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Tax Ethics and Legal Indeterminacy

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ABSTRACT

The modern framework of professional tax ethics is often given in reference to famous quotations of Justice Oliver Wendell Holmes or Judge Learned Hand. The common quote from Holmes is that "the very meaning of a line in the law is that you may intentionally go as close to it as you can if you do not pass it"; Hand's quote is that "there is nothing sinister in so arranging affairs as to keep taxes as low as possible . . . [a taxpayer] is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." However, there are two significant problems when these are applied to form the basis of tax ethics. First, Holmes' idea of "crossing the line" is taken as a presumption that tax laws are legally determinate. They are not. Every tax practitioner ought to be aware that tax laws are not legally determinate. Accordingly, the limits of tax planning should not be expected to be clearly marked. Second, Hand's premise of the legitimacy of "arranging affairs" raises the problem of structuring. By structuring, the tax practitioner creates a convoluted and indeterminate transaction out of a previously known set of facts. The respective "facts" then become slippery, just as Karl Llewellyn said, so the dream of tax law as a complete and fully valid set of intersecting code provisions dramatically falls apart. The Internal Revenue Service has struggled to respond to this challenge with new penalties and ever-changing tests. However, tax structuring represents a new animal in terms of legal philosophy comprising Factual Indeterminacy, where the underlying "facts" become indeterminate in various ways. This changes things for tax ethics because the standard line—"the lawyer applies the law to the facts"—is not an exclusive description of tax lawyering. By structuring, the tax lawyer is sometimes pushing *toward* indeterminacy. In nearly all other legal contexts lawyers push in the opposite direction, *away from* indeterminacy. Various ethics scholars have proposed that the tax lawyer merely acts in different roles in different contexts, and that personal standards of ethics (or, morals) could serve as a guide to ethical lawyering. An alternative framework of professional tax ethics based on the *direction* of tax planning toward or away from indeterminacy is proposed here.

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I. INTRODUCTION

Tax ethics begins with the reasonable premise that a tax lawyer or accountant should not assist the client toward fraud or other illegal activity.[1] Building on the writings of Justice Holmes, most tax scholars in both the United States and internationally propose a "bright-line" rule distinguishing mere "tax avoidance" from "tax evasion."[2] Tax evasion is given as an allusion to fraud or other illegal activity that is to be avoided.[3] The relevant excerpt from Justice Holmes is as follows:

> The only purpose of the [taxpayer] was to escape taxation. … The fact that he desired to evade the law, as it is called, is immaterial, because the very meaning of a line in the law is that you may intentionally go as close to it as you can if you do not pass it.[4]

The lesson seems to be that on matters of "aggressive tax planning" a lawyer or accountant should see the clearly-marked fraud line and immediately know not to cross it. This is similar in concept to the 38th parallel line dividing North and South Korea. The demilitarized zone ("DMZ") is clearly marked on both sides and constitutes the demarcation line—only a fool or very desperate person would cross that line. However, a legal standard that says merely "don't cross the line" really tells us nothing about the nature of tax fraud, except to warn that a line exists which should not be crossed.[5] The ubiquitous reference to Holmes is rather a description of the nature of tax law and compliance more generally, and thus an attempt to answer the more fundamental question of tax practice, a question that some tax scholars have even doubted,[6] which is whether or not there is such a thing as wrongful conduct in professional tax practice.

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1. *See* DONALD TOBIN, RICHARD LAVOIRE & RICHARD TROGOLO, PROBLEMS IN TAX ETHICS (West: Thomson Reuters eds., 2009); LINDA GALLER & MICHAEL B. LANG, REGULATION OF TAX PRACTICE (Matthew Bender & Co. eds., 2010); DEBRA SCHENCK, BERNARD WOLFMAN & JAMES HOLDEN, ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE 156 (Michie & Co. eds., 2d ed. 1985).

2. *See* Don Hansen, Rick Crosser & Doug Laufer, *Moral Ethics v. Tax Ethics: The Case of Transfer Pricing Among Multinational Corporations*, 11 J. BUS. ETHICS 679, 683 (1992); Zoë Prebble & John Prebble, *The Morality of Tax Avoidance*, 43 CREIGHTON L. REV. 693, 715 (2010) (citing Duke of Westminster v Commissioners of Inland Revenue [1936] AC 1 at 19-21 (Eng.)) ("Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.").

3. Michael C. Durst, *The Tax Lawyer's Professional Responsibility*, 39 U. FLA. L. REV. 1027, 1054 (1987) ("The prohibition of lawyer assistance in 'criminal or fraudulent' behavior has considerable appeal in identifying conduct in which the client has no proper claim to legal assistance. While different criminal acts may involve varying degrees of culpability, by designating conduct as 'criminal' the legislative authority clearly signifies that the conduct is normatively wrong.") (citations omitted).

4. Superior Oil Co. v. Mississippi, 280 U.S. 390, 395 (1930).

5. TOBIN, *supra* note 1, at 190 ("Tax administration has long been hampered by taxpayers who seek deceptive and fraudulent means of avoiding tax. These types of transactions are obviously illegal and a lawyer's participation in advising, adding or marketing such transactions clearly violates ethical and statutory rules.").

6. *See* Robert W. McGee, *Is Tax Evasion Unethical?*, 42 U. KAN. L. REV. 411, 434-35 (1994) ("If there is nothing ethically wrong with tax evasion, it seems to follow that attorneys, accountants and financial planners should not be penalized for advising their clients to evade taxes or even for helping them to evade taxes. . . . If the advocacy of tax evasion is not unethical, and it appears that it is not, then a code of ethics that punishes individuals for advising their clients to evade taxes may itself be

This article presumes that wrongful conduct in professional tax practice is possible in theory, and further, that it does exist in reality.[7] Projects involving tax fraud at large organizations are often described in colloquial terms as "passing the monkey." This refers to pushing the responsibility for tax fraud to others, usually down a chain of command. The standards of professional tax ethics premised on the personal ethics or morality of the tax lawyer do not address this type of ethical problem that arises in "aggressive tax planning" projects.[8] The prior omission of this key aspect of tax practice means that a workable standard of professional tax ethics is urgently required for the good of the profession.[9]

The philosophy of self-regulation by lawyers in the tax context has been viewed with skepticism by prior generations of tax scholars. For instance, Ann Southwood wrote: "[y]et the bar has failed consistently to provide meaningful standards and discipline for its members in return for its status as a licensed profession closely tied with government and law enforcement. The concept of self-regulation is fundamentally flawed."[10] If this is true, then the ethical problems described in this article are important because the tax profession could lose its ability to self-regulate if popular frustration with the tax system grows and workable standards of tax ethics are not implemented. The broad professional ethics standards given in the Model Rules comprise an invitation for the development of a common law on the subject of tax ethics.[11] However, this may prove difficult: the development of ethical rules by a common law process would require decades, if ethics enforcement cases were relatively common. But because such cases are, in fact, relatively uncommon, the development of a common law on tax ethics might take longer than decades—perhaps centuries. That may not be fast enough. A workable ethical rule to limit

perpetrating an injustice because it is punishing someone for advocating something that is not unethical."); *see also* Robert McGee, *Three Views on the Ethics of Tax Evasion*, 67 J. BUS. ETHICS 15 (2006) (describing three standards of ethics in tax evasion).

7. Geoffrey C. Hazard, Jr., *How Far May a Lawyer Go in Assisting a Client in Legally Wrongful Conduct?*, 35 U. MIAMI L. REV. 669, 669–70 (1981) ("This analysis indicates the dimensions of the lawyer's duty under criminal and civil law to refrain from 'assisting' a client in conduct that is 'illegal.' A lawyer violates that duty if… (3) The lawyer facilitates the client's course of conduct either by giving advice that encourages the client to pursue the conduct or indicates how to reduce the risks of detection, or by performing an act that substantially furthers the course of conduct.").

8. *See, e.g.*, Linda Galler, *The Tax Lawyer's Duty to the System*, 16 VA. TAX REV. 681, 692 (1997) ("[T]he lawyer's personal integrity is particularly significant in tax planning, where the lawyer assists her client in making or creating facts, rather than in characterizing events that have already occurred."); Heather M. Field, *Aggressive Tax Planning & the Ethical Tax Lawyer*, 36 VA. TAX REV. 261, 266 (2017) ("So how should a tax planner, who wants to engage in 'permissible tax planning' but not cross the line over into 'unethical loophole lawyering,' exercise her discretion and judgment? … [A] lawyer seeking to pursue a career as an ethical tax planner should identify and implement her philosophy of lawyering to help her make difficult discretionary tax advising decisions in a principled way, and when implementing that approach to tax lawyering, she should work to counteract the subtle factors that can skew her professional judgment.").

9. John S. Dzienkowski & Robert J. Peroni, *The Decline in Tax Adviser Professionalism in American Society*, 84 FORDHAM L. REV. 2721, 2723 (2016); *see also* Anthony C. Infanti, *Eyes Wide Shut: Surveying Erosion in the Professionalism of the Tax Bar*, 22 VA. TAX REV. 589, 601–02 (2003).

10. Ann Southworth, *Redefining the Attorney's Role in Abusive Tax Shelters*, 37 STAN. L. REV. 889, 905 (1985) ("However committed to public service individual members of the bar may be, lawyers as a group cannot subordinate their own interests to larger societal concerns. Rather, they can agree only to ethical rules necessary to keep the public at bay.").

