note that the lawyer may not volunteer information, even if it is material, without the client's permission. See WOLFMAN ET AL., supra note 62, at 126 (discussing disclosure of facts on audit).

159. Such disclosure is permitted under Model Rule 1.6. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(a) (stating that disclosure without prior express permission of the client is permitted if the disclosure is impliedly authorized in order to properly represent the client).
iv. Tax Fraud and Ethical Conflicts

Representing a client who has committed tax fraud presents a complex ethical dilemma for an attorney because it involves a choice between preserving the client's confidence or revealing the fraud to the government. The Model Rules require an attorney to disclose "a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client." But, as previously mentioned, the ABA does not consider the IRS a tribunal, so the special disclosure obligations owed to tribunals under the Model Rules are not operative in dealings with the IRS. Instead, the Model Rules generally prohibit the attorney from revealing confidential information without the client's permission.

On the other hand, according to the ABA, the attorney has a duty not to mislead the government "either by misstatements or by silence or by permitting his client to mislead." This duty is echoed in Circular 230, which also provides that an attorney who participates in or perpetrates a fraud on the government will be disbarred from practicing before the IRS. This can have further serious consequences for the attorney. First, an IRS disbarment may trigger state disbarment proceedings. Second, under Circular 230, an attorney may not obtain assistance from or hire a person who has been disbarred from practicing before the IRS. If the disbarred attorney is a member of a law firm or

160. MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.3(a)(2).
161. See supra note 26 and accompanying text.
162. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(a). Moreover, the ethics committees of several states have held that lawyers cannot reveal misstatements made by a client to tax authorities unless the client authorizes the disclosure. See WOLFMAN ET AL., supra note 62, at 155 (listing Alabama and New York as two such states).
164. See 31 C.F.R. § 10.51(b) (1998). Circular 230 includes within its definition of disreputable conduct "giving false or misleading information, or participating in any way in the giving of false or misleading information . . . ." Id. It further defines reckless conduct as "a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances." Id. § 10.51(j).
165. See id. §§ 10.50, 10.51. There are several types of disreputable conduct under 31 C.F.R. § 10.51 that may be considered fraudulent: conviction of tax fraud, giving false or misleading information to the government, committing tax fraud or advising a client to do so, misappropriating client funds received for the purpose of paying taxes or any other obligations due the U.S., knowingly, recklessly, or through gross incompetence giving a false opinion to the government or establishing a pattern of fraudulent conduct. See id. § 10.51(a), (b), (d), (e) & (j).
166. The converse is also true. See id. § 10.51(g) (listing disbarment or suspension from practice as an attorney as disreputable conduct for which an attorney may be disbarred from practicing before the IRS); see also id. § 10.76(b) (stating that suspension, or revocation for cause, of license to practice law is ground for expedited suspension from practice before the IRS).
167. See id. § 10.24(a).
an accounting firm, this means that the firm must either cease its tax work altogether or disassociate itself from that attorney.\textsuperscript{168} The choices are that simple and devastating.

When the attorney discovers in advance that her client intends to mislead or defraud the government or any other third party, under the Model Rules the attorney may inform the client of the consequences and must advise the client not to undertake this action.\textsuperscript{169} If the client persists, the attorney must withdraw from representing the client in order to avoid being a party to the fraud.\textsuperscript{170}

In the more common and difficult situation, however, when the attorney subsequently discovers that the client has misled or defrauded the government or other third party, the attorney's obligations to the client and to the government will depend on the initial role of the attorney, and on the circumstances of the noncompliance, error, or omission. Circular 230 requires the attorney to advise the client promptly of the "noncompliance, error, or omission"\textsuperscript{171} but it does not address the issue of what happens afterward. Yet the consequences may vary tremendously, depending upon whether the noncompliance, error, or omission amounts to an innocent error, negligence, or fraud. In the case of fraud, the consequences to the client may be severe. Thus, advising a client to correct a questionable return position without fully informing the client of the consequences of fraud on a return may itself constitute a violation of Circular 230,\textsuperscript{172} as well as expose the lawyer to a malpractice claim. In any case, whether or not to file an amended return is solely the decision of the client. Failure to inform the client fully of the consequences of the fraud means that the client cannot make an informed decision.

This presents the first hurdle for the attorney: determining whether the noncompliance, error, or omission amounts to fraud. Tax fraud is not specifically defined under the Code\textsuperscript{173} and may include a variety of offenses.\textsuperscript{174} A common element of each offense, however, is willful conduct, which is defined as "an intentional violation of a known legal

\begin{itemize}
  \item \textsuperscript{168} See id. § 10.24(b). Maintaining a law partnership with a person who has been disbarred from practicing before the IRS constitutes disreputable conduct under Circular 230. See id. § 10.51(h).
  \item \textsuperscript{169} See Model Rules of Professional Conduct Rule 1.2(d) (1997); ABA Comm. on Ethics and Professional Responsibility, Formal Op. 314 (1965).
  \item \textsuperscript{170} See Model Rules of Professional Conduct Rule 1.16 (1997).
  \item \textsuperscript{171} See id. § 10.24(b).
  \item \textsuperscript{172} A practitioner . . . must inform the client of the penalties reasonably likely to apply . . . with respect to the position advised . . . ."
  \item \textsuperscript{173} See, e.g., I.R.C. § 6663 (1994) (providing for a civil fraud penalty).
  \item \textsuperscript{174} See I.R.C. §§ 7201-7207 (1994) (providing for various criminal penalties).
\end{itemize}
The difficulty lies in distinguishing between an intentional or willful violation, and ordinary negligence. At the extremes, the two are readily distinguishable. Even nontax lawyers may find themselves representing clients facing “piggyback” tax fraud charges in cases involving an undeclared, illegal source income. But between the extremes there is a chasm in which it is very difficult to distinguish between willfulness and negligence. It is a very subjective determination, and those who tend to think along the lines of Justice Potter Stewart that, like obscenity, they will “know it when [they] see it” may find themselves badly mistaken.

Fraud is proved by circumstantial evidence. The IRS publishes a list of so-called “badges of fraud,” which are red flags that revenue agents are instructed to look for in interviews with taxpayers as suggestive of fraudulent acts. These include maintaining a double set of books, lying to a revenue agent, concealing assets or hiding the source of income, making false entries or alterations, handling one’s affairs to avoid making records usual in transactions of that type, and a consistent pattern of income understatement or overstatement of deductions.

A second hurdle for the attorney is that there is a very fine line between civil fraud and criminal fraud. Both involve the element of willfulness, and the definition is apparently the same whether the fraud is civil or criminal. In general, the degree of fraud will depend on the
egregiousness of the offense and the aggressiveness of the government.\textsuperscript{181} The classification is important, not only because of the substantive differences between the sanctions, but also because of the procedural differences between the statutes of limitation and the burdens of proof.

Fraud is never initially imputed or presumed; the government bears the burden of proving intentional wrongdoing amounting to fraud.\textsuperscript{182} In the case of civil fraud, the government must establish its case with clear and convincing evidence. In the case of criminal fraud, the burden must be met beyond a reasonable doubt.

If the attorney suspects that a client has committed tax fraud, a third hurdle lies in determining whether to advise the client to file either an original return, if no return has previously been filed, or an honest, amended return to correct the fraud. This could present a very difficult ethical choice for the attorney.

The problem is that the attorney owes a legal duty to the client to represent the client in the matter in which the attorney accepted employment. Thus, first and foremost, the attorney must consider the interests of the client. But the attorney also has distinct duties that may conflict with the client’s interests. For example, according to the ABA, an attorney has a duty to avoid deliberately misleading the IRS and to prevent the client from doing so.\textsuperscript{183} If the attorney discovers that the client has misled the government, the attorney must advise the client to

\textsuperscript{181} For instance, the government usually will not wage a criminal prosecution when the taxpayer is seriously ill, mentally or physically. See, e.g., United States v. Boyle, 469 U.S. 241, 253 (Brennan, J., concurring) (stating that a taxpayer who shows he was unable to file due to physical or mental incapacity might be excused from harsh section 6651(a)(1) penalty). Also, the government will pay close attention to the personal attributes of the taxpayer, such as level of education and business acumen, in determining whether or not to prosecute. See, e.g., Grosshandler v. Commissioner, 75 T.C. 1, 19 (1980) (prosecuting taxpayer, “an attorney and a well-educated person,” for fraudulent failure to file returns); Guterman Strauss Co. v. Commissioner, 2 B.T.A. 433 (1925) (finding taxpayer not liable for fraud penalty when books did not accurately reflect income but were kept by an inexperienced bookkeeper).

\textsuperscript{182} See I.R.C. § 7454(a) (1994) (stating that burden of proof shall be upon the Secretary). There is, however, an exception to the statement that fraud is never presumed. Once the government meets its initial burden of proof, it will assess the fraud penalty on the entire underpayment. See I.R.C. § 6663(b) (1994). The taxpayer then has the burden of proving, by a preponderance of the evidence, that only a portion of the underpayment is attributable to fraud. See id. The statutory shift in the burden of proof was enacted in 1986. The result is a much more complicated trial for taxpayers accused of fraud because it may not be obvious during the trial whether or not the government has met its burden. Consequently, it may not be obvious to the taxpayer whether the burden of proof has shifted. Moreover, while, in theory, the government’s burden of proof was not altered in the 1986 legislation, in practice, the government’s burden is much lighter because if the government proves that a single item on a return is fraudulent, the presumption is that everything on the return is fraudulent. Thus, the 1986 burden shift greatly changed the playing field for taxpayers. See generally SALZMAN, supra note 176, ¶ 7B.01(1).

correct the noncompliance, error, or omission.\textsuperscript{184} Thus, the attorney is obligated to inform the client of the noncompliance, error, or omission, and should advise the client of the consequences of committing tax fraud. So far, the duty of the attorney and the interest of the client are in harmony.

