Articles

CLASH FOR CASH: THE CONFLICT OVER TAX WHISTLEBLOWER CONTRACTS

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THE Internal Revenue Service’s (IRS) handling of the revised statutory tax whistleblower program under Internal Revenue Code section 7623 has faced heavy criticism for several years. Congress, hoping to attract more valuable information on high-dollar tax evasion by sweetening the potential award payout, revamped the program in 2006 as part of the Tax Relief and Health Care Act of 2006. But many whistleblower advocates see the IRS as unwilling to take some actions necessary to make the program truly effective.

The Service’s refusal to enter into written information-sharing contracts with informers, as provided for under code section 6103(n), has greatly frustrated tax whistleblower practitioners. Those agreements allow the IRS to sidestep traditional prohibitions on disclosure of confidential tax return information, giving tax whistleblowers access to financial records and other information that are normally deemed out-of-bounds. However, the IRS has steadfastly refused to utilize written contracts, potentially dampening the attractiveness of the program and, according to critics, reducing the nation’s revenue coffers by billions in unpaid taxes.

Understandably, one potential reason for the IRS’s current course is a fear that giving tax whistleblowers access to sensitive information regarding the individuals and entities who they are submitting claims on will weaken the tax system by making taxpayers feel less safe about the privacy of reported tax information. While improper disclosure is a legitimate concern, whistleblower advocates contend that the use of section 6103(n) agreements is unlikely to harm the continued confidentiality of taxpayer information that supports the tax system. But other practitioners believe any extension of the opportunity to delve into sensitive personal records

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of another taxpayer puts those individuals and companies at risk of having information misused without effective deterrents in place.

This Article reviews the sharp disagreement between those who want the government to start making written contracts under section 6103(n) a routine part of whistleblower cases versus tax traditionalists who worry that an expanded whistleblower program will end up further impinging on taxpayer rights of confidentiality. Even though the IRS has yet to give in to whistleblower proponents, the aggressive lobbying makes it seem possible that administrative practice could change in the future, leaving corporate and high net-worth taxpayers wondering what such a shift means for their privacy.

I. TAXPAYER PRIVACY

Section 6103 has operated for the past several decades as a type of high-security firewall guarding against the disclosure of taxpayer information and protecting the integrity of the tax system. The section’s current statutory iteration is often viewed as a key mechanism for keeping public compliance with the tax code fairly high. The seemingly tight limits placed on when tax return information can be shared helps foster the self-assessment model upon which the U.S. tax system is based by providing taxpayers a sense of security that the information they provide to the IRS is kept confidential.

Although section 6103 quietly existed from 1910 until its major revision in the 1970s, the predecessor version of the statute actually provided little protection to taxpayers. In characterizing taxpayer returns as public records, the pre-1976 statute allowed the executive branch great license in deciding with whom to share return information. Indeed, the alleged abuse of access to taxpayer information by President Nixon led to the 1976 reforms to section 6103 that made Congress the gatekeeper of tax return information and established the strict privacy regime that exists today.


3. See Michelle M. Kwon, Whistling Dixie About the IRS Whistleblower Program Thanks to the IRC Confidentiality Restrictions, 29 VA. TAX REV. 447, 471 (2010) (“The
Section 6103 now prohibits the IRS from disclosing taxpayer information "absent an explicit legislative exception."  

But section 6103 actually is more porous than many taxpayers realize. In 2012, the IRS acknowledged that it legally made more than 8 billion disclosures of tax returns and return information to properly authorized recipients under section 6103. The bulk of those disclosures were made to states, congressional committees, and the Census Bureau. Although the Treasury Department and the Joint Committee on Taxation are required to produce an annual public report detailing disclosures under the exceptions enumerated in section 6103, the statute does not require record-keeping for releases under section 6103(n).

With such a high number of authorized disclosures to various agencies and quasi-governmental entities, one would assume that leaks of taxpayer information would be relatively common. Fortunately, it is rare for taxpayers to be harmed by a violation of section 6103, but IRS vigilance is a crucial component of the good safety record afforded taxpayer information. Unknown is whether the same record could continue if whistleblowers are afforded access to return information when it is possible that the unique motives underlying an informant’s submission may be at odds with sound tax system administration.

1976 amendments marked a philosophical shift from treating tax information as a 'generalized governmental asset' that the executive branch was able to dole out at will to a confidential, protected asset that only Congress could disseminate.

4. Id.


6. Section 6103(p)(3)(C) of the Internal Revenue Code states:

Public report on disclosures. The Secretary shall, within 90 days after the close of each calendar year, furnish to the Joint Committee on Taxation for disclosure to the public a report with respect to the records or accountings described in subparagraph (A) which—(i) provides with respect to each Federal agency, each agency, body, or commission described in subsection (d), (i)(3)(B)(i) or (7)(A)(ii) or (1)(6), and the Government Accountability Office the number of—(I) requests for disclosure of returns and return information, (II) instances in which returns and return information were disclosed pursuant to such requests or otherwise, (III) taxpayers whose returns, or return information with respect to whom, were disclosed pursuant to such requests, and (ii) describes the general purposes for which such requests were made . . . .

I.R.C. § 6103(p)(3)(C) (2012). Section 6103(p)(3)(A) provides that "the Secretary shall not be required to maintain a record or accounting of requests for inspection or disclosure of returns and return information, or of returns and return information inspected or disclosed, under the authority of subsections . . . (n)."

7. The most common occurrences of unauthorized section 6103 disclosures happen from information technology-related security issues or inadvertent online postings.
II. Administrative Steps

Section 6103(n) already permitted the IRS to use services contracts for disclosure of return information prior to the 2006 amendments to section 7623, and the amendments did not specifically address whether Congress intended for the revised whistleblower program to make use of section 6103(n) agreements. That space of silence has generated differing opinions as to what role section 6103(n) should play in the IRS’s new whistleblower framework.

The Department of the Treasury (Treasury) issued proposed regulations in 2008, under the authority of section 6103(n), to allow disclosure to a whistleblower of some return information and claim status information after a contract has been entered into. Final regulations governing section 6103(n) contracts for whistleblowers were released in 2011, adopting the position in the 2008 regulations with only minor grammatical changes.

Under the general rule of the regulation, an IRS or Treasury employee is “authorized to disclose return information” to a whistleblower and legal representative “to the extent necessary in connection with a written contract” involving whistleblower claims. The regulation gives the IRS discretion in deciding whether to enter into a section 6103(n) services contract with an informant. In further language limiting when disclosures in whistleblower cases can occur, Treasury stated that released information “shall be made only to the extent the IRS deems it necessary in connection with the reasonable or proper performance of the contract.” In some instances, only portions of the relevant taxpayer return information need be provided under the contract.

As with any improper use of taxpayer return information, unauthorized inspection or disclosure of information obtained under a section 6103(n) contract is subject to strict civil and criminal penalties.
Whistleblowers also must agree to a series of restrictions that the IRS labels as “safeguards” under a section 6103(n) contract. For example, whistleblowers agree to comply with any and all requirements that the IRS decides are necessary to protect the confidentiality of return information provided under the agreements.\textsuperscript{16} Whistleblowers (and their representatives) also must agree to allow the IRS to inspect their premises as part of the access exchange.\textsuperscript{17}

Internal Revenue Manual (IRM) Exhibit 25.2.2-10 provides a sample confidentiality agreement under section 6103(n):

\begin{quote}
I, (name of whistleblower/representative), have received notice from the IRS of the award recommendation in the case initiated by my submission of a claim for award under 26 U.S.C. 7623 (state claim number). I wish to participate in the administrative proceeding leading to the determination of an award by the Director of the Whistleblower Office in this case, by reviewing additional information related to the award recommendation. I understand that information will not be disclosed to me unless the disclosure is necessary as part of the administrative proceeding, and unless I agree to maintain the confidentiality of any information on taxpayers other than myself (my client) disclosed to me. I agree that I will use any information disclosed to me (my client) by the Whistleblower Office only for the purpose of preparing comments on the recommendation to the Director, or in appealing the Director’s determination by petitioning the US Tax Court. I understand that use of any information disclosed to me (my client) for any other purpose may be considered a negative factor in determining the award payable under 26 U.S.C. 7623, and may result in a reduction of the award (but not less than the minimum award required by law). This agreement applies to any information disclosed as part of the administrative proceeding leading to the determination by the Director of the Whistleblower Office, including information contained in a Preliminary Award Report or any other information made available for my review by the IRS Whistleblower Office. Any disclosures made in connection with a request for review of the Director’s determination by the US Tax Court, including re-disclosure of information previously disclosed as part of the administrative proceeding, will be governed by the rules of the Court.

Signed and witnessed[.]\textsuperscript{18}
\end{quote}

\textsuperscript{16} See id. § 301.6103(n)-2(d).
\textsuperscript{17} See id § 301.6103(n)-2(d)(3).
One main reason for seeking a section 6103(n) contract for a whistleblower is the possibility of getting some indication about how the claim is progressing within the IRS. The final regulations permit a whistleblower to make a written request to the IRS, to which the IRS in response “may inform the whistleblower . . . of the status of the whistleblower’s claim for award . . . including whether the claim is being evaluated for potential investigative action, or is pending due to an ongoing examination, appeal, collection action, or litigation.”19 This avenue can provide insight into the section 7623(b) case pipeline that may not be available when contracts are not used. Whether that justification warrants relaxing the nondisclosure mandate is a central part of the debate surrounding the tradeoffs inherent under section 6103(n).