11. MICHAEL HATFIELD, ETHICS OF TAX LAWYERING 1 (3d ed. 2015) ("[T]he Model Rules reflect the complex realities of lawyering, prescribing different standards for a lawyer working as an advisor, neutral third party, and advocate, as well as unavoidable duties to third parties, opposing counsel, and the tribunal.").

aggressive tax planning to some degree is needed in the nearer future and within the lifetimes of the current generation of tax scholars and practitioners; the purpose of this article is to provide a first proposal based on the direction of tax planning toward or away from indeterminacy, especially Structuring Indeterminacy, as explained below.

Part II of this article provides some basic context on tax ethics and previous attempts to distinguish the concepts of avoidance, evasion, and fraud in the context of tax planning. Part III introduces the concept of Legal Indeterminacy and explores its possible applicability to the field of tax ethics. Part IV discusses how aggressive tax planning on the part of lawyers or accountants structures facts in a way that eludes determinate legal scrutiny. Part V of this article explores the problem of Factual Indeterminacy where tax structuring involves, predominantly, the creation of facts to create indeterminacy under the tax laws. Part VI presents a hypothetical fraudulent transfer pricing situation reflecting concepts of Legal Indeterminacy, with a discussion on how a tax professional may not be able to resolve it in a manner consistent with traditional views on tax ethics. Finally, Part VII proposes an ethical standard for transactional tax practice based on the direction of movement along a spectrum of indeterminacy within tax planning activity.

II. Background: Tax Avoidance, Tax Evasion and Tax Fraud

Scholars in tax ethics typically refer to the supposed demarcation line between good and bad behavior amongst tax practitioners as the line between "tax avoidance" and "tax evasion."[12] The idea is that students of tax ethics might determine the meaning of "tax evasion" by referring to the other term, "tax avoidance."[13] Outside the United States, these buzz words are often taken to have specific meanings in reference to particular types of tax avoidance,[14] whereas within the United States, it is often conceded that the meanings of the buzz words are insufficient to distinguish between legal and illegal conduct. As renowned tax scholar Michael Durst explained: "[i]n the past, analysis of the lawyer's professional obligations has been impeded by a tendency to assume that questions concerning the client's normative obligations have clear answers."[15] In the actual practice of law and accounting, tax structuring toward determinate tax outcomes is uncertain, and correspondingly, the ethics of conduct related to tax structuring is also uncertain.

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12. Here, the term tax practitioner is used broadly to include tax lawyers and others. GALLER & LANG, *supra* note 1, at 171 ("The tax professional community includes a range of people with different levels and kinds of experience, education and professional licenses. Members of this community include lawyers, CPAs, other accountants, enrolled agency, return preparers with limited experience, enrolled actuaries, [and others] . . . .").

13. *Id.* at 683 ("It is important to point out that the transfer pricing scheme adopted constitutes legal planning for the minimization of the tax burden (e.g., tax avoidance). Tax avoidance must be distinguished from tax evasion. Tax evasion would clearly be viewed as unethical. It is also illegal. Tax evasion entails deception and concealment. On the other hand, the taxpayer practicing tax avoidance is merely behaving in a way which hopefully will reduce tax liability.").

14. *See, e.g.*, EUR. COMM'N, EUROPEAN SEMESTER THEMATIC FACTSHEET: CURBING AGGRESSIVE TAX PLANNING (2017), https://ec.europa.eu/info/sites/info/files/file_import/european-semester_thematic-factsheet_curbing-agressive-tax-planning_en.pdf ("Aggressive tax planning (ATP) consists in taxpayers' reducing their tax liability through arrangements that may be legal but are in contradiction with the intent of the law.").

15. GALLER & LANG, *supra* note 1, at 4 (citing Michael C. Durst, *The Tax Lawyer's Professional Responsibility*, 39 U.FLA. L. REV. 1027, 1082 (1987)).

Geoffrey Hazard described these type of ethical concerns in his article *How Far May a Lawyer Go in Assisting a Client in Legally Wrongful Conduct?*[16] In modern descriptions of tax ethics, we are led to believe this should never happen as long as the tax lawyer uses her internal moral compass to know where the line of legally wrongful conduct is and avoid going across it.[17] Nonetheless, the situation becomes more difficult where we begin to add uncertainty into the mix, both in the lawyer's knowledge of what the client may be up to and in respect to various forms of legal uncertainty.[18] Rather than a "bright-line" rule, Hazard posited a spectrum of lawyer conduct depending on the type of assistance offered to the client toward wrongful conduct.[19] Hazard's spectrum accounts for several different types of uncertainty in client assistance:

> At the least instrument end of the spectrum, the lawyer merely provides the client with an expert definition of the limits of the law, leaving it to the client to consider whether those limits should be transgressed. At the other end of the spectrum, the lawyer personally provides the means without which the client could not achieve the illicit purpose.[20]

The scholarly discussions of the appropriate rendering of tax opinions by lawyers on tax shelters have concerned tax ethics scholars for many years.[21] Yet these types of legal opinions on tax shelters seem to fall on the tame side of Hazard's spectrum. Tax structuring, on the other hand, seems more like a lawyer providing the means without which the client could not achieve a favorable tax result and, thus, seems to fall on the more questionable side of the spectrum. If there is a spectrum of potentially wrongful conduct by tax lawyers rendering advice on aggressive tax planning, then concern over "tax evasion" is not limited merely to the marketing of tax shelters; ethical concerns might relate to other types of "aggressive tax planning," especially structuring. In respect of the oft-raised ethical concerns regarding legal opinions on tax shelters, the concern is that the tax laws are improperly drafted, or insufficiently precise, and leave open "loopholes"[22] that a clever tax lawyer could exploit.[23] To the contrary, the primary ethical concern is not legal "loopholes" due

16. *See* Hazard, *supra* note 7, at 676.

17. Field, *supra* note 8, at 264–65.

18. Hazard, *supra* note 7, at 672. ("As the matter unfolds, it may appear to the lawyer that the portents of abuse are strong or weak, clear or ambiguous, firm or wavering. When are these portents sufficiently certain so that the lawyer 'knows' that the client intends an illegal objective and is bent on its accomplishment?").

19. *Id.* at 671.

20. *Id.*

21. GALLER & LANG, *supra* note 1, at 55 ("Section 6692(d)(2)(C) defines the term "tax shelter" to mean a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement if a significant purpose of the partnership, entity, plan or arrangement is the avoidance or evasion of Federal *income* tax.")

22. Rachelle Holmes Perkins, *The Tax Lawyer as a Gatekeeper*, 49 U. LOUISVILLE L. REV. 185, 196 (2010) ("[C]lients want to push the limits of textualist interpretations in order to capitalize on loopholes that are created.").

23. David Schizer, *Enlisting the Tax Bar*, 59 TAX L. REV. 331, 334-35 (2006) ("First, shelters (and, indeed, all aggressive planning) exploit poorly drafted statutes and regulations. The relevant rules are capable of being read (albeit aggressively) to allow, for example, tax losses with no corresponding economic losses. Drafters need to be more effective in anticipating this sort of misreading. This task is especially important, and especially difficult, when judges focus on the text, instead of on congressional purpose, and construe ambiguities against the government. Textualist judges cannot be counted on to

to poor statutory drafting,[24] but structuring which would likely overcome any method of statutory drafting. This is more precisely described as tax planning toward indeterminacy in the facts.[25]

Several of the more recent discussions of aggressive tax planning seem to place an emphasis on the term "aggressiveness." Yet once again, problems arise in that the key term is defined only by reference to broad categories and is otherwise undefined, but seems to fall somewhere under the umbrella of "profit shifting."[26] One is left to wonder whether there is a non-aggressive version of tax fraud; I suppose that would be a small businessman just taking a few dollars out of the till upon a lawyer's suggestion. The truth is that the terminology and ethical standards when applied to aggressive tax planning are as close to free from content as any legal standard could be free from content, as we have no working definitions—only illustrations.[27]

At the very least, these standards leave unanswered the primary question of the scope of illegality in aggressive tax planning, where "the lawyer personally provides the means without which the client could not achieve the illicit purpose," most of the time. A more objective standard is needed, first to identify "tax fraud" where it exists, and second to judge whether the tax lawyer materially assisted in that specific type of wrongful conduct. Therefore, in tax ethics we really have two problems: we do not have an objective standard to determine tax fraud in the first place,[28] nor do we have an objective standard to say whether the lawyer assisted in the fraud.

In the actual world of aggressive tax planning and tax fraud, tax executives rarely, if ever, refer to "tax evasion." Executives instead often refer to tax fraud by the colloquial phrase "passing the monkey": the unfortunate soul deemed responsible for implementing the tax fraud has the proverbial monkey on his back. The monkey is rarely tame and has a tendency to bite and scratch and to ask for updates, timelines, and status reports. The goal within large corporations is to transfer the monkey to someone else, nearly always down the chain of command, such as in the

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ask, "Why would Congress allow such a generous result?" Instead, they consider it the job of Congress or Treasury, not the courts, to shut down abusive transactions.").

24. Michael Schler, *Effects of Anti-Tax-Shelter Rules on Nonshelter Tax Practice*, TAX NOTES 915 (Nov. 14, 2005) ("I believe broad statutory antiabuse rules are necessary to combat tax shelters, because specific statutory language will never be sufficient to keep ahead of creative tax planners.") (citing Michael Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbac*h, 55 TAX L. REV. 325, 379–84 (2002)).