The decision to file an initial return or an amended return, however, is solely the client's, and in order to make an informed decision, the attorney must point out to the client all the pros and cons of filing such a return. The problem is that, after careful consideration of the pros and cons, the attorney may decide that it is not in the client's best interest to file such a return. To illustrate the problem, we must examine the considerations inherent in advising a client to file a correct (or corrected) return.

One problem is the statute of limitations, which is unlimited in fraud.\textsuperscript{185} Thus, if the usual three-year statutory period for assessment has expired, the government has an incentive to allege fraud. A concern of the attorney is whether the unlimited statute of limitations can be limited by the filing of an honest, amended return—and that depends upon the type of fraud involved. There are two general categories of tax fraud: fraudulent failure to file and fraud in the return itself.

In the case of a fraudulent failure to file,\textsuperscript{186} the subsequent filing of a nonfraudulent return will start the running of the three-year statute of

\textsuperscript{184} See id. Note that there is no such duty to advise the client to correct the misrepresentation under Circular 230. Instead, if the attorney discovers an error, omission or noncompliance on any document submitted to the IRS, the attorney must advise the client of the error, omission or noncompliance. See 31 C.F.R. \$ 10.21 (1998).

\textsuperscript{185} See I.R.C. \$ 6501(c)(1) (1994). There is also no statute of limitations if no return is filed. Thus, the tax liability, plus penalties and interest, may be assessed at any time without a time bar. See supra note 135 (discussing the various statutes of limitation). In addition, there is a six-year statute of limitations for criminal fraud prosecutions. See I.R.C. \$ 6531 (1994). This period runs from the time of the commission of the offense and is suspended during any time the individual to be charged is outside the United States or is a fugitive from justice. See id. A criminal action is commenced when an indictment is returned by a grand jury or an information is filed with the court. The tax-related offenses under the Criminal Code (Title 18) are subject to a five-year statute of limitations, with the exception of conspiracy, which has a six-year limitations period. See 18 U.S.C. \$ 3282 (1994).

\textsuperscript{186} The failure to file a return may constitute fraud if the failure to file is intentional and is done for the purpose of evading a tax liability. See I.R.C. \$ 7203 (1994) (imposing penalty for willful failure to file a return when required to do so). In this situation, the taxpayer has a legal obligation to file a return. See I.R.C. \$ 6012 (1994) (stating that any individual with gross income equal to or greater than the exemption amount plus the standard deduction is required to file a return).
limitations on assessment. But when a fraudulent return has been filed, the unlimited statute of limitations in fraud cases cannot be shortened by subsequently filing a nonfraudulent amended return, nor does filing an honest amended return preclude a fraud prosecution. The rationale is that a taxpayer has no legal obligation to file an amended return, just as there is no legal obligation on the part of the government to accept one; rather, it is a matter of administrative grace and convenience of the government. Thus, the amended return relates back to the original return, but as far as the statute of limitations is concerned, the fraud cannot be purged, and the amended return will have no effect on the unlimited statutory assessment period.

But by filing such a return, the client may be placing himself in jeopardy of a criminal prosecution for tax evasion, because the amended return may highlight the potential fraud and constitute an admission that a false original return was filed. If the taxpayer does not file an amended return to correct the original false return, the chances of the false return being detected generally are not great because less than two percent of individual returns are audited. Thus, the attorney, in adequately representing the client, should inform the client of the slim chance of a tax audit (and thus of discovery), but the attorney also must be careful not to use the audit lottery to justify the client's illegal

187. See Bennett v. Commissioner, 30 T.C. 114 (1958) (stating that three-year assessment applies after nonfraudulent return is filed); Rev. Rul. 79-178, 1979-1 C.B. 435 (stating that once a nonfraudulent return is filed, I.R.C. § 6501(c) no longer applies and tax must be assessed within the three-year period under I.R.C. § 6501(a)).

188. See Badaracco v. Commissioner, 464 U.S. 386, 387 (1984) (stating that amended return has no effect whatsoever on the statute of limitations); see also Zellerbach Paper Co. v. Helvering, 293 U.S. 172, 180 (1934) (stating that the amended return relates back to the original return and the statute of limitations is determined by the filing of the original return).


190. There is no statutory provision authorizing the filing of an amended return. Such returns are a matter of IRS administrative grace. See Badaracco, 464 U.S. at 397 ("[T]he Internal Revenue Code does not explicitly provide either for a taxpayer's filing, or for the Commissioner's acceptance, of an amended return; instead, an amended return is a creature of administrative origin and grace."); see also MICHAEL MULRONEY, FEDERAL TAX EXAMINATIONS MANUAL § 2.8 (1985).

191. See Badaracco, 464 U.S. at 397. The Supreme Court's opinion is based on the Treasury Regulations. See Treas. Reg. § 1.451-1(a) (as amended in 1993) (stating that taxpayer should amend return and pay additional tax due if, within limitations period the taxpayer discovers that an item was omitted from gross income in a prior taxable year); Treas. Reg. § 1.461-1(a)(3) (as amended in 1994) (stating the same obligation with respect to liability improperly taken into account in prior taxable year).

192. See SALTZMAN, supra note 176, ¶ 5.02[2].

193. See supra note 33.
position. Supposedly, an amended return does not increase the audit potential, but if the government suspects that a discrepancy between the original return and the amended return might indicate fraud on the original return, this will almost certainly increase the risk of an audit.

An argument in favor of filing an amended return is that if an honest amended return is not filed, the fraud may taint other taxable years and other returns, thus increasing the risk that the original fraud may be detected. Thus, the filing of an initial return, whether honest or fraudulent, in one of those subsequent years may constitute a link in the chain of evidence needed to prosecute the taxpayer for fraudulent acts in the prior years. In this situation, the taxpayer is truly faced with a dilemma because the Fifth Amendment privilege against self-incrimination does not permit the taxpayer to avoid filing the initial return.

Instead, the privilege must be validly claimed on a properly filed return. But if the client is under investigation for tax evasion, and the filing of a return would constitute the last link in the chain of evidence needed to prosecute the client, the attorney may decide that it is in the client's best interest not to file the return, or in the alternative, to file

---

194. This would be a violation of Circular 230. See 31 C.F.R. § 10.34(b) (1998) (stating that a willful violation of the realistic possibility standard, which provides that advice cannot be predicated on audit potential, will subject a practitioner to suspension or disbarment from practice before the IRS).

195. See MULRONEY, supra note 190, § 2.8, at 85 (noting that instead, such returns are treated as a timely filed return, provided the original return was timely filed).

196. Moreover, if the subsequent returns are considered fraudulent because of the taint of the earlier fraud, the taxpayer also may be prosecuted for those acts of evasion as well. See United States v. Shorter, 608 F. Supp. 871, 874 (D.C. Cir. 1985) ("An act constituting evasion . . . brings the prosecution within the statute of limitations even if the taxes being evaded were due and payable prior thereto.").

197. See infra notes 238-44 and accompanying text.

198. See Hoffman v. United States, 341 U.S. 479, 486 (1951). Hoffman held that return information does not necessarily have to lead to a criminal conviction. See id. Rather, the privilege against self-incrimination is validly claimed if the information that would be revealed in the return would "furnish a link in the chain of evidence needed to prosecute the claimant for a federal crime," id. It also has been held that the link does not have to be strong enough to support a criminal conviction. See United States v. Neff, 615 F.2d 1235, 1239 (9th Cir. 1980); Hashagen v. United States, 283 F.2d 345, 348 (9th Cir. 1960). It is sufficient if it would supply merely a "lead or a clue." Neff, 615 F.2d at 1239; Hashagen, 283 F.2d at 348.

The situation of an attorney advising a client not to file an initial return is not addressed by Circular 230, although it recently has been considered an actionable offense. See Sheryl Stratton, Talking to IRS Agents and Advising Clients Not to File, 80 TAX NOTES 657, 658 (1998) (reporting remarks of Michael I. Saltzman that the ostensible amendment has not been clearly thought through). Yet an attorney may recommend that a client not file if the client is under investigation for tax evasion and the filing of the return would constitute the last link in the chain of evidence needed to prosecute the taxpayer. See Hoffman, 341 U.S. at 486.
a return omitting the required financial and tax information and asserting a wholesale claim of the Fifth Amendment privilege.\footnote{199}

Another important consideration is that the filing of any tax return, whether an initial return or an amended one, may waive the attorney-client privilege, not only with respect to the data transmitted in the return itself, but also with respect to the information underlying the data.\footnote{200} For example, it has been held that the listing of income on a return waives the attorney-client privilege as to the source of the income.\footnote{201} It has also been held generally that client identity and fee information fall outside the scope of the attorney-client privilege because that is not typically part of the confidential communication from the client.\footnote{202}

\footnote{199} In general, such a return does not constitute a return and the exercise of the privilege is not a valid one. See Neff, 615 F.2d at 1238 (citing courts that have recognized this principle and rejected it in favor of the independent Fifth Amendment analysis). Such a return, however, may constitute a valid exercise of the privilege if the defendant is faced with a “substantial hazard of self-incrimination”; that is, “real and appreciable” and not merely ‘imaginary and unsubstantial’ ” when the defendant has “cause to apprehend [such] danger from a direct answer” to questions posed to him,” and the information revealed in the direct answer would “furnish a link in the chain of evidence needed to prosecute the claimant for a federal crime.” \textit{Id.} at 1239 (citations omitted). Note, however, that when the crime is a tax crime, such as fraudulently claiming excess withholding exemptions, the Fifth Amendment does not prevent compelled self-incrimination. See United States v. Carlson, 617 F.2d 518, 520 (9th Cir. 1980).