III. Hesitancy Favored

The IRS has publicly proclaimed that written whistleblower contracts could be a good thing in the right circumstances, but it has not yet entered into a contract under section 6103(n).

The IRS updated the IRM following the 2006 amendments to section 7623 to set out procedures for handling high-dollar award claims. As part of its internal instructions to agents, the manual states that “it may be required and in the best interest of the Government to have a formal agreement with the whistleblower when it is necessary to share information obtained by the IRS from the taxpayer.”20 Although it characterizes the use of the contracts as happening only in “rare circumstances,” the IRM provision notes that section 6103(n) contracts with whistleblowers would “include safeguards to protect the privacy of any taxpayer information revealed.”21

The tone of the IRM provision has seemingly had the effect of discouraging the use of section 6103(n) contracts in practice. For example, the IRM declares that such agreements “must be initiated by the Executive responsible for the function seeking the contract, and approved by the Business Operating Division not lower than the Deputy Commissioner level.”22 That language has kept written whistleblower contracts from occurring, in part because requiring high-level review to initiate a contract makes it less likely that a subject matter expert or agent in an operating division reviewing an award claim will take the time to pass the request up the management chain.23 Proponents believe that the whistleblower pro-

21. Id.
22. Id.
23. See Jeremiah Coder, Treasury Finalizes Whistleblower Contract Regs, 130 Tax Notes 1399 (2011) (“Thus, the lack of contract use may be partially attributable to the reluctance of the IRS operating divisions rather than the IRS Whistleblower Office.”).
gram would be better served if the IRS determined that the Whistleblower Office, which has the most at stake in helping to change public perception of the program, should have a role in getting section 6103(n) contracts into existence, such as by championing contracts on an individual basis as necessary in each case and working with the appropriate operating division executive.

A 2011 letter to Senator Charles E. Grassley (R-Iowa) from Steven T. Miller, then IRS Deputy Commissioner for Services and Enforcement, provided further insight into the agency’s views on section 6103(n) contracts. In the letter, Miller stated that the IRS took to heart the position articulated by the Joint Committee on Taxation that such agreements would “be infrequent and would be made only when the assigned task cannot be properly or timely completed without the return information to be disclosed.” Miller went on to clarify the IRS’s position that “[c]ontracts relying on the authority of section 6103(n) are to be rare, based on a finding of necessity to perform a tax administration function.” The IRS would decline to enter into informant services contracts when it “can obtain the required information or analysis using its own resources on a timely basis,” he said. Yet later in the letter, Miller acknowledged that “there are cases where it would be beneficial for us to contract with the Whistleblower for technical assistance throughout the examination.”

In a June 2012 memo, Miller pushed to make the whistleblower program more effective by establishing tighter deadlines for specific actions regarding informant claims. In addition to establishing a “set of expectations for timely actions on whistleblower submissions”—such as initial claim reviews within ninety days of receipt and award decisions provided to whistleblowers within ninety days of a final determination of collected proceeds—Miller tried to convey a new mindset with which whistleblowers should be viewed by the IRS. Noting that whistleblowers have “insights and information that can help the Service understand complex issues or hidden relationships,” he called debriefing sessions with whistleblowers


25. Id. (quoting “the Joint Committee on Taxation Report issued in conjunction with the 2006 amendments to section 7623”).

26. Id.

27. Id.

28. Id. The IRS has willingly utilized the assistance of whistleblowers in investigations following submission of an award claim. For example, in Jarvis v. Commissioner, the court noted that the whistleblower “work[ed] for the IRS in reviewing and interpreting documents seized” from the taxpayer. Jarvis v. Comm’r, 47 Fed. Cl. 698, 705 (2000).

29. Memorandum from Steven T. Miller, Deputy Comm’r for Servs. & Enforcement, IRS, to Operating Div. Comm’rs, the Chief of Criminal Investigation, and the Director of the Whistleblower Office, IRS Whistleblower Program (June 20, 2012), 2012 Tax Notes Today 121-15 [hereinafter Miller Memo].

30. Id.
an important component of the evaluation of whistleblower information” and said that debriefings should “be the rule not the exception.”³¹

Miller also wrote that, “with appropriate controls, interaction with a whistleblower during an examination can assist in timely and correct resolution of issues.”³² A section 6103(n) written services contract, he continued, “may be used when disclosure of taxpayer information is necessary to obtain a whistleblower’s insights and expertise into complex technical or factual issues.”³³

The permissive instruction of “may” in Miller’s memo was not as emphatic as some would have liked, but it offers the possibility that someday the IRS might allow written contracts as a step in review of a whistleblower award claim.

The memo received high praise from tax whistleblower practitioners, many of whom hoped the directive would spur the IRS to follow the suggested timelines and lead to a more accepting attitude toward informants. Instead, the IRS has continued to eschew whistleblower contracts, which has only increased the perception of many informants and their representatives that the agency is treating them dismissively. For those wanting change, the result of the IRS’s apparent philosophy of avoiding information sharing with whistleblowers only leads to the unnecessary duplication of efforts, wasted resources, and ultimately a slower IRS response to legitimate tax avoidance claims.

IV. WORKING SMARTER

Whistleblower practitioners might argue that the IRS’s obstacles in the section 6103(n) context stand in stark contrast to its general goals in almost all other facets of tax administration of achieving efficiency and instituting knowledge management practices.

The IRS has deployed several audit tools in recent years in an attempt to be more efficient in its examinations of taxpayer returns. For example, under the IRS Large Business and International Division’s (LB&I) compliance assurance process (CAP), which some practitioners and government officials refer to as a “real-time audit,” the taxpayer and IRS exam team continuously resolve outstanding tax issues so that the taxpayer obtains certainty much sooner. For the most part, previously contentious disputed issues are resolved before a tax return is filed. The process appeals to many taxpayers and the government because it forgoes a retrospective look at tax transactions wherein information is not as readily available and provides more certainty regarding treatment in future years given an exam’s outcome. CAP has been made even more attractive with the addition of a maintenance phase for CAP taxpayers that the IRS deems low

³¹. Id.
³². Id.
³³. Id.
risk, which thereby narrows the number of issues that are under continuous audit.

Another example of the IRS’s efforts to increase efficiency is the joint LB&I-IRS Appeals initiative called Fast-Track Settlement, which began in 2001 and provides an alternative, accelerated dispute resolution procedure for corporate taxpayers. Although the procedure cannot be used unless all parties—the taxpayer, the exam team, the issue management team coordinator, and the fast-track coordinator—agree to participate, the settlement process typically ends up with more efficient resolutions.

Also, there is the Schedule UTP, on which corporations are required to self-report their uncertain tax positions. Despite widespread corporate criticism, the schedule was rolled out in 2010 as a way to clue auditors in to possible areas of uncertainty that could represent tax noncompliance. The goal is to increase transparency, allowing the IRS to spend less time identifying issues and helping the agency prioritize the selection of issues and taxpayers for examination, while spotting significant areas of uncertainty that require guidance. The corporate reporting requirement affects taxpayers or related parties that issue audited financial statements and have both uncertain tax positions and assets greater than $10 million. The current filing requirements compel corporate taxpayers to submit a list of UTPs ranked by actual size of the tax reserve amount, along with a concise description of each position. The IRS expanded its policy of restraint, promising to forgo seeking specific documents concerning a corporation’s UTPs as well as the workpapers that document the completion of Schedule UTP.

All three processes are examples of initiatives the IRS has established specifically to enhance tax enforcement by streamlining the audit process to use fewer government resources. Given all the energy spent devising and implementing these creative examination processes, critics of the current administrative procedures complain that the IRS whistleblower program is allowed to operate with many obstacles in place that thwart Congress’s intended goal of flushing out unpaid taxes via timely and well-placed information on high-dollar tax evasion.

The IRS itself has apparently noted that examinations resulting from informant-provided information are more productive than traditional examinations arising from the use of the Discriminant Index Function

36. I.R.S. Announcement 2010-30 outlined a graduated adoption for companies, requiring only companies with assets greater than $100 million to report in the first two years, after which companies with assets more than $50 million would be required to file Schedule UTP. See I.R.S. Announcement 2010-30, 2010-1 C.B. 668 (2010). Companies with $10 million in assets are not required to file Schedule UTP until tax years beginning in 2014. See id.
In an unreleased report from 1999, the IRS determined that whistleblower-inspired audits have a highly desirable cost-benefit ratio, with the agency incurring only four cents of costs per dollar collected. That figure contrasts with the ten cents of costs incurred per dollar collected in DIF-selected exams. In a more recent study, the Treasury Inspector General for Tax Administration (TIGTA) discovered in 2006 that the adjustment dollars secured per hour spent on a whistleblower case for tax returns from the 1996–1998 tax years yielded $946 per hour versus only $548 per hour for DIF audits. In addition, the no-change rate was significantly lower for audits involving whistleblower-provided information (12%) than for normal examinations (17%). The same return analysis held true for audits examined by TIGTA for fiscal years 2003–2005. The 2006 report concluded that “IRS data indicated that examinations initiated based on informant information were often more effective and efficient than returns initiated using the IRS’ primary method for selecting returns for examination.”