25. *See generally* TOBIN, ET AL., at 190 ("A much more difficult question arises, however, when the transaction is not simply a fraudulent transaction, but is instead a complicated transaction that achieves significant tax savings by manipulating various tax provisions. These transactions are also built on fanciful profit projections that almost never materialize. In common parlance these transactions are referred to as tax shelters.").

26. *See, e.g.*, *Aggressive Tax Planning*, ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, http://www.oecd.org/tax/aggressive/ (last visited Feb. 22, 2020) (Base Erosion and Profit Shifting (BEPS) initiative, Aggressive Tax Planning, referencing Action Item(s) 2, 3, 4 and 12 ("Hybrid Mismatch Arrangements (Action 2), Controlled Foreign Companies (Action 3), Interest Deductibility (Action 4) and Mandatory Disclosure (Action 12)")).

27. *Id*.

28. Durst, *supra* note 3, at 1054 ("The prohibition against assistance in 'fraudulent' conduct reflects universal social condemnation of deceit in interpersonal and commercial relations, as well as in legal proceedings, which depend on truthful presentations by opposing parties to resolve disputes fairly. From a strictly logical standpoint, the prohibition of assistance in 'fraudulent' activities may be unnecessary, because conduct that is fraudulent should, as a general rule, also involve potential criminal liability.").

famous Societe General fraud case of Jerome Kerviel.[29] Really good and successful corporate executives are skilled experts in "passing the monkey" onward without anyone ever realizing they had it in the first place. This is not meant to trivialize the role of corporate executives, but rather acknowledges that skill in passing the monkey is a necessary and essential skill for survival in the corporate world, and perhaps within other large organizations.

Yet, since "the monkey" is a very real and a thing that could be accounted for, and because "the monkey" was intentionally created as a company project by the higher-ups in the chain of command, it is accordingly not realistic or even plausible to think that a corporate lawyer, as example, might just withdraw from representation as the Model Rules discuss,[30] nor pass the monkey back up the chain returning it from whence it arose. This is why, when fraud is discovered at big companies, often the responsible person is found to be a junior employee within the organization, representing the final person who received the monkey as a project and was unable to pass it any further. Critically, the monkey does not pass up the chain, at least not very often. One glaring problem in the terminology of tax ethics is that using the phrase "tax evasion" gives the impression that such activity is relatively rare and can be avoided if one keeps a close lookout. However, tax fraud usually arises in situations of uncertainty which are often referred to in philosophical terms as "Legal Indeterminacy."[31] Accordingly, if tax fraud was related to uncertainty rather than certainty, and instead referred to with its colloquial terminology as "passing the monkey," along with an explanation of how tax fraud lives and breathes and scratches and bites in large organizations, then any legal or accounting student thinking about the subject of professional ethics for the first time would realize that the problem of tax fraud was very real.

III. Legal Indeterminacy and Tax Ethics

The Holmesian quote as given above–"you may intentionally go as close to it as you can if you do not pass it"[32]–also suffers from severe problems related to Legal Indeterminacy. The problem of Legal Indeterminacy is well known in the existing literature.[33] In tax contexts, the contemporary application of that maxim

29. *See Société Générale: The Anatomy of a Fraud*, INFOMINA 2 (Feb. 2008), http://www.infomina.ro/pdf/Societe%20Generale%20-the%20anatomy%20of%20a%20fraud.pdf ("[Kerviel] continued with these strategies, his superiors appearing not to observe it . . . How was it possible? According to the bank, for 12 months, the 31 year old Jérôme Kerviel had tricked all the security systems. The method of operation was basic: he would issue a payment order and he would hide it with another fictitious selling order. As a result the bank only saw the balance of threse [sic] two operations, meaning it saw nothing.").

30. Hazard, *supra* note 7, at 670 ("There can be situations in which a lawyer's duty is overborne by concern for personal survival."); GALLER & LANG, *supra* note 1, at 115 ("Model Rules 1.6(b)(2) and (3). The first permits a lawyer to reveal information relating to the representation of the client 'to the extent the lawyer reasonably believes necessary' to 'prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another [i.e., the IRS] and in furtherance of which the client has used the lawyer's services.'").

31. Hazard, *supra* note 7, at 671–72 ("[T]he question is how far a lawyer may go in conduct that might enable the client to accomplish an illegal purpose… [This] deals with the additional dimension of probability, or, to refer to it by another name, the dimension of uncertainty.").

32. However, Holmes' legal analysis would look different under the tax laws that exist today. *See* Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 460–61 (1897).

33. *See e.g.* Brian Bix, *Can Theories of Meaning and Reference Solve the Problem of Legal Indeterminacy*, 16:3 RATIO JURIS 281 (2003).

begins by taking that quote to presume determinacy in tax law. The term "Legal Indeterminacy" refers to indeterminacy or the inability to find an answer, or just one possible answer, within legal frameworks on a legal question. Although this problem can arise anywhere in the law it usually arises in legal frameworks that involve codes, like the Internal Revenue Code (the "Code").

Nonetheless, there are many legal and accounting scholars that think of the Code as fully valid, meaning that any and all questions that arise in the field of taxation should be answerable by either looking to the text of the Code or through "interpretation" of its context. In other words, if the answer is not covered in the actual text, it can be gleaned. The term "legal interpretation" is taken to mean gleaning content from context. Significantly, even the leading positivist tax scholars in the world readily admit the potential for Legal Indeterminacy in the gleaning or "interpretation" process;[34] basically, tax lawyers might glean in different ways and the difference in gleaning creates Legal Indeterminacy. Other scholars, often referred to as Legal Realists, going back to G.W.F. Hegel, who was perhaps the first realist in legal interpretation, do not think that the Code is fully valid.[35] This means that there are factual situations not covered by the code itself or by a gleaning process from the framework of the code. Under this view, Legal Indeterminacy exists because the code does not cover all possible situations and, as new situations arise, these may or will be indeterminate or unknown. Luckily, it is not necessary to debate the issue further in this article, since either way, positivist or realist, Legal Indeterminacy exists in the world. And, the simple fact that Legal Indeterminacy exists creates several significant problems for the "bright line" view of tax ethics, four of which are discussed here: (i) difficult cases; (ii) bona-fide disagreements; (iii) spectrum of "illegality"; and (iv) bad actors in the tax profession.

A. Difficult Cases

The first significant problem is that an ethical standard that refers to personal ethics or morality of the individual tax lawyer in the context of aggressive tax planning does not provide the basis for an accusation of ethical misconduct at all. The only way that tax misconduct could occur is if tax lawyers were to admit they violated the terms of their own morality. Furthermore, assuming that some easy cases exist where the lawyer could look to her own personal standards of ethics and work out a solution, it is safe to assume that tax lawyers and accountants do not often get assigned to the easy cases.[36] Many situations are likely to involve ethical dilemmas where there is no answer under the applicable tax laws, let alone the given ethical standards of prior cases.

34. *See* Michael Potács, *Legal Theory* (Kluwer, 2015) at Ch. V, sec. A, part 2 ('Even Kelsen stressed the exact opposite: 'All previously developed methods of interpretation always lead only to a possible, not a single correct result.' The assumption here is that legal positivism constitutes an objective meaning (or content) of legislation. However, this assumption does not exclude the possibility that the objective meaning of legislation is vague or indeterminate.').

35. *See* Bret Bogenschneider, *5 ½ Problems with Legal Positivism and Tax Law*, 2017 PEPP. L. REV. 1 (2017).

36. Ronald Dworkin, *Hard Cases*, 88:6 HARV. L. REV. 1057, 1060 (1975); Frederick Schauer, *Easy Cases*, 58 S. CAL. L. REV. 399, 407 (1985) (The distinction between easy and hard case within legal philosophy seems to have begun with *Hard Cases* and then continued with *Easy Cases*, a work that is often cited).

The related problem in difficult cases is that if the rules of professional ethics exist to discipline tax lawyers for misconduct, then there ought to be rules that provide an ethical choice or option—not a decision between two unethical alternatives. If any situation exists under the rules of professional ethics that does not provide an ethical alternative for the tax practitioner, then there really is no guarantee of "mis"-conduct: the tax practitioner legitimately may have chosen between the lesser of two evils. If the tax practitioner correctly chose the lesser evil, then there may not have been any grounds of mistake to make an accusation of misconduct either.

This absence of any mistake comprising misconduct is a severe shortcoming. In fact, it is so severe that it could be grounds to abandon the entire existing set of tax ethics rules as unworkable.

B. Bona Fide Disagreements

The second significant problem of Legal Indeterminacy, identified by Ronald Dworkin, arises when a highly-experienced and knowledgeable tax practitioner really thinks the situation is within the bounds of the tax law and this substantive view is later challenged on this point by the Internal Revenue Service (the "IRS") in audit or legal proceedings.[37] Later, the legal analysis reflected in the initial position is found to be unethical by some reviewing body of professional conduct. Let us assume that the tax practitioner proceeded with the tax planning after a full substantive review that is well documented and bona fide in every possible way, except that the IRS does not agree with the ultimate conclusion. The IRS then formally disagreed upon review, and the tax practitioner is determined not to have acted ethically and protests the decision. The problem of Legal Indeterminacy has then become septic because the tax practitioner will not agree, even with the benefit of hindsight, that the tax planning decision was legally wrong, let alone ethically wrong.