\footnote{200} See, \textit{e.g.}, United States v. Windfelder, 790 F.2d 576, 579 (7th Cir. 1986) (holding that disclosure of estate tax information on a return effectively waives the attorney-client privilege); United States v. Lawless, 709 F.2d 485, 488 (7th Cir. 1983) (holding that attorney-client privilege was waived, not only as to the transmitted data, but also as to the details underlying that data). See \textit{infra} notes 218-44 and accompanying text (discussing in detail the attorney-client privilege).

\footnote{201} See \textit{In re} Grand Jury Investigation of Glen J. Schroeder, Jr., 842 F.2d 1223, 1225 (11th Cir. 1987) (ordering that the source of income be revealed in prosecution for tax evasion because no attorney-client privilege applied).

\footnote{202} See, \textit{e.g.}, United States v. Goldberger & Dubin, P.C., 935 F.2d 501, 504-05 (2d Cir. 1991) (holding client identifying information not privileged); Holifield v. United States, 909 F.2d 201, 204 (7th Cir. 1990) (holding fee information not privileged); United States v. Davis, 636 F.2d 1028, 1044 (5th Cir. 1981) (holding billing records generally discoverable); United States v. Dickinson, 308 F. Supp. 900, 901 (D. Ariz. 1969) (holding fees paid and means of payment discoverable), \textit{aff'd per \textit{curiam},} 421 F.2d 702 (9th Cir. 1970).

Even when there may have been an expectation of privacy, cash transactions of more than $10,000 are strictly subject to the disclosure and recordkeeping requirements of I.R.C. § 60501, which requires any person engaged in a trade or business who receives more than $10,000 in cash in a single transaction or in a series of related transactions to report to the government the payment and the identification of the payor-name, address, and taxpayer identification number. See I.R.C. § 60501(a) (1994). Failure to adhere to this requirement will subject the person to civil and criminal penalties for “intentional disregard” of I.R.C. § 60501. See I.R.C. § 6721(a)(2)(C) (1994) (providing for civil penalty equal to the greater of $25,000 or amount of cash received in the transaction up to $100,000); I.R.C. § 7203 (1994) (providing that failure to comply with I.R.C. § 60501 is punishable as a misdemeanor).

Objections raising Fifth and Sixth Amendment claims and the attorney-client privilege have not been successful. See, \textit{e.g.}, United States v. Sindel, 53 F.3d 874, 1876-78 (8th Cir. 1995); \textit{In re
The attorney-client privilege also does not protect communications made in furtherance of a crime or fraud. This exception generally applies once the government establishes a prima facie case of tax evasion, and the exception may apply even though the attorney may not have known at the time that the client was engaged in tax evasion activities. Thus, an attorney can be compelled to testify against the client as to the source of income revealed in connection with other legal services rendered.

The crime-fraud exception to the attorney-client privilege can cut both ways in determining whether it is in the client's best interest to file an amended return. On the one hand, it may be argued that if the original return is fraudulent, there is no attorney-client privilege. Thus, the issue of privilege should not be of concern to the client in deciding whether to file an amended return. On the other hand, the government bears the burden of proving fraud and until that burden is met, the attorney-client privilege presumably applies. If the client files an amended return and highlights the fraud, the government's job of proving fraud becomes much easier and the deck is then stacked against the taxpayer—no statute of limitations, the original fraudulent return is highlighted, the amended return may constitute an admission against the taxpayer, and the attorney-client privilege may not apply. The only point in favor of filing an amended return is that if the client voluntarily does so, without threat of prosecution, the government might be more inclined to believe that the misrepresentation in the original return was attributable to innocent error.

If not, at least a court or jury, or both, may be more sympathetic to the taxpayer if the taxpayer acted voluntarily.

Grand Jury Proceedings 88-9 (MIA), 899 F.2d 1039, 1042-44 (11th Cir. 1990). The only exception to the disclosure requirement has been when anonymity of the client was part of the reason the client sought the attorney's services or when disclosure would provide the last link in proving guilt. See Goldberger & Dubin, 935 F.2d at 505 (recognizing legal advice exception); Baird v. Koerner, 279 F.2d 623, 631-33 (9th Cir. 1960) (establishing last link exception). Many jurisdictions, however, do not recognize these exceptions, and those that do apply it only rarely. See, e.g., Lefcourt v. United States, 125 F.3d 79, 88 (2d Cir. 1997) (rejecting these exceptions), cert. denied, 118 S. Ct. 2341 (1998).


204. See In re Grand Jury Investigation, 842 F.2d at 1227-29 (compelling attorney to testify against client in tax evasion prosecution even though attorney had no knowledge of evasion at time legal services were rendered).

205. Of course, this depends upon the type of error, misrepresentation or omission. Some carry more credibility than others. The IRS currently recognizes four general categories of tax evasion: (1) understatement or omissions of income; (2) claiming fictitious or improper deductions; (3) false allocation of income; and (4) improper claims for credit or exemptions. See IRS Manual Handbook 4231 (1981). Obviously, the more egregious the error, misrepresentation, or omission, the less credible it will be as an innocent error.
After digesting these points, plus additional information on the civil and criminal fraud penalties, the client may decide against filing the amended return. What happens then? At this point, the attorney has presented the myriad considerations to the client, the client has made an informed decision, and the attorney’s legal duty is technically done. Now the attorney must consider her ethical obligations, not only to her client, but also to the government. But these obligations may conflict, depending on the attorney’s initial role and the circumstances of the fraud.

The attorney’s primary consideration is to avoid being a party to the fraud. This could result both in the loss of her license to practice law and in her disbarment from practicing before the IRS. There are two general ways in which an attorney may be considered a party to the fraud. First, when she is perceived to be counseling the client to commit tax fraud, or to conceal the fact of the fraud.

Second, when the attorney has knowledge of the fraud, continues to represent the client, and subsequently gives false or fraudulent information to a third party.

An attorney representing a client in tax matters may assume several roles: (1) return preparer, (2) planner and advisor, and (3) advocate in litigation and at audit. If the attorney unwittingly prepared the fraudulent return, or the fraud is likely to affect other taxable years, the attorney must withdraw from further representation of the client if the client refuses to file an amended return, in order to avoid perpetrating the fraud. In such a case, the ABA permits the attorney to make a “noisy withdrawal.” But this withdrawal must be undertaken carefully so as not to disclose any client confidences or otherwise prejudice the interests of the government.

206. Not surprisingly, such conduct is prohibited under both the Model Rules and Circular 230. See 31 C.F.R. § 10.51(b) (1998) (disseminating or participating in the dissemination of false or misleading information constitutes disreputable conduct); 31 C.F.R. § 10.51(j) (1998) (defining false opinion as including "counseling or assisting in conduct known to be illegal or fraudulent"); MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1(b) (1997) (stating that an attorney must not fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting in a criminal or fraudulent act by a client).

207. A common defense in tax evasion cases is to blame the attorney or advisor in order to establish that the conduct in question is not intentional on the part of the accused. Therefore, the attorney should be particularly cautious when dealing with a client who has demonstrated a propensity to commit a crime.

208. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(a)(1) (1997) (stating that if the lawyer’s continued representation of a client would result in a violation of the rules of ethics or law, the lawyer must withdraw from representing the client); id. Rule 1.2 cmt. (stating that when the lawyer is representing client in activity lawyer ultimately discovers is criminal or fraudulent, lawyer must withdraw from representation).

of the client. Such a balance makes the withdrawal extremely difficult because any withdrawal by the attorney is likely to trigger suspicion, thereby prejudicing the interests of the client.

If the attorney did not prepare the fraudulent return, or the fraud will not affect other taxable years, the attorney may continue to represent the client. If so, the attorney may find herself in a conflict of interest. One way in which a conflict may arise is through an audit of the client’s tax return(s). It is common practice at the conclusion of an audit for the revenue agent to inquire whether the taxpayer’s representative has knowledge of any item on the return in question or on any open returns that require adjustment. The attorney will then be trapped because deliberate misrepresentation is a violation of Circular 230. Conversely, revealing a client confidence without that client’s permission is a violation of the Model Rules. In recognition of this dilemma, the ABA requires the attorney to advise the revenue agent that she is not in a position to answer that question.

Another troublesome issue for the attorney is whether the client can be trusted. If the client is unwilling to file an amended return, by definition that client has demonstrated a willingness to commit a federal crime. In tax practice, an attorney is entitled to rely on information furnished by a client without having to verify the accuracy of every piece of information the client furnishes, unless the attorney has reason to question that information. Once a client demonstrates a willingness to commit tax fraud, however, the attorney’s duty of inquiry becomes much greater. Stated differently, the attorney’s liability for failure to inquire becomes much greater.


211. See supra note 126.

212. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1997).


215. See id. (stating that the practitioner may not ignore the implications of information known to her and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent, or incomplete).
III. THE ATTORNEY-CLIENT PRIVILEGE AND THE PREPARATION OF INCOME TAX RETURNS

Lawyers engaged in the general practice of law, particularly those practicing in small towns, frequently fill out income tax returns for clients. A taxpayer has the option of preparing his own return, or enlisting the aid of a professional such as an attorney, a CPA, or a commercial tax preparation service. Generally, when the taxpayer chooses a lawyer, it is because he has complicated transactions that require sophisticated advice, or he anticipates a problem with the government at some point. The taxpayer may feel more comfortable with a lawyer who can give him legal advice and represent him at every stage of any potential conflict. Another consideration is that the taxpayer may have established a previous relationship with that lawyer, and the lawyer is now familiar with the taxpayer’s financial transactions. Thus, the taxpayer may not want to establish a new relationship with someone else. Most taxpayers, regardless of the category in which they fall, have probably assumed that their communications are protected from disclosure by the attorney, and that the lawyer’s notes, memoranda, and work papers are similarly beyond the reach of a summons or a subpoena. That, however, may not be the case.