However, tax attorneys who represent corporations and high-net worth individuals say that whistleblower claims are often based on vindictive motives and misleading or incomplete information. Tax audits driven by a whistleblower submission are sometimes merely a reflection of an overlooked mistake or foot-fault that is corrected once the taxpayer is made aware.


39. INFORMANTS’ REWARDS PROGRAM REPORT, supra note 37, at 4.

40. An audit is classified as “no-change” when it is closed with no adjustments or changes to the taxpayer’s reported tax liability.

41. INFORMANTS’ REWARDS PROGRAM REPORT, supra note 37, at 4.

42. See id. at 5. The adjustment dollars for whistleblower cases were $688 per hour versus $382 per hour for DIF audits for fiscal years 2003–2005. Id. The no-change rate in that period was 21% for whistleblower exams and 28% for DIF audits. Id.

43. Id. at 1–2.

44. See Jeremiah Coder, Tax Whistle-Blowing: Many Cases, Few Results, 125 TAX NOTES 186 (2009), available at http://www.tax-whistleblower.com/articles/Tax_Whistle-Blowing_Many_Cases_Few_Results.pdf (quoting practitioner who stated that whistleblower rules “do not adequately protect companies against disgruntled employees,” creating “‘an incentive for even claims of dubious merit to be made’ . . . because there is no fraud requirement in the new framework”).

45. See id. (quoting same practitioner who stated that whistleblower program fails to “weed[ ] out claims regarding errors that the taxpayer planned to disclose anyway”).
The rub with whistleblower representatives is the belief that in the absence of a written contract that allows a whistleblower to directly interact with IRS employees when necessary, the resulting information gathering processes can be inefficient and limiting for all parties involved. Because of the strictures of section 6103, if an IRS auditor wants to obtain more information in an exam based on a whistleblower claim, the agent must first pass along a request to a taint review team, which gathers the requested information from the whistleblower and relays it to the agent.46

The IRS processing of the Form 211 award claim can be long and follow a winding path.47 When a claim initially appears to meet the section 7623(b) threshold, a Whistleblower Office analyst will review the claim for fraud potential and, if necessary, send the claim to the IRS Criminal Investigation division. If the claim has no fraud component, and the analyst decides to further process the claim, it is sent to a subject matter expert in the applicable operating division.48 The subject matter expert conducts the taint review, identifies potential legal issues with the whistleblower’s information, and often conducts a debriefing with the whistleblower, before deciding whether to recommend pursuing the informant’s lead. If the lead is pursued, it is sent along for examination and monitored until the exam is resolved.

Although the IRM envisions the use of debriefings—and those meetings usually occur in practice—whistleblower practitioners do not view debriefings as a sufficient substitute for entering into a section 6103(n) contract. IRM section 25.2.2.7.7 describes the debriefing as a meeting at which the IRS can receive additional information from the informant, assess the informant’s credibility, and learn about legal issues affecting the use of documents supplied by the informant. Although subsequent meetings are contemplated to clarify a submission, the IRS generally believes it can “proceed with an investigation or examination without further assistance from the whistleblower.”49

46. One practitioner has called this process a “grown-up game of Operator.”
48. If the analyst decides not to process the claim, a rejection recommendation is sent up the chain of command and ultimately a rejection letter is issued to the informant. See IRM 25.2.2.7.4 (2010), available at http://www.irs.gov/irm/part25/irm_25-002-002.html#d0e589.

The law requires the Whistleblower Office to analyze 7623(b) claims, and authorizes the Whistleblower Office to request assistance from the whistleblower or their counsel. In most cases, the IRS should be able to receive information from a whistleblower, conduct a debriefing to ensure the information provided is fully understood and that the IRS has all relevant information the whistleblower can offer, and then proceed with an investigation or examination without further assistance from the
It is possible that the IRS might try to obtain some benefit from additional taxpayer information without the use of a section 6103(n) agreement during the examination phase by expanding the scope of the award determination administrative proceeding. In its 2012 proposed regulations, the Treasury said it was considering allowing whistleblowers to participate in the award determination process before a final award determination is made. Under the proposed regulations, following issuance of a preliminary award recommendation letter, the IRS Whistleblower Office would engage the informant in a “structured process involving correspondence and other communications” that allows the informant to provide more information regarding the claim that is relevant to the award determination.

The IRS’s iteration of negative consequences from violating the terms of a section 6103(n) agreement implicitly acknowledges that violations are possible, even if expected to be rare. The proposed regulations provide that the IRS “may treat a claimant’s violation of the terms of the confidentiality agreement as a negative factor and, thus, as a basis for reducing the amount of an award.” An honest informant understands that failing to abide by the terms of section 6103(n) is self-injurious to the informant’s goal of the maximum award possible, but it is also naive to ignore the likelihood that some whistleblowers, already motivated by either greed or spite, might wantonly disclose confidential information in an attempt to further punish a taxpayer.

VI. A FINELY BALANCED ADMINISTRATIVE SOLUTION

IRS officials and agency reports have highlighted the significant increase in the number of whistleblower claims submitted as a result of Congress’s enactment of a higher payout regime for some high-dollar claims. Consequently, the IRS’s decision to avoid the use of any section 6103(n) contracts has led whistleblower practitioners to call the regulations under section 6103(n) practically useless.

In the 2012 proposed regulations, the IRS acknowledged that it would use confidentiality agreements in appropriate circumstances as “safeguards, to minimize possible redisclosures of return information while still whistleblower. In some cases, there may be a need to pose additional questions to the whistleblower. Such inquiries are governed by the appropriate disclosure provisions contained in I.R.C. section 6103. When such an inquiry is made of a whistleblower, an exception to the requirement for reporting this type of third-party contact applies.

Id. (internal citations omitted).


52. Id. (discussing administrative proceedings for awards paid under section 7623(b)).

53. See Miller Letter, supra note 24 (confirming IRS has not entered into any section 6103(n) contracts with whistleblowers in pending claims).
providing meaningful opportunities for claimants to participate in whistleblower administrative proceedings."\textsuperscript{54} Those statements were not assuring to whistleblower representatives, however, who do not believe that the IRS intends to make section 6103(n) contracts a meaningful part of the award claim process.

Instead, the whistleblower community strongly believes that the IRS should adopt a more clearly defined position that makes mandatory the use of whistleblower assistance. One group of commentators who responded to the proposed regulations argued that "[m]andatory language regarding a request for assistance will make clear to enforcement agents in the field that whistleblowers are a valuable resource for ensuring payment by tax scofflaws."\textsuperscript{55} To that end, the commentators urged the IRS to change the text of the proposed rules from "may" to "shall request the assistance of an [informant] . . . in debriefing by meeting in person or by telephone."\textsuperscript{56} Another interest group took the IRS to task for being "silent regarding the use of [section 6103(n)] agreements to promote full utilization of whistleblower knowledge" in timely investigating and resolving whistleblower claims.\textsuperscript{57} The Service’s “reluctance to engage with whistleblowers through 6103(n) agreements has impeded” more efficient resolutions, the group claimed.\textsuperscript{58}

Presumably, the frequent use of section 6103(n) agreements also would reduce the likelihood of intentional disclosure of taxpayer information during litigation. The IRS has been worried that as part of the award claim process, denial of a claim that raises the right for an informant to challenge that decision in U.S. Tax Court\textsuperscript{59} would necessitate disclosure of the Service’s grounds for an award determination, which could include taxpayer information normally protected by section 6103. While noting that both the IRM and the 2012 proposed regulations provide for disclosure under a confidentiality agreement, the IRS rightly acknowledges that "[t]here appears to be no effective sanction, and no effective restraint, when a whistleblower obtains confidential taxpayer information in discovery and chooses to release that information to the public."\textsuperscript{60}

\textsuperscript{54} 77 Fed. Reg. 74798, 74804 (Dec. 18, 2012).
\textsuperscript{56} Id.
\textsuperscript{58} Id.
\textsuperscript{59} See I.R.C. § 7623(b)(4) (2012) (allowing whistleblowers to appeal an award determination to U.S. Tax Court, which is given specific jurisdiction under the statute).
The IRS’s deep concern over disclosure to whistleblowers during the discovery process should not be lightly dismissed. The IRS, through its Office of Chief Counsel, can seek appropriate mechanisms during the discovery process that limit the extent to which taxpayer return information could be mishandled. For example, Tax Court rules 27 and 103 expressly permit parties to seek protective orders and privacy protections for filings made with the court. The IRS could ask the court to limit viewing of taxpayer information by a whistleblower to an in camera proceeding or request other limits appropriate to the situation to ensure that return information is handled with the requisite care for privacy.