So, the question arises then, who decides if not the tax practitioner herself? In order to implement an objective standard, someone else must step in later to render judgement about the meaning of the positive law and, by implication, the rules of tax ethics; this is sometimes referred to as the problem of hindsight, where legal decisions are rendered by judges retroactively on bona fide matters of dispute. The retroactivity problem is magnified in the context of professional tax ethics where there is not a judge and there may be no substantive legal content to know or guess how a novel tax problem might be decided in advance. When confronted by hypotheticals raising this concern, experts in tax ethics will usually say something like "well, don't put yourself in that situation." The actual standard that professional tax ethics promised is, thus, not a "bright line" standard at all, but is really the "you ought to have known what to do" standard of professional tax ethics.

C. Spectrum of "Illegality"

The third significant problem of Legal Indeterminacy as applied to tax ethics is that described by Hazard in relation to conduct that is *by some degree* illegal and

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37. Dworkin, *supra* note 36, at 1058.

to which the lawyer might assist.[38] The client's purpose is often relevant to the determination of degree of legality.[39] Hazard's approach directly challenges the idea that attorney conduct can be understood on a black-and-white basis, suggesting instead that wrongful conduct exists along a spectrum. Hazard wrote:

> By what criteria can the types of client conduct that it is legally improper for a lawyer to further be identified? Put differently, what kind of wrongfulness should we include in the term 'illegal' for this purpose? … We may feel confident about including crimes that are mala in se, but as we move away from this core meaning, the boundaries become increasingly doubtful.[40]

Aggressive tax planning often falls into boundaries where the structuring is not *mala in se.* This is to say that we do not have full criteria to identify wrongful conduct across the spectrum. These criteria might differ between subject areas of the law. Accordingly, if indeterminacy exists, then the goal of tax ethics is to identify criteria that might work in practice to delineate wrongful conduct.

D. Bad Actors in the Tax Profession

The fourth significant problem of Legal Indeterminacy as applied to tax ethics is also described by Justice Holmes where the client has little or no respect for the law, or a Holmesian "bad man."[41] Most professional tax ethics textbooks are filled with conclusions about what the lawyer should do when the client has made a false statement to the taxing authority, filed a false tax return, or similar problems. The tax practitioner has no duty to amend an inaccurate tax return, for example.[42] If the tax practitioner *suspects* the client is engaged in tax fraud, she *may* withdraw; if a tax lawyer *knows* the client is engaged in tax fraud using the lawyer's services, she *must* withdraw. These problems are often described in furtherance of the duty to the client versus the duty to the system.[43] But, either way, the rules of professional conduct describe what a lawyer should do in various difficult situations related mostly to litigation contexts. In litigation, a noisy withdrawal is taken as potentially

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38. Hazard, *supra* note 7, at 672 ("Finally the question concerns actions by the client that is in some degree illegal. 'Illegality' is itself a matter of degree. The narrowest connotation of illegality is conduct violative of the criminal law that is *mala in se*.").

39. *Id.* at 678 ("The lawfulness of a lawyer's conduct in aid of a client is determined in the first instance by reference to the client's purpose, not the lawyer's.").

40. *Id.* at 674.

41. *See* Bret N. Bogenschneider, *Professional Ethics for the Tax Lawyer to the Holmesian "Bad Man"*, 49:4 CREIGHTON L. REV. 775 (2016); *see also* TOBIN, ET AL., *supra* note 1, at 193 (citing Sheldon Pollack & Jay Soled, *Tax Professionals Behaving Badly*, 105 TAX NOTES 201, 205 n.31 (Oct. 11, 2004)).

42. *See* Michael Hatfield, *Ethics of Tax Lawyering*, http://hatfieldethicsoftax.lawbooks.cali.org (last visited Feb. 22, 2020).
("Ethical Problems for Tax Lawyers. [S]everal distinction situations pose ethical problems for tax lawyers . . . such as discovering that a prior year's tax return is incorrect or catching the IRS making a mistake in the client's favor.").

43. *See* Camilla E. Watson, *Tax Lawyers, Ethical Obligations, and the Duty to the System*, 47 U. KAN. L. REV. 847, 852 (1999) ("[A] client can put a lawyer at risk if the client has committed tax fraud and the tax lawyer's advice might assist in furthering the fraud.").

harmful to the client, for example.[44] The withholding of services from a tax planning matter does not seem as potentially harmful if the tax advisor can be readily replaced, and probably would not serve as significant a deterrent to a tax client compared to a criminal defendant;[45] on the other hand, a noisy withdrawal could very well be harmful to the career prospects of the lawyer or the relation of the firm to the respective client or other client. Hence, the litigation-related rules of professional conduct are often not helpful in the context of aggressive tax planning because the context is different.

The involvement of the tax lawyer gives the potential for attorney-client privilege or work-product privileges.[46] This is extremely helpful to the Holmesian Bad Man. As Hazard said, "[i]t must be true, however, that some lawyers often help further their clients' illegal purposes and that almost every lawyer at one time or another has provided assistance to clients that the lawyer suspected might be put to unlawful use."[47] The trouble is that the Holmesian bad man" is not just aware of the existence of these privileges, but he also chooses to hire the tax practitioner *because* those privileges are available and may be used to conceal fraudulent activity. The "bad man" is also well-aware of the ethical rules applicable to tax practitioners; for instance, if the bad man is informed that some aspect of tax planning raises ethical concerns to the tax practitioner, he will modify his behavior slightly to induce the tax practitioner to continue in the tax planning activity.

The possibility that taxpayers are responsive to cues in the tax compliance process is not a new idea. Indeed, a whole new field within the burgeoning field of psychology and taxation has arisen referred to as "cooperative compliance."[48] Empirical evidence has shown that students will respond to compliance activities in varying ways, depending on the methods of enforcement, suggesting that taxpayers might do the same in relations to the taxing authority.[49] The existence of tax expertise within large corporations gives the impression that these well-advised taxpayers are more likely to be compliant with the tax laws; as Snider wrote: "Corporations were to be viewed as complicated organisms run by well-intentioned, well-educated management teams. Harmful acts in which they might—accidentally, of course—engage were better handled by gentle persuasion or education rather than by arrest and prosecution."[50] The "cooperative compliance" initiative has accordingly gained

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44. TOBIN, ET AL., *supra* note 1, at 55 ("A lawyer who knows or with reason believes that her services or work product are being used or are intended to be used by a client to perpetuate a fraud must withdraw from further representation of the client, and may disaffirm documents prepared in the course of the representation that are being, or will be, used in furtherance of the fraud, even though such a 'noisy' withdrawal may have the collateral effect of inferentially revealing client confidences.").

45. Holmes, *supra* note 22, at 191.

46. I.R.C. § 7525(a)(1) (2004) (The tax accountant gives only the tax practitioner privilege).

47. Hazard, *supra* note 7, at 669–70.

48. Erich Kirchler, Cristoph Kogler & Stephan Muehlbacher, *Cooperative Tax Compliance*, 23:2 CURR. DIR. PSYCH. SCIENCE 87–92 (April 2014) ("Whereas enforced compliance depends on the power of authorities, voluntary cooperation originates from taxpayers' trust in the authorities… The psychological approach to tax behavior has led to a change in tax authorities' practices for regulating citizen behavior. Under the labels of 'enhanced relationships,' 'horizontal monitoring,' and 'fair-play initiatives,' several European countries are advancing cooperative strategies with taxpayers.").

49. *Id.*

50. Laureen Snider, *Theft of Time: Disciplining Through Science and Law*, 40 OSGOODE HALL L. J. 89, 91 (2002);
see also Leigh Osofsky, *Some Realism about Responsive Tax Administration*, 66 TAX L. REV. 121 (2012).

traction, especially in European states, under this view.[51] Significant problems arise when the client is a "bad man," who might also be expected to respond similarly to incentives within the tax planning context.

The professional rules of tax conduct essentially presume that the behavior of the client is static (e.g., the client already filed a false tax return, and then once the tax practitioner becomes aware she must decide what to do). However, the professional rules are not so helpful in dynamic situations, such as when the Holmesian "bad man" conceals the existence of tax fraud by intentionally removing the tax practitioner from a crucial step in the tax process that would reveal the existence of the fraud, or when he is aware of or suspects ethical restrictions to the tax practitioner, and gives the impression that he is planning toward compliance, but is actually planning toward non-compliance all along. The existence of all the various privileges in the tax planning process is accordingly helpful to conceal aspects of planning activity during future litigation; if the planning turns out to be planning toward non-compliance, concealment with the aid of privileges is desirable. However, no one will know the aggressive tax planning undertaken today was actually in the furtherance of tax fraud until years later, or perhaps never. The crucial step from the perspective of the Holmesian "bad man" is concealing the intent to fraud from the tax lawyer in order to gain the protection of the privileges. This process of using an unwitting tax expert to further tax fraud obviously undermines the rule of law. The pertinent question, then, is if "bad man" behavior is possible, how common is it? To answer that question, this article uses the case example of tax structuring, especially the creation of "Factual Indeterminacy" in aggressive tax planning.