Confidentiality of information in the representation of a client is derived from two sources: the state ethical codes and the attorney-client privilege. The attorney-client privilege shields private communications between an attorney and a client, but it is a very limited privilege. The purpose of the privilege is to encourage clients to make full disclosure so that the attorney may fully and completely represent the client. Therefore, in order for the privilege to apply, the communication must have been made to the attorney in her capacity as legal advisor, advocate, or in some other role in which the attorney functions strictly as an attorney, and the communication must have been made with the intent that it remain confidential. A mere attorney-client relationship does not make every communication between an attorney and a client confidential.

217. See id.
218. See Fisher v. United States, 425 U.S. 391, 403 (1976). It is thus advisable at the outset to properly document the agreement between the attorney and the client with a contemporaneous engagement letter, specifying the role to be played by the attorney. See Ronald A. Stein, Preserving Client Confidences and Work Product Privacy, 72 Tax Notes 1287, 1300 (1996). Such an engagement letter is also advisable with respect to any other professional the attorney may hire or recommend that the client hire to assist the attorney with the rendering of legal advice. See id.
Thus, the government routinely advises its agents that the attorney-client privilege must be narrowly construed.219 If the attorney’s role is that of a mere scrivener or conduit for handling funds, or the advice relates to a business matter, as opposed to a legal matter, or “the transaction involves a simple transfer of title to real estate, without legal advice, communications from the client to the attorney are not privileged.”220 Because the privilege applies only to attorneys, the government historically has taken the position that communications made to a person who acts as both attorney and accountant are not privileged if the communications have been made “solely to enable the attorney to audit the client’s books, prepare a federal income tax return, or otherwise act purely as an accountant.”221 The rationale behind the government’s position has been that the privilege results in the “withholding of relevant information from the factfinder, [thus it should be applied] only where necessary to achieve its purpose.”222 Since there was historically no federal accountant-client privilege, communications between taxpayers and accountants, with respect to federal tax returns, were not privileged. Thus, communications between client and attorney also were not privileged when the attorney acted as an accountant. Recently, however, Congress has granted a privilege to nonlawyers who are authorized to practice before the IRS.223 But the newly enacted privilege has some severe limitations and many unresolved issues remain.

A. The Tax Practitioner Privilege

The privilege applies to “federally authorized tax practitioners,”224 to the extent that such practitioners render tax advice to clients in connection

220. Id. at 579 (citing Internal Revenue Manual, MT 9781-30, § 344.2, Jan. 18, 1980 (citing Olender v. United States, 210 F.2d 795, 806 (9th Cir. 1961))).
221. Graves, supra note 219, at 579. But a privileged communication can occur between an attorney and an accountant, or between the client and an accountant or other consultant, provided that the accountant or consultant is acting at the direction of the attorney to facilitate the rendering of legal advice to the client. See United States v. Kovel, 296 F.2d 918, 921 (2d Cir. 1961).
223. See I.R.C. § 7525 (1994). The underlying rationale is perhaps best characterized by Stein: “[W]ithholding the confidentiality privilege from communications involving selected members of the approved group would be virtually certain to subvert the congressional purpose by penalizing parties who unwittingly call upon the wrong professional.” Stein, supra note 218, at 1292.
224. I.R.C. § 7525(a)(1). A federally authorized tax practitioner is any individual who is authorized under federal law to practice before the IRS. See id. § 7525(a)(3)(A); see also supra note 7 (listing such individuals).
with civil tax matters (except tax shelters)\textsuperscript{225} before the IRS or in federal court proceedings.\textsuperscript{226} Because the privilege applies only to the extent that the communication would have been privileged under the federal common law if made between an attorney and a client,\textsuperscript{227} advice with respect to return preparation generally is not privileged because such advice would not be privileged under the common law if rendered by a lawyer.\textsuperscript{228} This has been the prevailing view among the courts, regardless of the rationale of the client in choosing an attorney to prepare his tax returns, and regardless of the complexity of the return or the expertise required to prepare it. The underlying rationale divides along two lines. First, the privilege applies only to legal advice, and because the preparation of tax returns is considered an accounting (rather than a legal) service, the privilege does not apply.\textsuperscript{229} Second, communications that are disclosed or intended to be disclosed to third parties lose the benefit of the privilege. Because return information is intended to be transmitted to the government, the privilege is waived with respect to that information.\textsuperscript{230}

There are two general problems that must be resolved before the full scope of the privilege can be determined. First, there exists the problem of distinguishing tax advice subject to the privilege from advice that is not privileged, such as return preparation advice, business advice, and

\textsuperscript{225} See I.R.C. § 7525(b).

\textsuperscript{226} See id. § 7525(a)(2).

\textsuperscript{227} See id. § 7525(a)(1).

\textsuperscript{228} The Second Circuit, however, takes a different approach. See Colton v. United States, 306 F.2d 633, 637 (2d Cir. 1962) ("There can, of course, be no question that the giving of tax advice and the preparation of tax returns...are basically matters sufficiently within the professional competence of an attorney to make them prima facie subject to the attorney-client privilege."); United States v. Kovel, 296 F.2d 918, 922 (2d Cir. 1961) (extending privilege to accountant who worked closely with the attorney).

\textsuperscript{229} See, e.g., In re Grand Jury Investigation of Glen J. Schroeder, Jr., 842 F.2d 1223, 1224-25 (11th Cir. 1987) ("[A] taxpayer should not be able to invoke a privilege simply because he hires an attorney to prepare his tax return."); United States v. Davis, 636 F.2d 1028, 1039-40 (5th Cir. 1981) (holding that preparation of tax returns by an attorney is not a legal service); United States v. Gurtner, 474 F.2d 297, 299 (9th Cir. 1973) (holding that consultations, even with an attorney, in the preparation of tax returns are not privileged); see also Canaday v. United States, 354 F.2d 849, 857 (8th Cir. 1966) (holding no attorney-client relationship established in connection with the preparation of tax returns, which the court regarded as the work of a "mere scrivener"). But see United States v. Merrell, 303 F. Supp. 490, 492 (N.D.N.Y. 1969) (stating that attorney-client privilege is applicable to return preparation advice as long as it remains confidential); United States v. Judson, 322 F.2d 460, 462 (9th Cir. 1963) (holding the attorney-client privilege can apply to communications between attorney and accountant if the communication enables the attorney to render legal advice).

\textsuperscript{230} See Dorokee Co. v. United States, 697 F.2d 277, 280 (10th Cir. 1983) ("Even those courts holding that the attorney-client privilege can arise from the preparation of income tax returns do not apply the privilege to documents given by a client to an attorney for inclusion in the client's income tax return, because such information is obviously not intended to remain confidential.").
advice with respect to an accountant’s audit role. A particular problem for attorneys is whether the analysis of aggressive return positions with respect to the realistic possibility standard constitutes legal advice or accounting advice. A related problem is that if the taxpayer has to establish that his actions with respect to the aggressive position were reasonable in order to avoid a negligence penalty, an advice-of-counsel defense may impliedly waive the privilege.

Second, courts are split on the extent to which the privilege is waived with respect to documents or other supporting data underlying the information in the return. Under one approach, the waiver applies only to the data ultimately sent to the government. Thus, peripheral communications between the client and the attorney-preparer remain privileged. Another approach is that, in filing a return, the taxpayer has disclosed, at least in part, the substance of the confidential communications with the preparer and therefore waives any privilege as to details underlying the reported data. A third approach takes the middle

231. Typically, the privilege has applied only to communications between a lawyer and client regarding legal advice. Since accountants and nonlawyers are not licensed to practice law, the question may be raised as to whether the newly enacted privilege applies to nonlawyers at all. Such practitioners, however, may represent clients before the Tax Court because this authority has been specifically bestowed by the government. See supra note 7. Therefore, legal advice rendered by nonlawyers with respect to representation of clients before the IRS and the Tax Court may be privileged. Note, however, that the privilege does not apply to criminal tax matters or to communications made with respect to nontax matters pending before other government agencies. See Barton Massey, Practitioners Spell Out What CPA-Client Privilege Won’t Do, 79 TAX NOTES 1401, 1401 (1998) (stating that the privilege does not apply to private party litigation, state communications unless subject to a state-enacted accountant-client privilege, and “communications made directly to nonfederally authorized practitioners”).

232. The Fifth Circuit, which had previously held that preparation of tax returns by attorneys was an accounting function to which the privilege did not apply, see United States v. Davis, 636 F.2d 1028, 1043 (5th Cir. 1981), subsequently held that a lawyer’s analysis of “soft spots” in a return could constitute legal advice. See United States v. El Paso Co., 682 F.2d 530, 539 (5th Cir. 1982).

233. See United States v. Miller, 600 F.2d 498, 501-02 (5th Cir. 1979).

234. See, e.g., United States v. Schlegel, 313 F. Supp. 177, 179 (D. Neb. 1970) (“[A] more realistic rule would be that the client intends that only as much of the information will be conveyed to the government as the attorney concludes should be, and ultimately is, sent to the government.”); United States v. Jeremiah, 76-1 T.C. ¶ 84,181, 84,183 (1975) (“[The] government gains nothing by selective disclosure of information it already has anyway.”).