The Tax Court is grappling with what limits should be placed on discovery during whistleblower award suits. In a current whistleblower challenge to an award denial, the Tax Court has issued multiple orders, including a protective order, that establish a careful process by which the whistleblower is able to access a limited number of documents regarding the underlying taxpayer. The orders have required the IRS to redact the taxpayer documents, place the documents under seal, and subject them to an in camera review. Moreover, the Tax Court has required the whistleblower to submit a discovery request for specific taxpayer documents and granted the whistleblower access to only a small number of the requested redacted documents.\(^\text{61}\) The orders clearly state that the produced information may be used for litigation purposes only, and that any violation is subject “to sanctions and punishment in the nature of contempt.”\(^\text{62}\) Although the limiting mechanisms in Tax Court to preserve the confidentiality of taxpayer information are a first step, it is too early to tell how whistleblowers not represented by competent counsel might handle sensitive information despite the restrictions set in place by the court. A determined whistleblower could very well flout any court orders governing confidentiality in order to cause public embarrassment to a company, even at risk of contempt or other sanctions.

The extent to which company information will become a matter of public knowledge has already occurred as the result of whistleblower litigation in the Tax Court. For example, in *Insinga v. Commissioner*,\(^\text{63}\) the whistleblower’s public pleadings identified a large company and financial institutions as targets of his award claim, including extensive information regarding the basis of his allegations.\(^\text{64}\) The expected increase in litigation arising from revised section 7623 also presages the fact that, despite


\(^{62}\) Id.


noble efforts at protecting taxpayers from unwanted and spiteful exposure, judicial review will inevitably bring more taxpayer information into the public eye. As explicitly recognized in a recent case, the Tax Court’s general approach is that litigation within its domain is a matter of public record.65

VII. Conclusion

Although the IRS has clear statutory and administrative authority to enter into section 6103(n) whistleblower agreements, it has repeatedly elected not to pursue those agreements in favor of maintaining a cautious approach to information sharing. While proponents argue that the end result of that course of action is diminished capacity to fully investigate viable whistleblower claims, and consequently, to enrich the fisc through collection of high-dollar uncollected taxes, other tax practitioners believe that the IRS is acting fairly to avoid potential serious damage resulting from access to taxpayer information that ultimately cannot be appropriately supervised. Once out of the gate, there is no way to repair a taxpayer’s image or credibility if a whistleblower bent on harm is granted access to information within the taxpayer’s file.

Protection of taxpayer information is a good and necessary thing, and something that has become an embedded expectation in tax system administration; taxpayers have been harmed by unthinking or accidental IRS dissemination of personal financial information. The whistleblower program can be a useful tool for the IRS to engage informants who have valid claims against tax cheats. But the program must also continue to offer adequate protection of taxpayer information, sometimes even at the risk of making the process more cumbersome, in order to maintain stable tax system administration based on a strong foundation of taxpayer privacy.

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NOT JUST WHISTLING DIXIE: THE CASE FOR TAX WHISTLEBLOWERS IN THE STATES

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I. INTRODUCTION

TAX whistleblowing has been in the news lately. In September 2012, the IRS wrote a check for $104 million to Bradley Birkenfeld, a former banker with UBS, the Swiss banking giant. The payment, made under the federal government’s tax whistleblower program,1 represented Birkenfeld’s cut for providing information to the IRS that exposed how UBS actively concealed taxable income of U.S. clients for decades by hiding assets in secret offshore accounts.2 Birkenfeld’s assistance was “exceptional in both its breadth and depth,” the IRS explained in making the award, and allowed the U.S. government to pursue “unprecedented actions against UBS AG, with collateral impact on other enforcement activities.”3

“Collateral impact” hardly does justice to the effect of Birkenfeld’s whistleblowing. The “treasure trove of inside information” that Birkenfeld provided U.S. officials formed “the foundation for the UBS debacle and everything that followed.”4 Indeed, thanks to one of “the biggest whistleblowers of all time,”5 the U.S. government (take a deep breath)

* Professor of Law, UC Davis School of Law. I thank Gregory Krakower, Darien Shanske, and Dean Zerbe for their helpful comments. I also benefited from suggestions and conversations at the Norman J. Shachoy Symposium, sponsored by the Villanova Law Review, particularly those from Jeremiah Coder and J. Richard Harvey.

1. For a discussion of the IRS whistleblower program, see infra notes 349–86 and accompanying text. Birkenfeld’s whistleblower payment of $104 million was calculated off a portion ($400 million) of the total fine ($780 million) paid by UBS pursuant to a deferred prosecution agreement reached with the U.S. Department of Justice in early 2009. The $400 million represented money that UBS failed to withhold from U.S. taxpayer accounts while the remaining $380 million represented profits that UBS earned from its cross-border business between 2001 and 2008. See William P. Barrett & Janet Novack, UBS Agrees to Pay $780 Million, FORBES (Feb. 18, 2009, 7:00 PM), http://www.forbes.com/2009/02/18/ubs-fraud-offshore-personal-finance_ubs.html; see also infra notes 2–3 and accompanying text.
4. Robert Goulder, Year in Review: The 2009 Person of the Year, 126 TAX NOTES 7, 9 (2010). A DOJ official stated, “without Mr. Birkenfeld walking through the doors of the Justice Department in the summer of 2007, I doubt this massive fraud scheme would have been discovered by the United States government.” Id.; see also Lee A. Sheppard, Swiss Banking Derobed: Implications of Birkenfeld, 136 TAX NOTES 1361 (2012).
5. Goulder, supra note 4, at 8.
received: $780 million and the names of 250 high-dollar Americans with secret accounts as part of a deferred prosecution agreement (DPA) with UBS;6 another 4,450 names and accounts of U.S. citizens provided as part of a joint settlement between the U.S. and Swiss governments;7 more than 120 criminal indictments of U.S. taxpayers and tax advisors;8 additional indictments against foreign bankers, advisors, and lawyers;9 still more foreign nationals pleading guilty to conspiring to assist U.S. taxpayers to file false returns and evade U.S. taxes;10 the closure of prominent Swiss banks—including the oldest private bank11—based on their participation in helping U.S. clients evade tax liability;12 more than $5.5 billion collected13 from the IRS Offshore Voluntary Disclosure Program (OVDP), with untold tens of billions of dollars still payable due to only a quarter of the 39,000 OVDP cases being closed;14 program participants ratting out banks as a requirement of their participation,15 banks themselves disclosing the names and accounts of clients who refuse to participate in the program to avoid their own monetary penalties and to defer or avoid crim-

6. See Jeremiah Coder & Lee A. Sheppard, UBS Settles with DOJ for $780 Million, 122 TAX NOTES 944, 944 (2009). Immediately after signing the DPA, the U.S. Department of Justice sought to enforce a summons against UBS for information pertaining to all 52,000 U.S. account holders. See David D. Stewart, DOJ Seeks Enforcement of John Doe Summons Against UBS, 122 TAX NOTES 945 (2009).


10. See David D. Stewart & Stephanie Soong Johnston, Swiss Lawyer Pleads Guilty to Helping U.S. Clients Evade Taxes, 140 TAX NOTES 879 (2013).


15. See id.
nal prosecution; and the IRS aggressively going after taxpayers who tried to “stay under the radar” by failing to participate in the program and then “quietly” filing amended returns on foreign bank accounts for prior years. All because one person blew the tax whistle.

Tax whistleblowers have been busy at the state level too. In 2012, the state of New York sued telecommunications provider Sprint Nextel based on a whistleblower’s information. According to the State’s complaint, Sprint “illegally avoided its New York sales tax obligations” by failing to collect sales taxes on its “flat-rate” calling plans and knowingly filing false tax returns, actions for which New York sought damages exceeding $300 million under the state’s False Claims Act (FCA). In June 2013, a New York Supreme Court denied Sprint’s motion to dismiss the case after concluding that New York had sufficiently alleged violations of the state’s tax laws, a decision unanimously affirmed by the Supreme Court’s Appellate Division. In a press release announcing the court’s decision on the motion to dismiss, New York Attorney General Eric Schneiderman stated, “[a]s the very first tax case prosecuted under the False Claims Act—which rewards and protects whistleblowers—this ruling sends a message that tax dodgers will be exposed and prosecuted to the fullest extent of the law.”