IV. STRUCTURING TO INDETERMINACY AS PART OF AGGRESSIVE TAX PLANNING

> Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. . . . Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands. - Learned Hand, dissent[52]

Outside persons not versed in the specialized field of taxation may be dubious as to the existence of structuring within tax planning activity. It is much easier to assume that most tax practitioners operate on the mild side of Hazard's spectrum of assistance toward wrongful conduct where the tax lawyer just gives some legal advice and then the client runs with it in unpredictable directions. A non-tax lawyer might even wonder: how could it be that tax lawyers and accountants are engaged in actually creating the facts that they then assess from a legal perspective? And, if tax lawyers and accountants do happen to create the "facts," this must be a relatively rare and ancillary event as it is in other areas of the law. Indeed, in other areas of finance, "structuring" financial transactions is a crime.[53]

Although it would greatly simplify matters of tax ethics if factual structuring were not commonplace, that unfortunately is not the case in the real world. In a

51. *See* Alicja Majdanska & Jonathan Leigh Pemberton, *Different Treatment, Same Outcome: Reconciling Cooperative Compliance with the Principle of Legal Equality*, 5:1 J. TAX ADMIN. 111 (2019).
52. Gregory v. Helvering, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935).
53. Structuring Transactions to Evade Reporting Requirement Prohibited, 31 U.S.C. § 5324 (2004).

simpler world, analysis could focus on the relatively easy questions in tax ethics of merely providing a legal opinion on tax shelters with a review of the facts underlying the shelter. In tax planning for large multinational firms, nearly all effort by accounting and law firms is directed at sculpting the "facts" or even affirmatively creating "facts" that will be used to avoid taxation. Notably, there are many ways to introduce uncertainty into tax results, but transfer pricing has become increasingly important as the means to do so, especially as business has become more international; more and more, companies are able to produce goods and services in one taxing jurisdiction and shift these into another taxing jurisdiction.[54] The crucial aspect of this type of aggressive tax planning, which has been largely skipped-over in prior literature, is that the manufacture of facts does not necessarily create determinate legal analysis. As such, it is necessary to introduce the topic of transfer pricing and explain what this means for lawyers that are not specialized in taxation or even for tax lawyers that do not normally work on international tax or transfer pricing.

A. Background on "Transfer Pricing"

The topic of "transfer pricing" is really where the action is in tax ethics. Transfer pricing refers to the intercompany prices companies charge their affiliates for goods and services.[55] This can be readily illustrated with respect to transfer pricing on finished goods, although the technical tax and related ethical issues often relate to transfer pricing on intangible goods and services. For example, imagine a company that manufacturers carpets in India and imports them into the United States. Once imported, the carpets are then offered for sale by the company's own local affiliate incorporated here in the United States. So, there are at least two legal entities, one in India that manufactures the carpets and one in the United States that sells the carpets. The company then needs to decide how much to charge for carpets on the sale between India and the United States; the setting of the intercompany price will determine how much taxable income is reported in both India and the United States. If the company charges itself a low price for carpets, then the carpets will be cheaper to the U.S. affiliate, and as a carpet is sold to the customer, more profit will arise in the United States. Alternatively, if the company charges itself a high price for carpets, then the carpets will seem more expensive to its U.S. affiliate, and less profit will arise in the United States. Accordingly, the taxes paid to both India and the United States depend entirely on the intercompany price that the company charges itself.

The potential ethical concerns from the tax perspective should be obvious merely from this explanation of how setting the price is related to tax rates, such that the company incentive is to report less income in the jurisdiction with the higher tax rate. Numerous academic studies have shown that the price charged varies by up to *six fold* between companies, probably due to transfer pricing.[56] Kimberly

54. *See* James E. Wheeler, *An Academic Look at Transfer Pricing in a Global Economy*, TAX NOTES 87 (July 4, 1988).

55. *See generally* Marta Pankiv, *Contemporary Application of the Arm's Length Principle in Transfer Pricing*, IBFD vol. 6 WU series (June, 2017).

56. Wheeler, *supra* note 54, at 89 (explaining the return on assets for US corporations is 6 times higher than for foreign-owned US subsidiaries indicating that transfer pricing is being used to reduce taxable profits allocated to the US).

Clausing has pointed out that economic models used in tax policy do not seem to take into account that companies are able to shift taxable income between taxing jurisdictions using transfer pricing techniques.[57] Therefore, the models used by economists to predict the economic consequences of shifts in tax policy are inaccurate, because they assume that taxable income will arise in the jurisdiction to where the substance of the activity relates (e.g., a company that manufactures carpets in India will report its manufacturing profits in India and its selling profits in the United States). Tax results depend on the transfer pricing rules and whether those rules are enforced by the taxing authority in both jurisdictions. The point is that transfer pricing matters to tax policy, and crucially, also to tax ethics.

Various tax practitioners and accountants have identified the importance of transfer pricing to ethics. A few articles have addressed the intersection of tax ethics and transfer pricing, albeit simply, to conclude that all transfer pricing must be ethically conducted by a tax practitioner.[58] Hansen, et al. wrote:

> The regulations which govern transfer pricing allow the tax preparer to select among alternatives. Accordingly, tax avoidance is granted by statute. Even an extreme moralist could not expect the taxpayer to opt for the most costly election. The courts have upheld the rights of taxpayers to practice tax avoidance. Tax avoidance is an acceptable motive in selecting between alternative, albeit choice of depreciation method or transfer pricing.[59]

Not exactly. The ethical problem is that transfer pricing is not solely a question of legal interpretation but relates directly to structuring. Transfer pricing may include a push toward Factual Indeterminacy, as explained in the next section. Accordingly, the ethical issue relates to whether the structuring reaches a determinate answer, which is rarely (if ever) the case in matters of transfer pricing.

V. Factual Indeterminacy in Tax Ethics

In order to begin a process of formulating an ethical rule for tax ethics we first need to say what is entailed by tax evasion, tax fraud, or simply "illegal" activity as described by Hazard. This is the first necessary step in saying whether a lawyer or other tax practitioner has aided in that wrongful conduct. The ethical problem probably cannot be solved by looking to examples of tax fraud, except by a common law process that would likely take centuries. Since we do not have centuries, it is necessary to consult with philosophy. Oddly, philosophy has gotten a bad name in tax where persons with little practical knowledge about taxation use it to step in and crowd out proposals from practicing tax lawyers and accountants. Since philosophy often means *methods*, philosophical methods in tax law might be enhanced by looking to the methods of tax practitioners.[60]

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57. *See* Kimberly Clausing, *In Search of Corporate Tax Incidence*, 65 TAX LAW REV. 433 (2012).

58. Robert W. McGee, *Ethical Issues in Transfer Pricing*, 7:2 MANCHESTER J. INT'L ECON. L. 24 (2010).

59. Hansen, et al., *supra* note 2, at 683.

60. *See* Majdanska & Pemberton, *supra* note 51.

Tax practitioners often refer to problems of legal interpretation, which is often referred to as Legal Indeterminacy.[61] Yet the Legal Indeterminacy that Hazard described is not at all sufficient to describe indeterminacy in tax structuring. Many other tax scholars have identified indeterminacy in tax planning.[62] However, many suppose that indeterminacy arises from the Code directly, meaning the law is itself inherently flawed.[63] If this is indeed the view, it is wrong; leading tax practitioners also conclude that view is wrong based on long experience in the context of tax planning.[64] Tax law cannot anticipate every possible shift in "facts" that tax lawyers and accountants might engineer at future times. In other words, tax law cannot be fully valid as to all current and future situations; all of the experience of tax practitioners over the past 50 years establishes that is true beyond any possible doubt.[65] Apart from taxation, this was also true about the law generally in 1821 when Hegel first said as such, and remains true today.[66] Furthermore, legal philosophy is filled with responses by positivist legal scholars objecting to an unfair characterization by Legal Realists that they are saying the law is fully determinate, which positivists *deny*. Accordingly, there is no debate as to whether laws are indeterminate in practice; the debate concerns only *why* tax laws are indeterminate, and to what degree.

Therefore, the next step is to begin to categorize the types of indeterminacy beyond Legal Indeterminacy. In addition, there are at least two types of indeterminacy related to facts that are relevant to tax ethics: Factual Indeterminacy and Structuring Indeterminacy.[67]

61. *See* Bret N. Bogenschneider, *Factual Indeterminacy in International Tax Law*, 3:3 BRICS LAW J. 73–74 (2016) ("[T]he potential for factual indeterminacy is not what is meant by the general usage of the term 'legal indeterminacy'. In the theory of positive law (particularly as relevant to tax law) 'legal indeterminacy' refers to the potential for differing interpretations of a given law. For example, where the legislature did not contemplate a particular situation in drafting a law the codified result may then be indeterminate in application. Both legal realists and positive law scholars allow for the potential of legal indeterminacy. however, the question not normally addressed by positive legal theory is: Where do legal 'facts' come from? here, the reference to 'facts' means the fact words necessary to identify the 'facts' relevant to legal interpretation under the law.") (citations omitted).

62. Hansen, et al., *supra* note 2, at 683 ("Tax practitioners are faced with the challenging task of applying existing tax law to the factual situation of a particular entity for purposes of complying with requirements under the law. The solution(s) which flow from this process often are not clear and concise. When there is a lack of specific authority, or the law allows a choice between two or more alternatives, the tax practitioner will select the approach or alternative which minimizes the tax liability of the entity.").

63. TOBIN, ET AL., *supra* note 1, at 211–12 ("Relating law to facts. In discussing the legal issues in a tax shelter opinion, the lawyer should relate the law to the actual facts to the extent the facts are ascertainable when the offering materials are being circulated. A lawyer should not issue a tax shelter opinion which disclaims responsibility for inquiring as to the accuracy of the facts, fails to analyze the critical facts or discusses purely hypothetical facts. It is proper, however, to assume facts which are not currently ascertainable, such as the method of conducting future operations of the venture, so long as the factual assumptions are clearly identified as such in the offering materials, and are reasonable and complete."); *see also* Dennis J. Ventry, Jr. & Bradley T. Borden, *Probability, Professionalism, and Protecting Taxpayers*, 68 TAX LAW. 83, 107 (2014) ("In addition, the practitioner must ascertain and consider all relevant facts, relate the applicable law -- including potentially applicable judicial doctrines -- to the relevant facts, and never, in evaluating the merits of a tax position or transaction, 'take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.'").