235. See, e.g., United States v. Cote, 456 F.2d 142, 144 (8th Cir. 1972) (holding waiver applied not only to information included in the return but to the underlying data as well); United States v. Merrell, 303 F. Supp. 490, 492 (N.D.N.Y. 1969) (“[The] attorney-client privilege protects only those papers or communications prepared by the client for confidential communication to the attorney, or by the attorney to record confidential communications.”). This view has been criticized because it disregards the purpose of the privilege to encourage full and free disclosure of information by the client to the attorney. If the client thinks that all information transmitted to the attorney would be potentially unprivileged, the client would be reluctant to give the information to the attorney. See Graves, supra note 219, at 592 (quoting United States v. Schlegel, 313 F. Supp. 177 (D. Neb. 1970)).
ground, initially assuming the information to be privileged, but if an item on the return is challenged by the IRS, the taxpayer must then choose between waiving the privilege and supporting the item in refute of the IRS's challenge, or asserting the privilege, conceding the challenge, and perhaps incurring a penalty as a result. There are two problems with the latter approach. First, when the source of income is at issue, the government may find itself frustrated. Second, it is currently unclear what the effect will be of the recently enacted shift in the burden of proof to the IRS. Currently, the government takes the position that the only prevailing privilege that applies in this situation is the Fifth Amendment privilege against self-incrimination. But the Fifth Amendment privilege applies only in criminal cases and it does not excuse the taxpayer from filing a tax return. Thus, the Fifth Amendment privilege is valid only if claimed on the return itself. If the taxpayer incriminates himself on the return, the privilege is waived not only because the information is considered voluntarily disclosed, but also because the privilege does not apply to communications made in furtherance of a crime or fraud. When the government makes a prima facie case of tax evasion by independent evidence, the attorney's advice related to the criminal activity is not considered privileged. Because the privilege must be asserted on an item-by-item basis, however, an in camera inspection of each document in question is often necessary to determine which documents, if any, are privileged.

Another problematic argument, which has been sanctioned by the United States Supreme Court in a nontax context, is that records required by law to be maintained pursuant to a valid regulatory purpose are "public records" which fall outside the Fifth Amendment privilege. See United States v. Shapiro, 335 U.S. 1, 32-34 (1947) (dealing with wartime regulations promulgated under the Emergency Price Control Act).

236. See In re Grand Jury Subpoena Dated March 24, 1983, 566 F. Supp. 883, 884 (S.D.N.Y. 1983) ("[B]y the mere filing of a tax return, the taxpayer does not agree to disclose to all comers the documentation underlying the deductions claimed.").

237. See supra note 182.


239. See id (holding that taxpayer was not excused from filing a tax return but could abstain from including incriminating items on the return). The problem is that the taxpayer may be subject to liability when the Fifth Amendment privilege is exercised if the privilege is claimed erroneously. The government may then prosecute the taxpayer under I.R.C. § 7203 for willful failure to file a tax return, unless the taxpayer can establish that he acted in good faith. See Garner v. United States, 424 U.S. 648, 649 (1976) (allowing a defendant's tax returns to be used against him in a nontax criminal prosecution).

240. See Garner, 424 U.S. at 665 (holding that the requirement to file a tax return does not constitute compelled self-incrimination, thus voluntarily disclosing information effectively waives the privilege).


242. See id.
The privilege also does not apply generally to the client’s identity, the attorney’s billing statements, the fees paid by the client, and the manner of payment; nor is such information protected from disclosure by the First, Fifth or Sixth Amendments. Thus, an attorney may be compelled to disclose such information.

B. Work Product Doctrine

A doctrine related to the attorney-client privilege is the work product doctrine. It provides that the discovery of documents and tangible items prepared in anticipation of litigation or for trial are not discoverable by the opposing party or that party’s representative unless the party makes a showing that there is a substantial need of the documents or items in the preparation of the party’s case, and that the party is unable to obtain the substantial equivalent by any other means without undue hardship.

The work product doctrine, like the attorney-client privilege, also encourages candor between a client and an attorney. The primary purpose of the doctrine, however, is to “preserve the integrity of the

243. If an attorney receives more than $10,000 in cash in a single transaction from a client, the attorney is required to file a Form 8300 with the government, providing the client’s name, address, taxpayer identification number, and the amount of cash received. See supra note 202. Courts generally have been unsympathetic to claims of attorney-client privilege. See, e.g., Lefcourt v. United States, 125 F.3d 79, 88 (2d. Cir. 1997) (“Although the contours of the special circumstance exception have not been exhaustively developed, no doubt due to the fact special circumstances are seldom found to exist, it is clear that there is no special circumstance in this circuit simply because the provision of client-identifying information could prejudice the client in the case for which legal fees are paid.”), cert. denied, 118 S. Ct. 2341 (1998); United States v. Sindel, 53 F.3d 874, 877-75 (8th Cir. 1995) (holding that the Sixth Amendment does not protect compelled disclosure because a client may use alternative forms of payment and avoid disclosure, that the Fifth Amendment protection does not apply because the privilege belongs only to the individual holding the privilege, and that the First Amendment does not apply because the attorney is only compelled to disclose information the client has given voluntarily). But see United States v. Goldberger & Dubin, P.C., 935 F.2d 501, 505 (2d Cir. 1991) (stating that the attorney-client privilege might shield the client’s identity from governmentally compelled disclosure in certain “special circumstances”); United States v. Gertner, 873 F. Supp. 729 (D. Mass. 1995). For a brief discussion of these “special circumstances,” see Sindel, 53 F.3d at 876 (listing the three “special circumstances” exceptions: legal advice, last link, and confidential communications). Note that not all jurisdictions recognize these particular special circumstances. See Lefcourt, 125 F.3d at 87 (rejecting an exception for incrimination of the client).

Note also that the Form 8300 contains a question as to whether the cash payment represents a “suspicious transaction.” The court in Sindel rejected the constitutionality of such a provision, which effectively compels the attorney to “act as an agent for the government” against her client. Sindel, 53 F.3d at 877.

244. See Lefcourt, 125 F.3d at 83 (affirming the imposition of a $25,000 fine on an attorney for failing to comply with IRS filing requirements).

245. This doctrine is codified in the Federal Rules of Civil Procedure. See FED. R. CIV. P. 26(b)(3).
adversarial system of justice by preventing the opposing party from profiting from the "mental impressions, legal theories or documents" prepared in anticipation of litigation by advisors for the other party. Unlike the attorney-client privilege, however, the work product doctrine has historically applied to nonlawyers as well as lawyers, for the doctrine insulates materials developed by consultants and other professionals working directly for the client.

The doctrine applies to two different types of materials: (1) opinion work product—mental impressions, legal theories and opinions; and (2) fact work product—tangible materials such as documents prepared in anticipation of litigation. Opinion work product has a much stronger protection than does fact work product. While courts are divided on the issue of whether the protection accorded opinion work product is qualified or absolute, there is agreement that the burden of proving necessity and unavailability is a much heavier one when opinion work product is at issue.

The privilege accorded fact work product is qualified by two general exceptions. First, documents that would have been created in essentially similar form irrespective of litigation do not receive work product protection. Second, the doctrine does not apply to documents prepared in the ordinary course of business, even if litigation had commenced at the time the documents were prepared. Thus, it has been held that materials assembled in the ordinary course of preparing an income tax

246. Stein, supra note 218, at 1301.
247. Hickman v. Taylor, 329 U.S. 495, 508 (1947). The work product doctrine protects "interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways" the attorney or any other professional represents the client in litigation or aids the attorney in such representation. Id.
248. See id. at 510-11.
249. See In re Grand Jury Investigation, 412 F. Supp. 943, 949 (E.D. Pa. 1976) (extending absolute protection to opinion work product). But cf. In re Grand Jury Investigation, 599 F.2d 1224, 1231 (3d Cir. 1979) (stating that the privilege is not absolute but is discoverable only in a "rare situation").
250. See Upjohn Co. v. United States, 449 U.S. 383, 401-02 (1981) ("While we are not prepared at this juncture to say that such material is always protected by the work-product rule, we think a far stronger showing of necessity and unavailability . . . would be necessary to compel disclosure.").
251. See Bernardo v. United States, 104 T.C. 408, 415 (1995) ("To show that a document was prepared in anticipation of litigation '[a] litigant must demonstrate that documents were created "with a special claim supported by concrete facts which would likely lead to [the] litigation in mind," not merely assembled in the ordinary course of business or for other nolitigation purposes"'), (quoting Linde Thomson Langworthy Kohn & Van Dyke v. Resolution Trust Corp., 5 F.3d 1508, 1515 (D.C. Cir. 1993) (quoting Coastal States Gas Corp. v. Dept. of Energy, 617 F.2d 854, 865 (D.C. Cir. 1980))).
return are discoverable.\textsuperscript{252} It has also been held that IRS summons are subject to the traditional privileges and limitations,\textsuperscript{253} including work product.\textsuperscript{254}

In order to invoke the doctrine, however, there must be some causal nexus between the document at issue and the litigation.\textsuperscript{255} The question is how substantial and imminent the threat of litigation must be to justify immunity. There is currently a split among the courts on this issue. The Tax Court has held that at the time the documents were prepared, the prospect of litigation must have been "more than a remote possibility."\textsuperscript{256} But the Second Circuit has more recently used a less demanding test, holding that when a "document is created because of the prospect of litigation" it does not lose work product protection "merely because it is created in order to assist with a business decision."\textsuperscript{257} Thus, a pre-transaction document may be covered under the work product doctrine.\textsuperscript{258}