Three years earlier, as a member of the New York State Senate, Schneiderman authored changes to New York’s FCA that prominently included a new section authorizing “claims, records, or statements made under the tax law.” The legislature unanimously passed the changes, making New York the first state to specify tax claims under its FCA. The

16. See Stephanie Soong Johnston, 10 Swiss Banks Agree to Participate in DOJ Settlement Program, 141 TAX NOTES 1285 (2013); Saunders, supra note 8.
tax press proclaimed the law “the most far-reaching in the country,” while Schneiderman proudly called it a “False Claims Act on steroids.” It permitted the state, local governments, and whistleblowers to bring tax enforcement actions against businesses with net income or sales exceeding $1 million and alleged damages exceeding $350,000. It made losing defendants liable for treble damages based on total damages incurred by the state, statutory penalties between $6,000 and $12,000 per claim, and all reasonable costs and expenses for bringing the action (including attorney’s fees). Moreover, whistleblowers were entitled to as much as 30% of all proceeds collected from the action, and the law extended anti-retaliation protections for informants. To process and investigate whistleblower submissions, and to enforce the enhanced FCA, Attorney General Schneiderman established the Taxpayer Protection Bureau. Other high-profile tax enforcement efforts based on whistleblower tips processed under the state’s FCA already include a conviction of a New York City “tailor to the stars” on felony tax evasion of sales and income taxes, a multi-million dollar settlement with a medical imaging company for knowingly evading New York state and city taxes, an active investigation of more than a dozen private equity firms for illegally converting ex-

27. See N.Y. STATE FIN. LAW § 189(4)(a)(i)–(ii).
28. See id. § 189(1)(h).
29. See id. The “per claim” penalty becomes significant when actions involve thousands of claims. “If a tax case involves numerous transactions, invoices, or billings, each of those documents can be considered a false claim.” Jack Trachtenberg et al., Applying False Claims Acts in State Taxation, 64 STATE TAX NOTES 373, 375 (2012).
30. See N.Y. STATE FIN. LAW § 189(3).
31. Id. § 190(6)(b).
32. See id. § 191.
executive management fees charged to investors into personal stakes in fund investments to “substantially reduce or escape [ ] tax liabilities,” another active inquiry into the operations of 501(c)(4) organizations that engage in “electioneering” with the help of dark money, and cases under investigation that are expected to “dwarf” the Sprint prosecution.

While some states are experiencing outsized benefits due to tax whistleblowers, others are under siege. Illinois finds itself in a particularly tight spot, with a single Chicago-based class action plaintiffs’ firm filing hundreds of cases against remote sellers under the state’s FCA alleging fraud for failure to collect sales and use taxes. In all cases, the law firm filed suit after conducting investigations based purely on information already in the public domain or simply after ordering a few items online from an out-of-state retailer and then bringing an action when the vendor failed to charge Illinois sales tax on the sale.


37. Hamilton, supra note 26, at 698; see also Nicholas Confessore, Julie Creswell & David Kocieniewski, Inquiry on Tax Strategy Adds to Scrutiny of Finance Firms, N.Y. Times (Sept. 1, 2012), http://www.nytimes.com/2012/09/02/business/inquiry-on-tax-strategy-adds-to-scrutiny-of-finance-firms.html?pagewanted=all&_r=0. By waiving all or part of a management fee (typically 2% of money under management) in exchange for an investment in the fund, private equity executives attempt to convert the fees (taxed at 39.6% and due upon payment) into “carried interest” plus returns on the fund (treated as long-term capital gains taxed at 20% and payable years later). If the compensation is not at risk of forfeiture, the argument for capital gain treatment is bogus. Or, as one prominent tax attorney has explained, “[t]he less the fees are at risk, the more it seems as though they are current income from labor that should be taxed at ordinary rates.” Reed Albergotti & Laura Saunders, Informer Sparked New York Probe, WALL ST. J. (Sept. 12, 2012, 10:34 AM), http://online.wsj.com/news/articles/SB10000872396390443696604 (quoting Bryan Skarlatos of Kostelanetz & Fink LLP). As part of the investigation, the New York Attorney General is also examining whether private equity executives deferred payment of the converted fees (or treated the fees as a return of invested capital). See id.


41. The basis of these claims is loosely grounded in an Illinois Supreme Court case from 2009 holding that shipping charges for certain internet purchases of tangible personal property are subject to Illinois sales tax. See Kean v. Wal-Mart Stores, Inc., 919 N.E.2d 926, 940–41 (Ill. 2009); see also Trachtenberg et al., supra note 29, at 376.
In response to these improper nuisance suits, a member of the Illinois Assembly, Michael Zalewski, introduced legislation to amend the state’s FCA by prohibiting qui tam actions—that is, actions prosecuted by a whistleblower on behalf of the government—based on alleged underpayment of tax.\textsuperscript{42} Specifically, the bill gave the state attorney general sole authority to prosecute tax-related matters originating under the Illinois false claims statute.\textsuperscript{43} Whistleblowers would still be permitted to submit a complaint alleging tax noncompliance under the FCA,\textsuperscript{44} but the department of revenue would initially investigate the complaint and then make a recommendation to the Attorney General as to the merits of the case. Meritorious claims would proceed under the tax department unless the Attorney General decided to prosecute the case, at which point the administrative action would be stayed until resolution of the judicial action.

Defaulting to the tax department ensured that tax experts would evaluate whistleblower submissions and filter out nuisance claims. Meanwhile, cutting out informants and “bounty hunter” attorneys would further reduce the prevalence of nuisance suits and mitigate the unauthorized disclosure of a defendant’s confidential tax return information.\textsuperscript{45} The bill had the support of the Attorney General and the Department of Revenue,\textsuperscript{46} heads of the legislative tax committees, taxpayer organizations, and business groups.\textsuperscript{47} Inexplicably, the proposal died in the Assembly’s Rules Committee, but observers predict the bill will be reintroduced in 2014.


\textsuperscript{43} The language of the bill read, “[n]o court shall have jurisdiction over a civil action brought under” the FCA and involving state taxation “unless the action is brought by the Attorney General.” House Bill 74, supra note 42.

\textsuperscript{44} Some observers of the events in Illinois have argued for removing tax claims altogether from the FCA. See, e.g., Amy Hamilton, MTC Project Would Minimize Seller Exposure to Class Actions, 65 STATE TAX NOTES 367 (2012) [hereinafter MTC Project Would Minimize] (summarizing comments by Todd Lard, general counsel for Council on State Taxation (COST), saying that allowing tax claims under state’s FCA “enable[s] enterprising class action attorneys to prey on some of those gray areas of the law”); Amy Hamilton, Negotiations Underway on Illinois Qui Tam Statute, 66 STATE TAX NOTES 379, 380 (2012) [hereinafter Negotiations Underway] (reporting that Lard proposes barring all claims involving taxes and unclaimed property under statute).

\textsuperscript{45} For a discussion of the proposal and what motivated it, see Jennifer Carr, Should the MTC Take on a Model False Claims Act? 68 STATE TAX NOTES 37, 38–40 (2013); Negotiations Underway, supra note 44, at 379.

\textsuperscript{46} In fact, the two offices jointly wrote the draft statute, according to knowledgeable insiders with whom I spoke.

\textsuperscript{47} See Amy Hamilton, MTC to Work on Limiting Tax Class Action and Qui Tam Suits, 67 STATE TAX NOTES 544, 545 (2013).
Illinois’s experience with FCA claims involving state taxation has also prompted action from the Multistate Tax Commission (MTC). In particular, the proliferation of nuisance suits under the Illinois FCA raises the specter of an untenable Catch-22 for retail businesses that collect state and local transaction taxes: over-collect taxes on behalf of a state and face consumer refund class action suits or under-collect taxes on behalf of a state and face qui tam actions initiated and even prosecuted by whistleblowers. To address the “rock and a hard place” dilemma that sellers experience when collecting tax for states,48 the MTC has formed a work group charged with considering a model statute that addresses both sides of the whipsaw.49 The MTC effort piggybacks on an earlier American Bar Association (ABA) project that produced a model statute to minimize vendor exposure due to under-collection and over-collection of state taxes,50 while addressing additional complications due to whistleblower actions under false claims statutes. Resolving the lose-lose paradox in a timely manner is imperative not just for Illinois, but also for other states that permit—or are considering—tax actions under their FCAs.51

48. I am grateful to Sheldon Laskin, Counsel to the MTC, for the apt phraseology of this dilemma.

49. See Hamilton, supra note 47, at 544; see also MTC Project Would Minimize, supra note 44. The group, the “Tax Undercollection Class Action & Tax Overcollection False Claims Act Work Group,” has been holding regular teleconference meetings. I have participated in the meetings.

50. See ABA, Section of Taxation, Report to the House of Delegates: Transaction Tax Overpayment Model Act Project 1 (2011) [hereinafter Model Act Project], available at http://www.americanbar.org/content/dam/aba/administrative/taxation/_resolution_with_report_model_model_transactional_tax_overpayment_act.authcheckdam.pdf (describing “two main liability risks” for sellers collecting state and local transaction taxes: “First, if sellers fail to collect sufficient tax, they face liability risks attributable to audit assessments. Second, if sellers over-collect or collect for the wrong jurisdiction, they face potential actions and lawsuits filed on behalf of purchasers or pursuant to consumer protection statutes.”). One member of the group that drafted the ABA model statute has said that the extent of the actions and lawsuits for refund “are really only limited by the imagination of plaintiffs’ attorneys.” Hamilton, supra note 47, at 545 (quoting Bruce Johnson, Chair of Utah State Tax Commission). The ABA subcommittee’s report was officially adopted by the ABA in 2011. See Model Act Project, supra note 50.