64. *See* Schler, *supra* note 24.

65. As perhaps the prime example of the foregoing, see the "Check the Box" regulations where the IRS has conceded the issue of entity classification. Treas. Reg. § 301.7701–3 (2006).

66. GEORG WILHELM FRIEDRICH HEGEL, PHILOSOPHY OF RIGHT 204 (Thomas Malcolm Knox, ed.) (Clarendon Press 1952).

67. This is technically "Mach/Feyerabend Factual Indeterminacy" as I have attempted to name it so. *See* Bogenschneider, *supra* note 61, at 76.

A. Factual Indeterminacy

Tax law often incorporates "facts" from other fields of law, such as corporate law.[68] Since the legal standards in other areas of law are indeterminate, this means the "facts" of tax law are indeterminate when legal conclusions are incorporated as "facts" into tax law. This is perhaps best illustrated by legal entity classification. The IRS eventually gave up on attempting to perform legal entity classification because the legal standards were indeterminate.[69] Accordingly, this type of "Factual Indeterminacy" is why there is such a thing as "check the box."[70] When a tax practitioner "checks the box" to select a legal entity classification, this resolves a problem that would otherwise involve Factual Indeterminacy.

B. Structuring Indeterminacy

Separately, tax law always reserves the right to create its own "facts"; these are "facts" that are only known to tax lawyers or other practitioners. A classic illustration is "original issue discount," a concept that exists only within tax law. The ability to use such words relating to unique concepts of taxation is what it means to be a clever tax lawyer, as the use of certain tax words can establish "facts" in tax law.

But, even more importantly, "facts" do not exist independent of theory. As a clever tax practitioner engages in structuring activity, this often requires a theoretical explanation of why the tax restructuring is necessary, which predicates the gathering or creation of "facts" that exist in the new structure, but which did not exist (or were not relevant) before. Therefore, the choice of legal theory entails a choice in "facts." This explains why the "facts" will often be viewed as commensurably different as between tax lawyers engaged on opposite sides in tax litigation or with different views on a tax planning structure. Nearly all aggressive tax planning will accordingly entail the affirmative creation of "facts," or the sculpting of "facts" to fit into a revised theory reflected in the tax plan. A tax partner at a large law firm or accounting firm is a person that can construct such a theory and then task associates with developing the necessary "facts" to fit into and support the theory. As a matter of tax ethics, it is then possible to categorize tax "structures" based on whether the structure is designed to increase or decrease indeterminacy, a concept explained further in Part VIII.

VI. Illustration of Tax Fraud in Transfer Pricing

Nearly all of the prior descriptions of illegal activity in aggressive tax planning fail to give plausible descriptions of actual tax fraud. A student may accordingly leave with the impression that fraud is rare or hard to find out in the wild, like a white leopard. In terms of its prevalence, finding tax fraud is less like a search for a white leopard in the Hindu Kush and more like a search for a garden ant in the backyard. One tried-and-true means to commit fraud is to create two or more sets of books – one for the company, one for the auditors, or predictably, a separate set

68. *See generally* Bret Bogenschneider, *Wittgenstein on Why Tax Law is Comprehensible*, 2015 BRITISH TAX REV. 252 (2015).
69. Treas. Reg. § 301.7701–3.
70. *Id.*

of books for the IRS. Transfer pricing is no exception. By way of introduction, it may be helpful to illustrate how transfer pricing can enable tax fraud by using multiple sets of books. Consider the following hypothetical:

A company realizes that it has begun to make a considerable profit from sales of crackers in France. Internal company forecasts suggest that the increase in sales will likely increase further in the coming quarters. However, the tax rate in France is high. A corporate executive suddenly realizes, to his dismay, that the tax rate in France is very high. As the sales trend continues, the profits are increasing, but so do the taxes reported on the financial statements. This is a problem—not so much because the company will be required to pay taxes in France, but because the company calculates bonuses for corporate executives based on profits-after-tax. As a result, the expected taxes booked and reported in the financial statements are reducing the potential for executive bonuses. The high tax rate in France constitutes an emergency situation that must be addressed *now*.

Notably, the fraud that will arise in this hypothetical is designed to increase reportable profits, and not to diminish cash taxes to be paid. This is crucially important because all of the fraudulent schemes that the taxing authorities may have made illegal over the years may still exist within the cost accounting structures of large corporations, even if they are not intended to defraud the fisc by reducing taxes payable. Tax ethics scholars are often focused on cash taxes when the real concern is reportable profits and transfer pricing relates to both, or at times, only the latter.

Upon discovery of the tax problem in France, the corporate executive then contacts the head of tax, and says: "We've got a problem here. The taxes in France are high and we are selling crackers really well, but the taxes are going to reduce profits this quarter. What can we do?" The head of tax then says, "Well, that's no problem. We just need to update our transfer pricing structure for this unexpected increase in cracker sales in France." The updating of the transfer pricing structure is a possible solution because it could reduce the expected taxes that will be paid in the future for book accounting purposes. As an extremely simplified illustration, this would occur by increasing the intercompany charges for crackers sold to the France affiliate. Let's assume the company manufactures the crackers in various countries and sells them over to France. By modifying the transfer pricing structure to increase the charge for crackers, the profits in France could be reduced and the expected taxes to be paid to France would also be reduced. A more realistic example would involve adjusting the transfer pricing on the intangibles related to the manufacturing process for the crackers (i.e., patents) or the trademarks on the crackers. Significantly, the company is not so much concerned with whether the government of France will accept the adjustment at some point in the future. The goal is to increase reported profits on the financial statements today; if tax adjustments are required in the future, that might be embarrassing to whoever the head of tax is at the time of the adjustment, but it will only ultimately decrease somebody else's bonus in the future. By increasing profits today, everybody gets the bonuses from the increase in cracker sales in France. Therefore, the objective is to convince the internal company lawyers and perhaps some auditors that the transfer pricing for crackers can be adjusted. The head of tax would then ask herself, "How do we best do that?"

The adjustment to a transfer pricing structure is not an easy thing if the intercompany contracts are already established that say how much to charge for crackers. A large company will often have an intercompany structure that will explain the overall strategy, but it must be reflected in the legal documents. The U.S. regulations require these to be set in advance.[71] But, crucially, the IRS does not audit the records every year. This leads enterprising tax planners to ask: what if the transfer pricing documents were malleable, with a more aggressive version created in advance for an emergency such as this? The transfer pricing structure could then be changed and updated upon the occurrence of unexpected events. This would make it possible for the company to make adjustments for future events that are currently unknown; in other words, retroactive adjustments to the transfer pricing structure could be made with the benefit of hindsight. This sort of malleability in the structure could be particularly helpful, say, if sales unexpectedly increase. So, the head of tax asks herself: "how do we make transfer pricing records malleable?" Again, a solution seems to present itself. "We just need to create multiple sets of transfer pricing contracts," the head of tax realizes. "A different contract could apply in different situations to change the tax result. But how do we accomplish that?"

In order to create multiple sets of transfer pricing documents within a large company, one needs the witting (or unwitting) assistance of the lawyer who is responsible for the intercompany contracts. But how does one get a lawyer to create two sets of transfer pricing documents related to France and the affiliates involved in the manufacture of crackers? One method might be to take two different sets of intercompany contracts to multiple lawyers at different times. To be safe, one may be an external lawyer that the internal lawyer does not know has been engaged by the company. This avoids the uncomfortable possibility that the internal lawyer could discover that someone else is working on the same transfer pricing project, but with a different set of contracts with different terms. Then, once the lawyer gets two sets of contracts done, both are placed in his desk, with either to be pulled out when the time is right.

The contracts would also have to be signed by an executive with signing authority for each intercompany affiliate;[72] although the executives are often more than willing to participate in the fraud, somebody has to sign both sets of documents in the signature field. The risk is that, if the two sets of contracts are both available and dated, internal company auditors may eventually discover them, leading them to ask why the executive signed transfer pricing documents both valid for the same dates. The head of tax says to herself: "to avoid discovery, we can just take the dates off the contract. With multiple sets of transfer pricing documents, at least one of which has been 'no-dated,' we can always have the possibility of using two."[73]

The head of tax may then attempt to shift responsibility for the transfer pricing fraud to another person down the chain of command. Responsibility for the "no-dated" version of the contracts could be assigned to a junior lawyer as her project to review and obtain signatures from the appropriate corporate officers. If the junior lawyer does not notice the missing dates (or even grasp the significance of their absence) and obtains a signature from the corporate officers with signatory power

71. Allocation of Income and Deductions Among Taxpayers, Treas. Reg. § 1.482–1(d)(3)(ii)(B) ("Identifying contractual terms - (1) Written agreement. The contractual terms, including the consequent allocation of risks, that are agreed to in writing before the transactions are entered into will be respected if such terms are consistent with the economic substance of the underlying transactions.").

72. *Id*.

73. *See generally* Dzienkowski & Peroni, *supra* note 9, at 2728 ("Tax professionals have an obligation to represent their clients zealously within the bounds of the law. In other words, no one suggests that a tax adviser should advise clients to falsify documents or backdate documents that have tax effect.").

for the affiliate, she effectively assumes responsibility for the fraud. Alternately, if the junior lawyer identifies an issue and affirmatively puts dates on the contract, the head of tax may just throw the contracts in the trash. This is a classic example of "passing the monkey" in a corporate setting. At minimum, the "blame the junior associate" gambit is available to the head of tax who may testify that the fraud was all the junior tax lawyer's idea.