It is worth noting, however, that in the case before the Second Circuit, the prospect of litigation was very likely. The client had been under close and continuous scrutiny by the IRS for the past thirty years, the transaction in question was creative and unprecedented, and the refund in question was large enough to trigger review by the Congressional Joint Committee on Taxation.\textsuperscript{259} Because of these factors, the chance of audit was much greater than usual. The Fifth Circuit has held that if the document is prepared in anticipation of dealing with the IRS, it may well have been prepared in anticipation of an administrative dispute, and this may constitute "litigation" within the purview of the doctrine.\textsuperscript{260} Commentators have noted that while foreseeability of litigation provides an objective guideline for determining whether the document was prepared with litigation in mind, the better test, nevertheless, involves a consideration of subjective and objective evidence in determining the purpose for which the document was created.\textsuperscript{261}

\begin{footnotesize}
\begin{enumerate}
\item[252.] See United States v. Davis, 636 F.2d 1028, 1040 (5th Cir. 1981).
\item[253.] See United States v. Euge, 444 U.S. 707, 712 (1980).
\item[254.] See Upjohn Co. v. United States, 449 U.S. at 398-99.
\item[255.] 8 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 2024 (2d ed. 1994).
\item[256.] United States v. Bell, 95-1 U.S.T.C. (CCH) ¶ 50,006 (N.D. Cal. Nov. 9, 1994).
\item[257.] United States v. Adlman, 134 F.3d 1194, 1202 (2d Cir. 1998).
\item[258.] Thus, the Adlman court held that a document may be prepared for litigation even though "based on actions or events that had not yet occurred at the time of creation." \textit{Id.} at 1196.
\item[259.] Refunds of over $1 million must be approved by the Joint Committee on Taxation. \textit{See id.} (citing 26 U.S.C.A. § 6405(a) (1994)). The anticipated refund in \textit{Adlman} was around $35 million. \textit{See id.}
\item[260.] United States v. Hodges, Grant & Kaufmann, 768 F.2d 719, 722 (5th Cir. 1985).
\item[261.] \textit{See Stein, supra} note 218, at 1303-04; \textit{see also} 8 WRIGHT ET AL., supra note 255, § 2024.
\end{enumerate}
\end{footnotesize}
imminent should be a factor, but not the decisive factor, because, as it has been noted, "prudent businessmen plan for litigation risks."262

IV. TAXPAYER CONFIDENCES AND THE GOVERNMENT

On the other side of the coin, to what extent is the government required to preserve the confidences of the taxpayer? By law, tax return information is confidential and may not be revealed by the government except in very narrow, enumerated circumstances.263 But the extent of this protection is currently unclear because there are several important issues which remain unresolved.264 Among them is the extent to which the IRS can publicly release information elicited at trial. There is no statutorily enumerated exception that would allow such information to be released. But the government's view is that return information loses statutory protection as a result of prior disclosure in a judicial proceeding because this information is a part of the public record, and the taxpayer can have no expectation of privacy once the matter has been raised in court. Thus, according to the government, this information constitutes an unenumerated statutory exception.265

The problems inherent in this view are most poignantly illustrated by the case of Johnson v. Sawyer,266 which had its genesis in the late 1970s,

---

262. See Stein, supra note 218, at 1304.
263. See I.R.C. § 6103 (1994). This section provides: "Returns and return information shall be confidential, and except as authorized by this title[,] no officer or employee of the United States . . . shall disclose any return or return information obtained by him in any manner in connection with his service as such an officer or an employee . . . ." Id. "Return information" is defined in I.R.C. § 6103 (b)(2)(A). It broadly encompasses "any information gathered by the IRS regarding a person's tax liability." Johnson v. Sawyer, 640 F. Supp. 1126, 1131 (S.D. Tex. 1986) (citing Dowd v. Calabrese, 101 F.R.D. 427, 438 (D.D.C. 1984)).
265. See, e.g., Johnson v. Sawyer, 120 F.3d 1307, 1314 (5th Cir. 1997); Lampert v. United States, 854 F.2d 335, 337-38 (9th Cir. 1988).
266. 120 F.3d 1307 (5th Cir. 1997). This case has had a tortuous history. Mr. Johnson initially filed suit in the federal district court in 1983, against the IRS employees involved in the media release. See id. at 1313. His initial complaint requested damages for wrongful disclosure of return information in violation of I.R.C. § 6103. See id. Later in 1983, Mr. Johnson amended his complaint to add a claim against the United States in violation of the Federal Tort Claims Recovery Act for negligent supervision. See id. at 1314. The defendants then moved for either dismissal or summary judgment. See id. These motions were denied without a written opinion. See id. In 1984, Mr. Johnson filed a second amended complaint, adding two other IRS employees as defendants and also adding another item of return information that he alleged had been wrongfully disclosed. See id. Once again, the defendants moved for dismissal or for summary judgment on the ground that there had been no I.R.C. § 6103 violation. See id. Mr. Johnson cross-moved for partial summary judgment on the ground that the releases constituted a violation of I.R.C. § 6103. See id. In 1986, the court ruled in favor of Mr. Johnson. See Johnson v. Sawyer, 640 F. Supp. 1126, 1133 (S.D. Tex. 1986).
when the IRS audited the joint income tax returns of Elvis Johnson and his wife. Johnson was Senior Executive Vice President of the American National Insurance Co. in Galveston, Texas.\footnote{267} His job required that he travel and entertain extensively.\footnote{268} Some of his expenses were covered under his company expense account and some were not.\footnote{269} Those that were not covered constituted deductible business expenses according to the district court.\footnote{270} As he returned from each business trip, Mr. Johnson had his wife record his expenditures.\footnote{271} This was an extensive job for Mrs. Johnson, who had had no training other than what she had received from her husband.\footnote{272} On occasion, the task proved larger than Mrs. Johnson’s capabilities, and she resorted to some apparently accurate but unorthodox accounting devices.\footnote{273} For instance, when she encountered a cash disbursement which she did not know how to record, she simply altered a credit card receipt, increasing the amount shown on the receipt by the exact amount of the cash disbursement.\footnote{274} She then recorded this amount in a daily summary, which she gave to her husband to transcribe into a ledger to be given at the end of the year to their accountant, who

\footnote{1986}. In 1990, a bench trial was held on the severed FTCA claim. See Johnson v. Sawyer, 760 F. Supp. 1216, 1218 (S.D. Tex. 1991). The court once again held in favor of Mr. Johnson, awarding him $10 million. See id. at 1233. This judgment was affirmed by the Fifth Circuit. See Johnson v. Sawyer, 980 F.2d 1490, 1492 (5th Cir. 1992) (affirming the $10 million verdict); Johnson v. Sawyer, 4 F.3d 369, 372 (5th Cir. 1993) (affirming the FTCA claim). Subsequently, however, the Fifth Circuit, sitting \textit{en banc}, reversed with respect to the FTCA cause of action and remanded with directions to dismiss this claim. See Johnson v. Sawyer, 47 F.3d 716, 738 (5th Cir. 1995). On retrial, a jury eventually awarded Mr. Johnson $9 million. See Johnson v. Sawyer, Civ. A. No. H-83-2173, 1996 WL 414050 (S.D. Tex. May 15, 1996). The IRS employees once again appealed the decision.


\footnote{267}. See Johnson v. Sawyer, 760 F. Supp. at 1218.
\footnote{268}. See id. at 1219.
\footnote{269}. See id.
\footnote{270}. See id. The view of the district court was that these expenses were deductible. See id. According to the facts of the case, however, Mr. Johnson had the right to seek reimbursement for all travel expenses for himself and his wife. See id. If that is the case, the expenses may not have been deductible, in the view of the government, because the expenses are not considered “necessary” under I.R.C. § 162. See Heidt v. Commissioner, 274 F.2d 25, 28 (7th Cir. 1959) (holding that the voluntary relinquishment of the right to reimbursement is a matter of personal choice and convenience, and not a business necessity). Johnson was not entitled to seek reimbursement for expenses involving the use of alcohol, so to the extent that the expenses were legitimate business expenses that involved the use of alcohol, these expenses would have been deductible under I.R.C. § 162, although perhaps subject to limitations on deductibility under I.R.C. § 274.

\footnote{271}. See Johnson, 760 F. Supp. at 1219.
\footnote{272}. See id.
\footnote{273}. See id.
\footnote{274}. See id. at 1220.
used it to prepare their income tax returns. Because of the alterations, however, the credit card receipts did not match the ledger entries, and when the receipts were examined by IRS agents during the audit, it was obvious that the receipts had been altered.

Mrs. Johnson employed two other accounting devices that caused problems in the audit. One was to record in the daily summary of Mr. Johnson’s expenditures an amount of a credit card expenditure that matched a cash expenditure of his where Mrs. Johnson was uncertain what the cash expenditure represented. Thus, some of the expenses that Mrs. Johnson transcribed in the ledger appeared to be attributable to personal expenses. She also often arbitrarily allocated cash disbursements among the various categories of expenditures, without knowing precisely how the cash had been spent. Hence, the expenses of a given period recorded in the ledger often did not correlate to Mr. Johnson’s activities at that time. Mr. Johnson would peruse the tallies at the end of each month but he had no knowledge of his wife’s “well-meaning but eccentric” accounting procedures, nor was there any evidence of fraudulent intent on the part of Mrs. Johnson. These data were then forwarded to their accountant.

During a routine audit, IRS examining agents uncovered the discrepancies and referred the matter to the Criminal Investigation Division, which in turn referred the case to the Justice Department, recommending a prosecution for income tax evasion. At this point, the alleged deficiency was approximately $3500. During the course of the examination, Mr. Johnson proclaimed his innocence, passed two polygraph tests, and offered to pay the amount of any deficiency plus interest and penalties. The government declined this offer.