51. The North Dakota Senate passed a concurrent resolution last year directing a committee to report at the beginning of the upcoming session on “the growth in use of state False Claims Acts with qui tam provisions in state and local taxation matters and whether that approach is feasible and desirable in North Dakota.” Act of Jan. 8, 2013, S. Con. Res. 4007, 63d N.D. Legislative Assembly (introduced by Dwight Cook, Chair of Senate Finance & Taxation Committee), available at http://openstates.org/nd/bills/63/SCR4007/documents/; see also Amy Hamilton, MTC Explores Qui Tam Issues, Advances Passthrough Project, 67 State Tax Notes 723, 725 (2013) (describing North Dakota resolution). At least two additional state legislatures will take up the issue in 2014, including Kentucky (considering legislation creating a false claims act explicitly barring tax actions, while also considering a separate bill establishing a standalone tax whistleblower program) and Mississippi (considering legislation that is silent as to tax claims, with the bill’s sponsors saying it will not apply to tax actions). See Henry J. Reske, Maryland and
This Article analyzes arguments for and against tax whistleblowing at the state level, both with respect to permitting tax actions under False Claims Acts and through standalone whistleblower statutes. Part II examines the contention that false claims statutes should be used only for instances of outright fraud, and that mere noncompliance with the law or overaggressive (though good faith) interpretations of the law should be handled through traditional tax administration procedures. After considering both the historic and modern culpability thresholds under false claims statutes, Part II demonstrates that the critics are in fact advocating for a more lenient standard of care under FCAs—both for taxpayers and tax advisors—than currently exists under the Internal Revenue Code (IRC), its underlying regulations, and Circular 230 (the Treasury Department’s prevailing standard of care for tax practitioners).

Part III scrutinizes a related argument from critics that tax law should be off limits to false claims statutes because it is somehow more complex, ambiguous, and uncertain than other areas of the law. It evaluates this argument in the context of assertions that whistleblowing in the tax arena threatens taxpayer rights of process, privacy, and confidentiality, that it circumvents tax administrators and expert review of tax claims, and that it encourages frivolous and harassing actions. In the end, this Part exposes fallacies in the argument that “tax is different” and thus entitled to special treatment—or no treatment at all—under false claims statutes. At the same time, it suggests structural safeguards for FCAs designed to protect against undue disclosure of tax return information, to filter out nuisance suits, and to guarantee that tax experts investigate whistleblower claims. Finally, this Part makes the case that leveraging whistleblowers’ unique, inside information can assist outgunned state tax agencies in combating two persistent and insidious problems in tax administration: namely the information gap and the tax gap.

Part IV addresses flaws in current whistleblower regimes by recommending specific improvements to whistleblower statutes at both the state and federal level. It identifies key characteristics that should be part of any state-level FCA permitting tax whistleblower claims. Moreover, it suggests organizational changes within businesses that reduce risks associated with tax whistleblower laws and that at the same time help organizations uncover economic crime while maximizing the potential of whistleblower procedures and statutes. This Part concludes by offering alternative policies for states to consider beyond authorizing tax claims under FCAs, particularly standalone whistleblower statutes based on section 7623 of the

Kentucky False Claims Act Bills Take Different Approaches to Taxes, 71 STATE TAX NOTES 392 (2014); David Sawyer, Bill Would Authorize DOR Whistleblower Program, 71 STATE TAX NOTES 574 (2014); David Sawyer, Proposed False Claims Act May Permit Qui Tam Actions in Tax Disputes, 71 STATE TAX NOTES 213 (2014). Another state, Maryland, enacted expansions to its FCA in early 2014, including an amendment clarifying that the statute does not apply to state and local taxes. See Jennifer DePaul, House Approves Expansion of False Claims Act, 71 STATE TAX NOTES 690 (2014).
Internal Revenue Code. It offers the case of California as a state ripe for a robust tax whistleblower program.

Part V summarizes the Article’s findings by concluding that a properly drafted and implemented tax whistleblower program, either run through a state’s FCA or under a standalone statute, can overcome the real and perceived shortcomings of permitting citizens to report tax noncompliance to the government. On balance, there is no compelling reason to prevent or discourage state tax enforcement actions from exploiting invaluable knowledge and information derived from citizen insiders. In fact, soliciting and rewarding such information can help tax enforcement at the state level and potentially yield significant revenue from unpaid tax liabilities.

II. FALSE CLAIMS ACTS DO NOT IMPOSE ANY NEW LIABILITY ON TAXPAYERS

Nearly all criticisms of using false claims statutes to uncover illegal behavior in the tax context focus on the purported uniqueness of tax noncompliance compared to other forms of legal noncompliance. According to this criticism, false claims statutes (beginning in 1863 with the enactment of the federal False Claims Act52) have been used to uncover and prosecute fraudulent behavior, while the overwhelming majority of tax noncompliance fails to rise to the level of fraud. Underpayments of tax, whether to federal or state tax agencies, rarely result from outright tax evasion, defined in the Internal Revenue Code as willful attempts to evade or defeat tax liability.53 Instead, taxpayers and their advisors engage in tax planning to navigate unsettled, complicated, and ambiguous areas of the law to satisfy their tax obligations in good faith.54 Permitting whistleblowers to bring claims against taxpayers in this context, the argument goes, would result in inapposite and unfair application of FCAs.

54. See Hamilton, supra note 33, at 155 (quoting Jack Trachtenberg as saying that tax noncompliance being swept up in FCA claims is really just about “legitimate tax planning and people legitimately trying to comply with ambiguous tax laws”); id. (summarizing defense lawyers as saying that using FCA statutes to uncover and prosecute tax noncompliance is inappropriate, because “False Claims Act cases are intended to address knowing and deliberate fraud”); see also Waltreese Carroll, Should State Whistleblower Laws Exclude Tax Fraud?, 65 STATE TAX NOTES 441, 442 (2012) (quoting Jordan Goodman of Horwood Marcus & Berk as saying, “[p]laintiffs should not be allowed to file qui tam lawsuits for state tax [,] because the law is often complicated and unclear and as a result, a taxpayer may be complying with the law to the best of its ability”); MTC Project Would Minimize, supra note 44, at 367 (quoting Todd Lard of COST as saying that qui tam lawsuits in tax context “focus on unsettled areas of tax law rather than [traditional] whistleblower concerns”); Trachtenberg et al., supra note 29, at 376 (stating that taxpayer-defendants in qui tam lawsuits are usually guilty only of taking “good faith” positions in “unsettled” areas of law).
The critics’ assertions of inaptness and unfairness stem in part from a fundamental misunderstanding of false claims statutes and, in further part, from the flawed belief that tax is somehow different than other areas of the law and therefore off-limits. Using false claims laws to uncover and prosecute tax noncompliance is not a trap for the unwary, as critics would have us believe, but rather a legitimate and powerful weapon in a multifaceted tax enforcement regime.

For starters, liability under false claims statutes has encompassed more than fraudulent behavior from the very beginning. Indeed, while the nineteenth century version of the federal False Claims Act aimed to “prevent and punish Frauds upon the Government of the United States” (specifically, with respect to illegal price-fixing and defective weaponry and supplies sold to the Union Army during the Civil War), it also identified a considerably wider swath of wrongdoing than traditional fraud. For example, the original statute forbade persons from making “any claim upon or against the Government of the United States . . . knowing such claim to be false, fictitious, or fraudulent.” “Knowing” or “knowingly” appeared six more times in the statute, and referred to behavior that was “false,” “fictitious,” and “fraudulent,” or that was meant to “cheat,” “defraud,” “injure,” or “conceal.”

In 1986, Congress significantly revised the federal FCA, but preserved the requirement that punishable behavior for submitting “false or fraudulent” claims had to be “knowing.” Moreover, Congress added the “reverse false claim” to covered behavior, whereby persons are prohibited not only from submitting false claims to obtain money or property from the

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55. Act of Mar. 2, 1863, ch. 67, 12 Stat. 696, 696 (codified at 31 U.S.C. § 3729 (2012)). Enacted during the heart of the Civil War, the original version of the FCA was popularly known as both Lincoln’s Law and the Informants’ Act.

56. Id. (emphasis added).

57. Id. at 697. It is also worth pointing out to critics of modern-day FCA statutes that the original 1863 statute levied a $2,000 fine on each claim—compared to between $5,500 and $11,000 under modern FCA statutes—which translates into $37,700 (using a simple calculation that multiplies $2,000 by the percentage increase in the consumer price index from 1863 to 2012), $451,000 (using an “economic status” index), or $4,220,000 (using an “economic power” index) in 2012 dollars. See Samuel H. Williamson, Seven Ways to Compute the Relative Value of a U.S. Dollar, MEASURINGWORTH (2014), http://www.com/uscompare/. In addition, successful whistleblowers received 50% of the amount the government collected from the claim, plus all costs. See Act of Mar. 2, 1863, ch. 67, 12 Stat. 696, 698 (codified at 31 U.S.C. §§ 3729–33).