From the hypothetical, it should be evident that an ethical dilemma occurs to the junior tax lawyer when she is provided the "no-dated" version of the transfer pricing contracts from her superior and instructed to get the necessary signatures. Assume for purposes of the hypothetical that she has no idea why the dates are being removed from the contracts,[74] and her superior, who orchestrated the endeavor, says it is normal not to use dates. How should she proceed when the "no-dated" version of the contracts is provided for signature?[75] Does she have a duty to inquire further?[76] Does it matter if the tax lawyer knows her superior is a crook from other situations?[77]

A. Raise an Ethical Concern

If the lawyer raises the ethical concern based on a standard of personal ethics, this will have no effect on the project *ab initio* because the superiors within the organization are already aware of the possible fraud and have reached their own conclusion that the project should proceed. One purpose of having a superior in any organization is that the superior assigns the projects in the organization, fraudulent or not. However, if the tax lawyer raised the ethical concern about the potential violation of an actual ethical rule, there could be a discussion about the ethics of multiple versions of "no-dated" transfer pricing documents, for example. Therefore, the use of a personal ethical standard known only to the tax lawyer herself may be the least effective ethical rule; even a bad rule would create the potential to raise a concern that might be valid and could form the basis for a discussion of the ethics with someone else. The use of the personal ethics standard leaves the tax lawyer

74. Hazard, *supra* note 7, at 672 ("It is rare that the lawyer fully knows a client's purposes or fully anticipates the ways in which the client might make use of the lawyer's services.").

75. *See* Galler & Lang, *supra* note 1, at 64 ("In gathering information, the preparer may in good faith without verification rely on information provided by the taxpayer and information and advice provided by third parties. Treas. Reg. 2.6694-1(e)(1). However, the preparer cannot rely on information that appears either on its face or from other facts known to the preparer to be incorrect, incomplete or inconsistent.").

76. *Id.* at 11 ("The difficult problem arises where the client has in fact misled but without the lawyer's knowledge or participation. In that situation, upon discovery of the misrepresentation, the lawyer must advise the client to correct the statement; if the client refuses, the lawyer's obligation depends on the situation."); TOBIN, ET AL., *supra* note 1, at 211 ("[T]he lawyer should, in the first instance, make inquiry of the client as to the relevant fact and receive answers. If any of the alleged facts, or the alleged facts taken as a whole, are incomplete in a material respect; or are suspect; or are inconsistent; or either on their face or on the basis of other known facts are open to question, the lawyer should make further inquiry.") (citing ABA Formal Opinion 355 (1974)).

77. TOBIN, ET AL., *supra* note 1, at 67; *see also* Hazard, *supra* note 7, at 672 ("It is sometimes suggested that the dilemma is false, because surely a lawyer cannot 'know' what a client intends. This suggestion is either disingenuous or absurd. Of course, speaking in radical epistemology, it is true that a lawyer cannot 'know' what a client – or anyone else – intends. In these terms it is impossible for a lawyer to 'know' anything. Yet the practice of law is based on practical knowledge, that is, practical assessments leading to empirical conclusions which for the basis for irrevocable action.").

with no substantive grounds to raise an ethics concern that might be persuasive to another person who has already decided to undertake the project. If there were a common law of tax ethics, the tax lawyer could conceivably find these cases and try to draw out the lessons to her supervisor, but that also seems impracticable.

Even worse, by raising an ethical concern, the tax lawyer has likely harmed her personal prospects significantly, in at least two ways. First, assuming the tax fraud is subsequently discovered, if the lawyer proceeds with the project and does not resign from her position, she has admitted her own responsibility and conceded legitimate concerns about the fraudulent activity. This is true even if she is understandably uncertain about the tax result, because it may contain various elements of uncertainty and create indeterminacy in various ways; even if there was a possible argument that creating multiple versions of "no-dated" transfer pricing documentation was legal, once the ethical concern has been raised, she could not then raise that indeterminacy argument later if disciplined by the state bar for carrying out the fraud.

A second way that the tax lawyer has harmed her personal prospects is by violating a cardinal rule in the eyes of her superiors, which is to attempt to "pass the monkey" back up the chain. The worst scenario is that her superiors may have been trying to implement a version of the "blame the junior associate" gambit to avoid ethical responsibility for the fraud themselves. Although the gambit is no longer available in law firms, it is still readily available within large corporations. This strategy could arrive at an end result where the junior lawyer ultimately takes the blame for the fraud, but suffers no consequence; conceivably, she subsequently could be found not ethically culpable because she is "young and dumb." However, by raising the personal ethics complaint, the junior lawyer admits she was not dumb and has thereby undermined her superior's attempts to "pass the monkey" downward.

B. Do Not Raise an Ethical Concern

If the lawyer does not raise an ethics concern based on standards of personal ethics derived from her "moral compass," the results will also be dramatically negative. First (and perhaps most importantly), as every self-respecting fan of the gangster film *Goodfellas* should know, by being complicit in one instance of fraud, the tax lawyer has now joined in every other instance of fraud in the organization. That is, by virtue of her complicity in the tax fraud, she now knows where a body is buried—but everybody else now knows where *her* bodies are buried. Therefore, no complicit person can ever realistically raise an ethics concern in the present or future, if they have failed to raise an ethics concern in the past. If other corporate executives are aware of the Goodfellas rule, it is possible to continuously test a younger lawyer on ethics matters until complicity is achieved, or perhaps not achieved; when attempts to achieve complicity in fraud fail, then the underachiever in fraudulent endeavors can be simply be removed from the project, fired, or worse. The failure to set workable standards of tax ethics yields the perverse situation within large organizations with some propensity for fraud that only the non-ethical persons will survive for very long within the organization. Notably, the Goodfellas concern described in this paragraph is perhaps the strongest argument for ethical standards in the tax profession.

Second, by failing to raise the ethical concern, upon review, she inevitably is less likely to meet the applicable standard of tax ethics—"you should have known what to do"—described above. The ethical concern further implies a *substantive* failure to apply the tax laws correctly to the situation. Insofar as the modern view of tax ethics applies a "you should have known what to do" standard, the reviewer is stepping into the shoes of the lawyer with the benefit of hindsight, second-guessing the actual legal judgment of the tax lawyer in the specific situation.[78] By not raising any concern, the lawyer has waived the substantive aspect of her tax analysis. Thus, in theory, the prosecution of the tax lawyer then could extend both to an ethics violation *and* legal malpractice.

Third, in not raising the ethical concern, the tax lawyer may have failed to take into account her duty to the system.[79] Although that may be true, one ray of light is that, in the hypothetical, it is presumed the company is inexorably moving forward with the potential fraud as a project. The lawyer's duty to the system is therefore mediated through the responsibility to file an internal report of fraud within the company; the compliance with federal regulations on that point might satisfy the duty to the system.

VII. ALTERNATE PROPOSAL FOR TAX ETHICS

A workable standard might be created based on the *direction* of aggressive tax planning. The tax planning activity of tax lawyers and other practitioners could be classified as either toward or away from indeterminacy, or more specifically, toward the type of Factual Indeterminacy given as "Structuring Indeterminacy." The basic idea of the proposal is that nearly everything lawyers do outside of tax is designed to reduce uncertainty in legal contexts, whereas in tax structuring, much of what tax lawyers do is designed to *increase* uncertainty. An alternative framework for professional tax ethics should be based on whether the direction for tax planning is toward or away from indeterminacy. The purpose of this section is to show the relevance of factual planning to professional tax ethics by evaluating the direction of tax planning as toward or away from indeterminacy. This approach can be perhaps best illustrated by distinguishing between the use of factual planning in two different scenarios.

A. Scenario #1: Tax Planning Toward Determinacy

In this scenario, the tax lawyer assists in structuring to create a legal outcome that is known or determinate. An example would be the formation of an offshore affiliate as a controlled foreign corporation rather than as a branch. This is achieved by incorporating in the foreign country. Here, the tax lawyer sets up the legal entity and the tax result is often determinative, at least in situations where the tax treaty has provisions that provide for the treatment of foreign corporations in comparison

78. Hazard, *supra* note 7, at 683 ("Should the license to practice law not only lawyers to provide assistance requiring professional legal judgment, but also permit them to provide assistance that otherwise would constitute complicity in an intentional tort or crime? This author thinks not; the inquiry, however, goes on.").

79. *See* David J. Moraine, *Loyalty Divided: Duties to Clients and Duties to Others—the Civil Liability of Tax Attorneys Made Possible by the Acceptance of a Duty to the System*, 63 THE TAX LAWYER 1, 169 (2009).

to branches. In many countries, including the United States, the tax issues are made determinative by allowing the taxpayer to elect the form of the legal entity by filing an election form with the taxing authority.