Instead, the U.S. Attorney handling the case offered the Johnsons a plea bargain: if Mr. Johnson would plead guilty to one count of tax evasion, Mrs. Johnson would not be prosecuted, the Justice Department would recommend a probated sentence for Mr. Johnson, and affirmative efforts would be made to keep the fact of the prosecution from becoming publicly known. For example, all papers filed in the case would list

275. See id.
276. See id.
277. See id.
278. See id.
279. See id.
280. See id. at 1220-21.
281. See id. Mr. Johnson was prosecuted under I.R.C. § 7201 with respect to the joint income tax returns for 1974 and 1975. See id. at 1221.
282. See id. at 1221 n.3.
283. See id. at 1221.
284. See id.
Mr. Johnson’s given name, Elvis, rather than E.E. or Johnny, as he was otherwise known; his attorney’s office address would be listed in lieu of Johnson’s home address; the information would be filed late on a Friday afternoon in an effort to make the proceeding as private as possible; and the Justice Department would not publish a press release.\textsuperscript{285}

On April 10, 1981, with no spectators present, Mr. Johnson pleaded guilty to one count of tax evasion\textsuperscript{286} and received a probated sentence. The district court summary judgment opinion noted that “as [Mr.] Johnson entered the weekend of April 11 and 12, 1981, he had good reason to believe that he had handled a difficult situation in the most sensible way possible, and that he had, at the cost of pleading guilty to a crime of which he did not feel himself guilty, protected both his wife and his career.”\textsuperscript{287} But on April 15, a Galveston journalist called the offices of American National to inquire about Mr. Johnson’s conviction, stating that he had learned of this from an IRS news release.\textsuperscript{288} The news release had contained Mr. Johnson’s full name and current home address, contrary to the terms of the plea bargain.\textsuperscript{289} It also gave his age, occupation, and place of employment, as well as the conviction and the sentence.\textsuperscript{290} It further erroneously stated that Mr. Johnson had pleaded guilty to criminal offenses involving two taxable years.\textsuperscript{291} Finally, it gave the impression that Mr. Johnson had admitted to altering documents and falsifying deductions.\textsuperscript{292}

The IRS mailed this release to at least twenty-one media outlets in the Galveston area.\textsuperscript{293} When informed by Mr. Johnson’s attorney that the press release contained erroneous data, the IRS placed a hold on the release, and over the attorney’s objections, it reissued a corrected release on April 17, again disclosing Mr. Johnson’s full name, age, address and occupation.\textsuperscript{294} The IRS officer who authorized the erroneous release did not verify the data by checking the public record, but instead relied solely on the special agent’s information.\textsuperscript{295} Moreover, the officer did not check with either the Justice Department or the U.S. Attorney to determine the

\textsuperscript{285} See id.
\textsuperscript{286} See id. at 1222. This count pertained to the 1975 joint income tax return only.
\textsuperscript{287} Id.
\textsuperscript{288} See id.
\textsuperscript{289} See id.
\textsuperscript{290} See id.
\textsuperscript{291} See id. The information charged tax evasion with respect to only one taxable year. See supra note 286 and accompanying text.
\textsuperscript{292} See Johnson, 760 F. Supp. at 1222.
\textsuperscript{293} See id.
\textsuperscript{294} See id.
\textsuperscript{295} See id. at 1223-24.
terms of any plea bargain, contrary to what the officer was required to do under the IRS District Director's guidelines.296

Mr. Johnson had previously obtained the assurance of his superiors that the conviction would not affect his job status as long as there was no publicity.297 When the release was issued, Mr. Johnson was demoted, he was forced to sell his home, and he was transferred from the Galveston office to the Springfield, Missouri office as a field agent.298 Because he was no longer an executive with the company, he was obligated to retire at age 65, instead of at age 70 as he had planned.299

Mr. Johnson filed suit against the various IRS employees involved in the prosecution and news release, and against the U.S. Attorney, alleging wrongful disclosure of tax return information in violation of the Internal Revenue Code.300 He requested $54 million in actual and punitive damages.301 The district court concluded that the release constituted a disclosure of return information which fell under no enumerated exception.302 The government argued that Mr. Johnson had no expectation of privacy in the information released because it was "incidental to information already in the public record."303 The court noted that the code provision in question was enacted in response to the wrongful use of tax return information for political purposes during the Watergate era.304 The court further noted that the provision encourages voluntary compliance with the self-assessment system by assuring taxpayers of the confidentiality of their returns.305

296. See Johnson v. Sawyer, 120 F.3d 1307, 1311-12 (5th Cir. 1997). There was apparently some discrepancy in the testimony of the IRS employee and the U.S. Attorney as to whether the U.S. Attorney had been consulted prior to the release. See id. The jury ultimately decided, however, that the U.S. Attorney had not authorized the release. See id. at 1314.


298. See id.

299. See id. at 1223 n.4.

300. See id. at 1217.

301. See id. The $54 million represented actual and punitive damages under I.R.C. § 7217 (repealed by Pub. L. No. 97-248 (1982)). See id. Section 7217 was replaced with section 7431 which permits a cause of action against the U.S. for violations of I.R.C. § 6103 by any federal employee. Section 7431 applies to wrongful disclosures made after September 3, 1982, the date of enactment. For a discussion of the policy rationale behind the change, see Karnes & Lirely, supra note 264, at 930-33. Because the disclosures in Johnson's case were made in 1981, the action was governed by prior law, section 7217. See Johnson, 120 F.3d at 1313.

302. See Johnson, 640 F. Supp. at 1133.

303. Id. at 1132.

304. See id. at 1132 n.17.

305. See id. at 1132 (citing Rueckert v. IRS, 775 F.2d 208, 210 (7th Cir. 1985)).
The court concluded that the government's actions had not been undertaken in good faith and it awarded Mr. Johnson nearly $11 million. The government appealed to the Fifth Circuit, which affirmed the district court's holding that the IRS agents had violated the nondisclosure provision of the Internal Revenue Code, but after a tortuous path through the appellate process, the Fifth Circuit ultimately held that one of Mr. Johnson's causes of action under the Federal Tort Claims Recovery Act precluded such suits against the government.

Mr. Johnson then sued the five individual IRS officers who were allegedly responsible for the release. In April 1996, a Houston jury awarded Mr. Johnson $9 million. On August 21, 1997, the Fifth Circuit once again reversed the district court, remanding the case on the ground that the jury instructions were overly broad. On January 23, 1998, shortly before the new trial was scheduled to begin, a settlement was reached. Pending final approval by the Department of Justice, Mr. Johnson will receive $3.5 million.

The courts are currently split on the issue of whether tax return confidentiality extends to information in the public record. Most of the courts that have considered this issue have held that such information is

---

306. See id. at 1133-34. Section 7217 of the Internal Revenue Code provides that a good faith disclosure of return information contrary to the provisions of section 6103 would excuse government employees from liability. See I.R.C. § 7217 (1994). The court determined, however, that the IRS employees had not acted in good faith because any competent person should have known that the disclosure of the information in this case was contrary to the provisions of section 6103. See id. Moreover, the IRS Public Affairs Officer, in releasing the data, acted contrary to the District Director's guidelines. See id.

An unresolved issue is what standard of good faith should be used—an objective or a subjective test of the agent's actions, or an objective test of the government's actions. See Karnes & Lirely, supra note 264, at 954-56.

307. See Johnson, 760 F. Supp. at 1233. Of this amount, over $5.9 million was for economic loss resulting from Mr. Johnson's demotion, and $5 million was for emotional distress and mental anguish. See Johnson v. Sawyer, 980 F.2d 1490, 1504 (5th Cir. 1992) (describing the breakdown of damages awarded before recalculation).

308. See Johnson, 980 F.2d at 1505.

309. See id. at 738-39 (Wiener, J., dissenting) (discussing the prior proceedings).

310. See Johnson v. Sawyer, 47 F.3d 716, 738-39 (5th Cir. 1995).


312. This figure included $3 million in punitive damages. The amount was increased by the trial court to around $14 million, consisting of $1.2 million in attorney's fees and $4 million in prejudgment interest. See id.

313. See Johnson v. Sawyer, 120 F.3d 1307, 1338 (5th Cir. 1997).

314. See Verdicts Reversed After Trial, supra note 311, at C17.

315. See id.
not protected under the statute. Others have held that confidentiality or privacy is not the issue. Instead, the issue is whether the information is protected under the statute, and if so, the government's disclosure is unauthorized.

None of these opinions has been as well reasoned as the final decision in Johnson v. Sawyer, rendered by the Fifth Circuit in 1997. In declining to follow the examples of the Sixth and Ninth Circuits, which have held that matters of public record are not subject to the Code's disclosure bar, the Fifth Circuit reasoned that the plain meaning of the statute does not provide for such an exception. Moreover, the Fifth Circuit found that following the list of express disclosure exceptions in the statute is a list of "Safeguards," under which federal agencies to whom the IRS may disclose return information are required to take certain steps to guarantee the security of the information. If any of the information becomes part of a public record, as in a judicial or administrative proceeding, the safeguards no longer apply. There is no express exception for the IRS from nondisclosure of such information. Thus, deduced the court, Congress did not intend to provide an implicit exception for such information.

Moreover, the court reasoned that Congress considered the possibility that the IRS would need to issue public notifications disclosing the identity of some taxpayers, as in the case in which the taxpayer is entitled...

316. See, e.g., William E. Schrambling Accountancy Corp. v. United States, 937 F.2d 1485, 1490 (9th Cir. 1991) (holding that there is no violation of I.R.C. § 6103 when the information in question was in the public domain and therefore no longer confidential); Lampert v. United States, 854 F.2d 335, 338 (9th Cir. 1988) ("Once tax return information is made a part of the public domain, the taxpayer may no longer claim a right of privacy in that information.").