58. See Act of Oct. 27, 1986, Pub. L. No. 99-562, 100 Stat. 3153, 3154 (codified at 31 U.S.C. §§ 3729–3733). The only notable revision of the statute between 1863 and 1986 took place in 1943. In that year, Congress significantly reduced the power and effectiveness of the law by, among other things, slashing the potential award for whistleblowers from 50% of collected proceeds to 25% in the event the government declined the case and the whistleblower took over primary responsibility for prosecuting the matter, and to just 10% if the government took over and prosecuted the case without the whistleblower. See Act of Dec. 23, 1943, Pub. L. No. 78-213, 57 Stat. 608, 609 (codified at 31 U.S.C. § 3730(d)).

government, but also to avoid paying or transmitting money or property to the government.\footnote{Id. § 3729(a)(1)(G). The reverse false claim provision covers a person who “knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money” to the government. Id.} In addition, Congress broadly defined the terms “knowing” and “knowingly” to require that a person possess “actual knowledge” of the false information, while also allowing for lower threshold levels of knowledge including acting in “deliberate ignorance of the truth or falsity of the information,” or acting in “reckless disregard” of the same.\footnote{Id. § 3729(b)(1)(A).} Under the statute, moreover, establishing “knowing” and “knowingly” does not require any specific intent to defraud.\footnote{Id. § 3729(b)(1)(B).}

The same knowledge requirement is reflected in subnational FCAs. Currently, twenty-nine states have their own false claims statutes.\footnote{The twenty-nine states with FCAs include California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Rhode Island, Tennessee, Texas, Virginia, Washington, and Wisconsin. An inventory of all state-level statutes is available at the Taxpayers Against Fraud Education Fund’s website. See Taxpayers Against Fraud Education Fund, States with False Claims Acts, https://www.taf.org/states-false-claims-acts (last visited Apr. 15, 2014).} All of them proscribe “knowingly” submitting false or fraudulent claims to the state government, and they adopt the broad federal definition of “knowing” and “knowingly.”\footnote{A handful of states deploy an even more expansive definition of “knowing” and “knowingly.” For example, Michigan substitutes for actual knowledge a definition covering persons “in possession of facts under which he or she is aware or should be aware of the nature of his or her conduct and that his or her conduct is substantially certain to cause the payment of” unwarranted benefits. Michigan Medicaid False Claims Act, Mich. Comp. Laws § 400.602(f) (2014) (emphasis added).} In addition, the District of Columbia and four municipalities have followed suit with their own false claims statutes.\footnote{See Whistleblowerlaws, District of Columbia False Claims Act, http://www.com/false-claims-act/district-of-columbia-false-claims-act/ (last visited Apr. 15, 2014) (Washington, D.C. act). The four municipalities include Allegheny County Pennsylvania, Chicago, New York City, and Philadelphia. See Pietragallo Gordon Alfano Bosick & Raspanti, LLP, County of Allegheny False Claims Ordinance, False Claims Act Res. Ctr., http://www.falseclaimsact.com/wp-content/uploads/2013/02/County_Alegheny_Municipality.pdf (last visited Apr. 15, 2014) (Allegheny County act); Pietragallo Gordon Alfano Bosick & Raspanti, LLP, Philadelphia False Claims Act, False Claims Act Res. Ctr., http://www.falseclaimsact.com/wp-content/uploads/2013/02/_Municipality.pdf (last visited Apr. 15, 2014) (Philadelphia act); Whistleblowerlaws, Chicago False Claims Act, http://www.whistleblowerlaws.com/-act/chicago-false-claims-act/ (last visited Apr. 15, 2014) (Chicago statute); Whistleblowerlaws, New York City False Claims Act, http://www.whistleblowerlaws./false-claims-act/new-york-city-false-claims-act/ (last visited Apr. 15, 2014) (New York City act).} Most of the subnational FCAs bar tax claims, as does the federal False
Claims Act. 66 Six states impose no bar on tax actions under their FCAs, 67 while three states impose only partial bars on tax actions involving state income taxes. 68

Members of the defense bar, the primary critics of FCAs authorizing tax claims (either implicitly or explicitly), express significant anxiety over false claims statutes. In particular, they fear a knowledge requirement for liability and punishment that they believe is too low; that is, for including acts of “deliberate ignorance” or “reckless disregard” of the truth and falsity of the information. They also fear that the use of false claims statutes as a tool for reinforcing state tax enforcement will proliferate as the early adopters enjoy success in uncovering and prosecuting tax underpayments. 69 And while the threat of insiders blowing the whistle on aggressive tax positions undoubtedly alters the risk calculus with respect to tax compliance, 70 some members of the defense bar have overreacted to

66. See 31 U.S.C. § 3729(d) (prohibiting “claims, records, or statements under the Internal Revenue Code of 1986”).

67. These states include Delaware, Florida, Nevada, New Hampshire, New Jersey, and New York. Although Florida’s FCA does not contain a tax bar, the Florida legislature added a provision to the state’s standalone tax whistleblower statute in 2002 that expressly disapproves of informant claims relating to taxes being brought under any other statute other than the tax informant statute: [T]his section is the sole means by which any person may seek or obtain any moneys as the result of, in relation to, or founded upon the failure by another person to comply with the tax laws of this state. A person’s use of any other law to seek or obtain moneys for such failure is in derogation of this section and conflicts with the state’s duty to administer the tax laws. FLA. STAT. § 213.30(3) (2013).

68. These states include Illinois and Indiana (barring claims based on all state income taxes) and Rhode Island (barring claims based on personal income taxes).

69. Like the federal FCA, state-level FCAs award civil penalties for each false claim (between $5,500 and $11,000 under the federal FCA) plus three times (or treble) the damages “the Government sustains because of the act of that person,” 31 U.S.C. § 3729(a)(1); see also CAL. GOV’T CODE § 12651(a) (West 2013) (awarding between $5,500 and $11,000 per claim plus treble damages); 740 ILL. COMP. STAT. 175/3(a)(1)(A) (2013) (same); N.Y. STATE FIN. LAW § 189(1)(h) (McKinney 2013) (awarding between $6,000 and $12,000 per claim plus treble damages, including consequential damages).

70. Anxiety over tax whistleblowing claims, either under state-level FCAs or the federal tax code’s section 7623, has had a discernible effect on corporate tax departments and outside counsel. See Michael P. Dolan & Timothy J. McCormally, Which Way the Wind Blows: Mitigating Whistleblowing Risk, 139 TAX NOTES 1537, 1537 (2013) (writing that uptick in tax whistleblower actions “underscores the need for corporate taxpayers and other tax professionals to take the possibility of tax whistleblowing seriously,” and furthermore that “the headlines” over tax whistleblowing “are alluring or disquieting. For tax executives, they certainly have the potential to be distracting.”); Tim Gustafson et al., Between a Rock and a Hard Place: Third-Party Enforcement Actions, 66 STATE TAX NOTES 49, 50 (2012) (“Various aspects of qui tam actions alter the playing field in favor of the government when it comes to enforcing state tax laws. First, after the whistleblower commences the action, the state’s attorney general may take over the case and prosecute the matter as an enforcement action. That places the attorney general in complete control of the litigation, which brings the full force of the government and its resources to bear against the taxpayer.”); Kendall L. Houghton et al., Qui Tam
the new compliance landscape with alarmist and misinformed calls for re-
trenchment. The remainder of this Part identifies and responds to some
of these overreactions.

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Notwithstanding the long history of false claims statutes imposing lia-
sibility without the intent to defraud, elements of the defense bar have gone
on record as saying that tax actions brought under false claims laws should
be reserved exclusively for fraudulent behavior. States “should enact a
safe harbor” as part of their false claims statutes, a trio of tax practitioners
recently wrote, that would apply “when a corporation has technically vio-
lated the false claims act but without willfully intending to defraud.”71
The same trio suggested enacting a corollary three-year safe harbor to pro-
vide corporate taxpayers an opportunity to “perform their necessary inter-
nal review to rectify any potential filing or reporting problems that could
result in false claims act suits brought by [whistleblowers] during the same
period.”72 For the duration of the safe harbor, “companies should be im-
munized from false claims act lawsuits.”73

Both proposals suffer from serious shortcomings. First, they inexplic-
ibly treat violations of state tax law differently than other areas of state
law, thereby making it easier to cheat a state out of tax revenues than
cheating a state out of other moneys and property. Second, both recom-
endations would limit the use of FCAs to instances of outright fraud, a
limitation never imposed on false claims statutes. Third, in combination,
the proposals would allow business taxpayers to comply with their annual
tax liabilities over three years while all other taxpayers—including individ-
ual taxpayers—would still be responsible for satisfying their tax liabilities
on an annual basis. Fourth, and finally, the proposals would create huge

Lauits: Recommendations for Meaningful Reform—Part 1, 67 State Tax Notes 595,
596 (2013) (noting that “corporations have grown increasingly fearful of qui tam
FCA suits”); Mary Kay Martire & Lauren A. Ferrante, A Decade of Lessons from Litigat-
ing State Tax False Claims Act Cases, 70 State Tax Notes 127, 130 (2013) (advising
corporations that “[w]hen deciding whether to take a particular tax position, con-
sider not just the possible penalties and interest associated with an adverse audit
determination, but also the risk of FCA or class action litigation. Risky tax posi-
tions can be fodder for litigation.”); Trachtenberg et al., supra note 29, at 373
(calling tax claims under state FCAs “disturbing trend”).