B. Scenario #2: Tax Planning Toward Uncertainty or Factual Indeterminacy

In tax structuring toward uncertainty or "Factual Indeterminacy," the tax lawyer assists in structuring to create a legal outcome that is unknown or indeterminate. A classic example would be the creation of a transfer pricing structure with the formation of an intangibles holding company in the Cayman Islands, where the tax rate on royalty income is 0%.[80] The idea is that the multinational firm headquartered in the United States might shift intangibles from a high-tax jurisdiction, such as intangibles for a fashion brand developed in Italy, into a low-tax jurisdiction, here the Cayman Islands. For purposes of this hypothetical, assume that, before the restructuring, there was a fashion brand in Italy that licensed rights for worldwide production of the brand, the profits of which flowed back to Italy. After the restructuring, the intangibles are owned in the Cayman Islands, which reduces taxes because the license fees flow from the rest of the world to that low-tax jurisdiction rather than to Italy. This structure can also be done domestically to avoid state income taxation such as by the transfer of intangibles from a high-tax state, such as Massachusetts, New York, and California, into a low-tax state, such as Delaware. The goal is to achieve a situation where the royalty payments are deductible in the high-tax jurisdiction when paid which can reduce taxes owed from other income, and also not subject to tax in the low-tax jurisdiction when received. The tax structure causes the royalty income not to be taxable and creates a tax deduction that could reduce tax from other income. This is sometimes referred to as the creation of an "IP holding company" structure.[81]

The tax planning involved in setting up an IP holding company structure involves layers of possible uncertainty. Here, there are many areas ranging from legal uncertainty in the structure to Factual Indeterminacy related to the transfer, including:

1. Legal Indeterminacy as to the treatment of IP holding companies under the ring-fencing rules of Italian law. This is a legal issue in Italy that will determine the "facts" as a matter of tax law (so is technically a type of Factual Indeterminacy also);

2. Uncertainty as to whether the description of the business operations used for purposes of the tax structuring actually match to the real business operations to any significant degree;

80. *Cayman Islands*, PWC WORLDWIDE TAX SUMMARIES http://www.taxsummaries.pwc.com/ID/Cayman-Islands-Corporate-Taxes-on-corporate-income (last visited Feb. 22, 2020).

81. *See* Bret Bogenschneider and Ruth Heilmeier, *Google´s "Alphabet Soup" in Delaware*, 16 HOUSTON J. BUS. LAW & TAXATION 1 (2016).

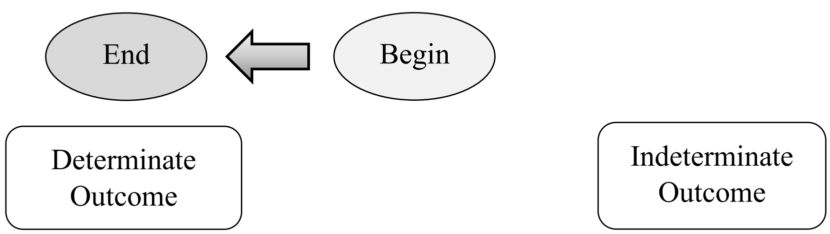
3. "Factual Indeterminacy" related to whether the intangibles have actually been shifted in substance to the Cayman Islands; and

4. "Structuring Indeterminacy" relating to uncertainty as to whether the price paid for the intangibles was adequate based on an appraisal or other documentation.

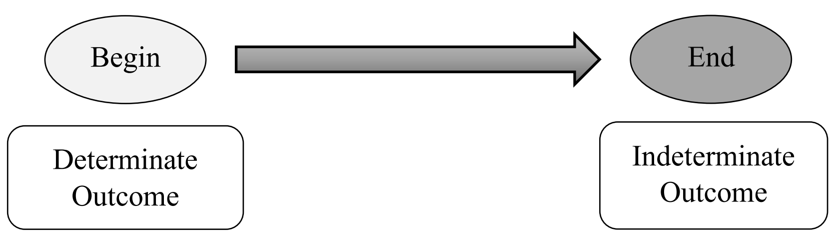
The critical issue is the identification of "Structuring Indeterminacy." The tax structuring itself gave rise to the underlying "facts" in the appraisal document; absent the structuring, these facts would not exist or even be relevant. The documents are necessary because, since there is no third-party buyer of the assets to establish a price, the tax consequences depend on an appraisal to determine the value for tax purposes. The entire structure then hinges on the appraisal being low-enough, such that the ongoing tax savings from the structure are not dwarfed by a tax bill resulting from the transfer itself.

(1) DIAGRAM OF DIRECTION OF "AGGRESSIVE TAX PLANNING" ACTIVITY

SCENARIO #1: TAX PLANNING TOWARD DETERMINACY



SCENARIO #2: TAX PLANNING TOWARD UNCERTAINTY OR STRUCTURING INDETERMINACY



VIII. CONCLUSION

In tax ethics there is often presumed to be a clear demarcation line between "tax avoidance" and "tax evasion."[82] The personal ethics of the tax lawyer has been repeatedly proposed by scholars as a primary factor in placing limits on aggressive

82. Zoe Prebble and John Prebble, *The Morality of Tax Avoidance*, 43 CREIGHTON L. REV. 693, 715 (2010).

tax planning.[83] The ethical requirements also depend on the role the tax lawyer has undertaken in various contexts under the Model Rules.[84] Yet, as identified and explained by Hazard, wrongful conduct by an attorney in assisting a client toward tax fraud exists along a spectrum.[85] Therefore, a bright-line rule is not workable in many contexts. Furthermore, the "moral compass" ethical rule has no content unless the tax lawyer being prosecuted for misconduct admits, against her own interests, that she did not follow her own moral standards.

An additional issue that has not been raised in the prior literature is whether a tax lawyer has obligations to a system of professional ethics (both under state law and by the IRS) when that system does not provide reciprocal duties and responsibilities of fair play to the lawyer or tax practitioner. An ethical standard that is not reciprocal among members of a bar or profession, for example, would not be an ethical standard. Likewise, where the Model Rules fail to provide a workable standard of ethics in the context of aggressive tax planning, potentially serious problems arise in assessing the validity of those rules. As illustration, if the conclusion under the Model Rules is that, in contexts of aggressive tax planning, the tax lawyer should apply her own moral compass to reach an ethical result, then how could a state bar applying those Model Rules set out to review decisions made under the individual moral compass of each member? The so-called ethics review could only be as to whether the bar member has violated her own ethical standards. Of course, this is not properly described as "ethics" or "professional responsibility" and represents simply confusion about personal morality versus professional ethics. Ethical standards are standard of a profession imposed across members of a profession and are not individual moral standards reflected in a "moral compass."[86] Rather, it seems axiomatic that any ethics rule requires ethical standards apart from the moral compass of the lawyer herself *even if* moral standards were good and standards of professional ethics in practice were sufficient. One purpose of this article has been to illustrate that they are not.

The "duty to the system" is also not so simple as we have previously been led to believe. If the tax lawyer reasonably looks at the world of tax practice and sees many bad actors, then perhaps the "duty to the system" should also require her to try to limit aggregate fraud to the best of her ability. Although not discussed in the prior literature, a strong argument against the duty standards given in respect to taxation is that any tax lawyer with a whisper of ethics is effectively required to "die in a ditch"; this ditch is likely the first position of new tax lawyers in the trenches of professional tax practice based on a bureaucratic system of "passing the monkey" downward.[87]

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83. Galler, s*upra* note 8, at 692; Field, *supra* note 8, at 265; Deborah H. Schenk, *Book Review: Tax Ethics*, 95 HARV. L. REV. 1995, 2007 (1982).

84. For a broader discussion of the various roles tax lawyers can serve, *see* Holmes, *supra* note 45, at 188–89 ("Yet, under the current tax regime, it is not unusual for the tax lawyer to play the roles of advisor, advocate, endorser, insurer, engineer, and even adversary. It can be a tricky business wearing all of these hats, particularly when tax lawyers are facing mounting pressures from powerful clients aggressively pushing to minimize their tax liabilities.").

85. Hazard, *supra* note 7, at 672.

86. *See generally* Schenk, *supra* note 83, at 2007 ("[Tax ethics should provide] a sufficient framework to enable a student to develop his own ethical norms. Students should begin (or perhaps end) an ethics course by asking the following questions: Are professional ethics and personal ethics the same? Are they mutually exclusive or even related? Where should a lawyer look for answers to ethical questions that arise in practice?").

87. *See e.g.*, Galler & Lang, *supra* note 1, at 115.

In conclusion, proposals for an alternative framework for tax ethics are needed. One possible idea is to begin with an assessment of the *direction* of aggressive tax planning activity either toward or away from Factual Indeterminacy. In nearly all other legal contexts apart from aggressive tax planning, lawyers push away from indeterminacy, whereas the tax lawyer, by Factual Structuring, sometimes pushes toward indeterminacy.[88] Just as Hazard described, this approach views lawyer assistance in tax planning along a spectrum of wrongful conduct. As the lawyer or tax practitioner engages in tax structuring and thereby pushes forward along the spectrum, that forward movement could be viewed as a hallmark of unethical conduct. However, tax structuring designed to take an uncertain position and make it certain consistent with the traditional role of a lawyer in other legal contexts apart from tax planning would remain presumptively ethical conduct. This standard would not work in all cases, but it would work far better than a standard based on the "personal ethics" of the individual lawyer, or even an inquiry into whether a taxpayer might have a "business purpose" for structuring to tax avoidance or similar standards as developed by the IRS. Such an ethical rule so designed would thereby restrict structuring activity designed to affirmatively create indeterminacy under the tax law.

88. For a further discussion of practical issues in tax ethics, *see* Henry Ordower, *The Culture of Tax Avoidance*, 55 ST. LOUIS U. L.J. 47, 53–55 (2010); *see also* Theodore C. Falk, *Tax Ethics, Legal Ethics, and Real Ethics: A Critique of ABA Formal Opinion 85–352*, 39 TAX LAW. 643 (1986).