317. See, e.g., Rodgers v. Hyatt, 697 F.2d 899, 906 (10th Cir. 1983) (holding that even if the information was no longer considered confidential, disclosure was, nevertheless, unauthorized); Chandler v. United States, 687 F. Supp. 1515, 1520 (D. Utah 1988) ("[P]rior in court exposure of . . . return information is not relevant to the decision whether the IRS unlawfully disclosed the information . . . "). affg 887 F.2d 1397 (10th Cir. 1991). The Sixth Circuit, relying on Schrambling, has distinguished disclosures of information in publicly recorded tax liens from information pursuant to a judicial proceeding. See Rowley v. United States, 76 F.3d 796, 801 (6th Cir. 1996) (stating that the recording of a federal tax lien is designed to provide public notice and is thus qualitatively different from disclosures made in judicial proceedings, which are only incidentally made public). It is interesting to note that, in Schrambling, the case dealt with the disclosure of information in a federal tax lien and in a bankruptcy petition. See Schrambling, 937 F.2d at 1489-90. The court reserved judgment on whether confidential return information disclosed through improperly issued levies would constitute a violation of I.R.C. § 6103. See id. at 1490.

318. 120 F.3d 1307 (5th Cir. 1997).
319. See id. at 1318-19.
320. See id. at 1320-21.
321. See id. at 1320 (relying upon I.R.C. § 6103(p)(4) (1994)).
322. See id. at 1320-21.
323. See id. at 1321.
to a refund and the IRS, "after reasonable effort and lapse of time, has been unable to locate such persons."\textsuperscript{324} According to the \textit{Johnson} court, this recognition gives further credence to the assumption that the omission of public record information from the enumerated disclosure exceptions was intentional.\textsuperscript{325}

The court then examined the rationale of the nondisclosure provision and concluded that Congress intended to provide confidentiality to taxpayers to encourage compliance with the voluntary assessment system.\textsuperscript{326} By prohibiting disclosure of all return information, issues of ad hoc determinations of what is and is not subject to the prohibition are avoided.\textsuperscript{327} As the court noted, "[i]n enacting . . . a prophylactic ban, Congress was determining that a taxpayer has a statutorily created ‘privacy’ interest in all his tax return information, despite the fact that some of it is not entirely ‘secret.’"\textsuperscript{328} The court opined that the test for determining whether return information can be lawfully disclosed by the government is the source of the information, not its status as “private” or “confidential.”\textsuperscript{329} If the source of the information is not the return or internal documents based on the return, the information may be disclosed.\textsuperscript{330}

Finally, the defendants raised a First Amendment claim which the court rejected on two grounds.\textsuperscript{331} First, the First Amendment applies differently to government employees than it does to members of the media, because government employees have "no First Amendment responsibility to report on criminal proceedings or other government operations."\textsuperscript{332} Second, government employees are specifically prohibited by law from disclosing return information.\textsuperscript{333} Thus, they have no First Amendment protection with respect to such disclosures.\textsuperscript{334}

At least one commentator believes that the better approach is that espoused by the government—that information disclosed in a judicial proceeding or other public record is no longer confidential, and therefore

\begin{itemize}
\item \textsuperscript{324} \textit{Id.} (quoting I.R.C. § 6103(m)(1)).
\item \textsuperscript{325} \textit{See id.}
\item \textsuperscript{326} \textit{See id. at 1322-23.}
\item \textsuperscript{327} \textit{See id. at 1322} (quoting \textit{Johnson v. Sawyer}, 47 F.3d 716, 735 (5th Cir. 1995)).
\item \textsuperscript{328} \textit{Id. at 1323.}
\item \textsuperscript{329} \textit{Id.}
\item \textsuperscript{330} \textit{See id.; see also} \textit{Thomas v. United States}, 890 F.2d 18, 21 (7th Cir. 1989) (holding that IRS could publicize information garnered from a Tax Court opinion).
\item \textsuperscript{331} \textit{See Johnson}, 120 F.3d at 1323-24.
\item \textsuperscript{332} \textit{Id. at 1324.}
\item \textsuperscript{333} \textit{See I.R.C. § 6103(a) (1994).}
\item \textsuperscript{334} \textit{See Johnson}, 120 F.3d at 1324.
\end{itemize}
loses its statutory protection against disclosure.\textsuperscript{335} There are problems, however, with such wholesale disclosure. First is the unresolved issue of erroneous disclosure of return information or wrongful levy.\textsuperscript{336} The government should not be allowed to hide behind a public record exception where the information is not legitimately a part of the public record. Second, the release of information to the media that has been previously disclosed in a judicial proceeding causes the information to become more widely disseminated than it would otherwise have been. The consequences to the taxpayer may be dire, as the case of\textit{Johnson v. Sawyer} so well illustrates. This puts the taxpayer in a position of having to choose between the statutory protection against disclosure of confidential return information and the right to litigate an issue in court.\textsuperscript{337} This is an untenable position for the taxpayer, and surely cannot be what Congress intended.

The government has two general reasons for disclosing return information. One is to assist the investigation and collection process, and the other is to encourage and improve voluntary compliance by publicizing the prosecutions of those who evade their tax liability. Both of these are legitimate and important governmental interests. Nevertheless, it does not follow that the ends justified the means in the case of\textit{Johnson v. Sawyer}. In the release of information during the investigation and collection process, the disclosure must be necessary to obtain the information sought.\textsuperscript{338} In determining whether the disclosure is necessary, the courts will look to whether the information is “otherwise reasonably available.”\textsuperscript{339} Thus, the interests of the government are weighed against the taxpayer’s right to privacy. This should also be the case with respect to the disclosure of information otherwise in the public record, because the release of such information may have devastating consequences to the taxpayer. Even if we were to assume that the information in\textit{Johnson v. Sawyer} could have been released without violating the prohibition against disclosure, where there are extenuating circumstances, as there were in that case, these circumstances should have been taken into account in the initial determination of whether to release the information to the media. Thus, even if the disclosure issue is ultimately resolved in favor of the government, the courts should require the government to consider the


\textsuperscript{336} See generally Karnes & Lirely, supra note 264, at 948-51 (discussing wrongful levies and other wrongful disclosures).

\textsuperscript{337} See id. at 964.

\textsuperscript{338} See generally id. at 940-48 (discussing the limitations on disclosures in the process of investigation and collection).

\textsuperscript{339} Id. at 941 (quoting Barrett v. United States, 795 F.2d 446, 451 (5th Cir. 1986)).
underlying circumstances before disclosing the information to the media. Thus, the need for disclosure should be weighed against the taxpayer’s right to privacy, even though the disclosure follows a conviction.

V. CONCLUSION

The difficulties normally inherent in resolving ethical problems in the general practice of law are compounded in the practice of tax law, not only because of the complexity of the substantive issues but also because of the nature of tax practice with its extra layers of ethical rules. These difficulties are further worsened by the tension and lack of meaningful dialogue between the IRS and the ABA, which create particular problems for lawyers who prepare returns, as defined under the Code and regulations.

While it has been stated that tax lawyers have a separate duty to the tax system, this author maintains that should not be the case. The lawyer’s only duty should be to obey the rules of law and ethics, although obedience to the rules of ethics may sometimes involve significant judgment calls by the attorney and a careful balancing of the rules of professional ethics of the various state bar associations with the ethics rules imposed by the government under Circular 230. A particular problem arises in balancing the tensions and conflicts between the ethics rules of Circular 230 and the preparer penalty provision under the Code on the one hand with the corresponding taxpayer penalty provision on the other hand.

A further problem for lawyers who prepare returns is the issue of the extent to which the attorney-client privilege applies. The position of the government is that the attorney-client privilege has a very narrow application and does not apply at all when the attorney is functioning as an accountant or a scrivener. This rationale has been based, in part, on the fact that there was no comparable accountant-client privilege and that when a lawyer performed the same role as an accountant, the attorney-client privilege did not apply.

It is currently unclear what effect, if any, the newly enacted nonlawyer-client privilege will have on the government’s view of the attorney-client privilege. It is likely, however, that the new privilege will have minimal, if any, effect because the newly enacted privilege is fraught with limitations, one of them being that the new privilege is subject to the interpretations of the federal common law as it has been applied to the attorney-client privilege. While the rationale behind much of the federal common law interpretations of the attorney-client privilege may involve circular reasoning as far as the newly enacted privilege is concerned, nevertheless, Congress has explicitly stated that the new privilege is
subject to the interpretations of the federal common law as it has evolved under the attorney-client privilege.

One effect the new privilege is likely to have is that the door will be opened wider for accountants, enrolled agents, and others entitled to practice before the IRS to encroach upon the practice of law. Law practice in the twenty-first century is likely to be very different from what it is today. As we are poised on the brink of the twenty-first century, the opportunity is ripe for the ABA both to reconsider its position on the prohibition of fee-sharing arrangements and to establish a meaningful dialogue with the IRS to resolve the tensions that have existed for the past thirty years. This opportunity is an important one not only for tax lawyers in particular, but for the legal profession in general.

Because of the IRS Restructuring and Reform Act of 1998, the IRS is currently undergoing a reorganization. Thus, the time is also ripe for the Supreme Court to seize the opportunity when it next presents itself to resolve the conflict among the circuits on whether the government’s duty to maintain the confidentiality of tax return information applies to information elicited at a public trial. If it should be determined that information in the public domain is no longer subject to confidentiality protection, the Court then needs to clarify whether there are any circumstances that might constitute an exception to this lack of confidentiality, such as the Johnson situation in which efforts were taken to make the proceeding less public.

If the government’s duty of confidentiality with respect to return information is limited, there is a danger that taxpayers may be victimized by the government because of their stature in the community rather than because of the seriousness of their offense. Until this issue is resolved, attorneys representing high profile clients should be aware that there is a greater danger of victimization by the government if the case should proceed to trial.

These issues are important ones that should be addressed by the ABA, the government and the courts as the legal profession hovers on the brink of a new era.