71. Houghton et al., supra note 70, at 595.

72. Kendall L. Houghton, Matthew P. Hedstrom & Charles C. Capouet, Qui
Tam Lawsuits: Recommendations for Meaningful Reform—Part 2, 68 State Tax Notes

73. Id.; see also Timothy P. Noonan & William Comiskey, Calling All Tax
Whistleblowers—New York Wants You!, 59 State Tax Notes 349, 352 (2011) (criticiz-
ing treble damages under false claims statutes where defendants might “not actu-
ally know that the claim was false,” “were not deliberately trying to defraud the
government,” and simply “should have known that the claim was false” but did not,
due to deliberate ignorance or reckless disregard of truth or falsity of
information).
opportunities for tax avoidance and evasion, as companies could neglect internal tax compliance procedures and instead play the audit lottery, knowing that even if they were caught underpaying taxes within the three-year safe harbor they could escape liability.

Other tax practitioners have insisted that false claims acts should never be applied to areas of law—and specifically tax law—that suffer from any uncertainty or ambiguity. In the tax context, these practitioners argue, the permissive knowledge requirement under false claims statutes, when combined with ambiguous and uncertain tax laws, imposes an unfair burden on taxpayers. The knowledge standard—including “deliberate ignorance” and “reckless disregard” of the truth or falsity of the information—“will be a challenge to apply in the tax area, where . . . the law and rules are not a model of clarity, and where mistakes occur even when taxpayers and practitioners act in good faith.”74 These standards are especially “unclear in the context of state tax and unclaimed property in which the law itself is unclear and companies regularly take ‘positions’ based on advice.”75 In these instances, business taxpayers could be subject to enforcement actions under state-level FCAs, even though they “took reasonable positions regarding unsettled areas of the tax law.”76 “Despite taking the correct position,” warns a particularly insistent practitioner, “defendants will settle qui tam actions because, if unsuccessful, the risks are so great and the costs are so high.”77

These claims of inaptness and unfairness are unfounded. To begin with, innocent mistakes are not prosecuted under false claims statutes. The New York FCA, for instance, explicitly makes “acts occurring by mistake or as a result of mere negligence” a defense under the statute.78 Moreover, in interpreting the knowledge requirement under FCAs (at both the state and federal level), courts regularly hold that defendants are not liable for reasonable interpretations of an ambiguous statute or regulation.79 Thus, not only would a “correct” position fall outside the purview

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74. Noonan & Comiskey, supra note 73, at 352.
75. Houghton et al., supra note 70, at 600.
76. Trachtenberg et al., supra note 29, at 374.
78. N.Y. STATE FIN. LAW § 188(3)(b) (McKinney 2013); see also Noonan & Comiskey, supra note 73, at 352 (arguing against knowledge requirement contained in FCAs, but acknowledging that “[s]omething more is required than merely making a mistake”).
79. See, e.g., Long v. Dell Computer Corp., No. PB 03-2636, 2012 R.I. Super. LEXIS 50, at *45 (Apr. 2, 2012) (noting, in context of state sales tax collection, “gray areas in applying the tax law” such that defendant’s “honest misinterpretation of a delicate area of state tax law cannot be held to be an unfair act”); see also Noonan & Comiskey, supra note 73, at 352 (writing that courts interpreting knowledge requirement under federal FGA “have held that a person who reasonably relies on an interpretation of an ambiguous statute or regulation should not face liability”).
of false claims statutes, but a taxpayer could take an “incorrect” position, even negligently, so long as it was an honest, good faith mistake.

But elements of the defense bar argue that their taxpayer-clients should be free to make not only innocent and negligent mistakes, but also reckless and deliberately ignorant mistakes. They also want clients to be free to take positions contrary to published guidance and clear agency interpretations of the law.\textsuperscript{80} And they further want to advise on those positions and transactions without fear of liability under false claims statutes for either the taxpayer or the tax advisor.

In other words, elements of the defense bar want a more lenient standard of care under FCAs than under either the Internal Revenue Code or the Treasury Department’s standards of practice contained in Circular 230. Even more pointedly, by arguing that deliberate ignorance and reckless disregard of the truth is too high a standard of care for tax compliance under false claims statutes, the critics of permitting tax claims under state FCAs are effectively asking for immunity to engage in behavior that currently subjects taxpayer-clients and tax practitioners to penalty under the IRC and that further subjects practitioners to discipline (including suspension and disbarment) under Circular 230.

Let me explain. Elements of the defense bar complain that FCA statutes “liberally define [ ]” the term “knowingly” by considering “reckless disregard” and “deliberate ignorance” of the law as knowing violations.\textsuperscript{81} Yet taxpayers are currently subject to penalty under the IRC for “negligence or disregard of rules or regulations.”\textsuperscript{82} “Negligence” is defined, moreover, as “any failure to make a reasonable attempt to comply” with the tax law “or to exercise ordinary and reasonable care in the preparation of a tax return,”\textsuperscript{83} which includes receiving any tax benefit that appears “too good to be true” under the circumstances.\textsuperscript{84} Meanwhile, the term “disregard” includes “any careless, reckless or intentional disregard of rules or regulations” (the latter of which encompasses provisions of the IRC, temporary or final Treasury regulations promulgated under the IRC, and published Revenue Rulings and Notices).\textsuperscript{85} Finally, taxpayers are not

\textsuperscript{80. See, e.g., Noonan & Comiskey, supra note 73, at 352 (criticizing scenario where “the agency responsible for administering the applicable law or regulation has publicly issued a definitive interpretation intended to resolve that ambiguity” and “a claim that does not comply with that definitive interpretation [ ] lead[s] to False Claims Act liability”).}

\textsuperscript{81. Id. at 353.}

\textsuperscript{82. I.R.C. § 6662(b)(1) (2012).}

\textsuperscript{83. Treas. Reg. § 1.6662-3(b)(1) (2003).}

\textsuperscript{84. Id. § 1.6662-3(b)(1)(ii); see also Neonatology Assocs., P.A. v. Comm’r, 299 F.3d 221, 234 (3d Cir. 2002) (finding that when taxpayer “is presented with what would appear to be a fabulous opportunity to avoid tax obligations, he should recognize that he proceeds at his own peril”); Stobie Creek Invs., LLC v. United States, 82 Fed. Cl. 636, 713–14 (2008); Jade Trading, LLC v. United States, 80 Fed. Cl. 11, 56 (2007).}

\textsuperscript{85. Treas. Reg. § 1.6662-3(b)(2) (2009).}
considered to have disregarded a rule or regulation if they take a position contrary to a Revenue Ruling or Notice so long as the position possesses a "realistic possibility" of success (or a 33% chance) on the merits.\(^{86}\)

Practitioners, for their part, are subject to penalty for "willful" or "reckless" conduct under the IRC.\(^{87}\) Specifically, they are prohibited from any willful attempt to understate a client’s tax liability or to engage in a "reckless or intentional disregard of rules or regulations"\(^{88}\) (with "rules and regulations" defined in the same manner as under the analogous statute for taxpayers).\(^{89}\) Furthermore, practitioners recklessly or intentionally disregard a rule or regulation if they advise a position on a client’s return or claim for refund “that is contrary to a rule or regulation,” and they “know[ ] of, or [are] reckless in not knowing of, the rule or regulation in question.”\(^{90}\) Finally, practitioners are not considered to have recklessly or intentionally disregarded a rule or regulation if they adequately disclose a position that possessed, at the very least, a reasonable basis for succeeding on the merits.\(^{91}\) Similarly, in the case of taking a position contrary to a Revenue Ruling or Notice, practitioners can escape liability so long as the position meets the “substantial authority” standard, a level of certainty reflecting a probability of succeeding on the merits approaching 50%.\(^{92}\)

Thus, the Internal Revenue Code already prohibits the kind of behavior—acting knowingly, in deliberate ignorance, and reckless disregard of the rules and regulations—that members of the defense bar say should not be covered under false claims statutes. Moreover, it already prevents taxpayers, except in very limited circumstances, from taking positions contrary to published guidance and clear agency interpretations of the law. And, it already punishes practitioners for advising on or facilitating this kind of behavior.

But that’s not all. Current law sanctions additional behavior that elements of the defense bar would like to see protected under state-level FCAs. Under the Internal Revenue Code, taxpayers face a "substantial understatement" penalty\(^{93}\) for taking positions or engaging in tax avoidance transactions unless, on the one hand, the position or transaction possesses “substantial authority,”\(^{94}\) or on the other hand, the taxpayer “adequately

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86. Id.
87. I.R.C. § 6694(b)(2).
88. Id.
89. See Treas. Reg. § 1.6694-3(e).
90. Id. § 1.6694-3(c)(1).
91. Id. § 1.6694-3(c)(2). For discussion of the meaning of “reasonable basis,” see infra notes 97–100 and accompanying text.
92. Treas. Reg. § 1.6694-3(c)(3). The practitioner’s “substantial authority” standard is a considerably higher standard than a taxpayer’s “realistic possibility of success” standard. For a discussion of the “realistic possibility of success” standard, see supra note 86 and accompanying text, while for the “substantial authority” standard, see infra notes 94–98, 101 and accompanying text.
93. I.R.C. § 6662(b)(2).
94. Id. § 6662(d)(2)(B)(i).
disclose[s]" and proves a “reasonable basis” for the sought after tax treat-
ment.95 Tax practitioners are held to the same standard, subject to pen-
alty for preparing or advising “unreasonable positions” (defined as
positions lacking “substantial authority”) that they knew or reasonably
should have known were reflected on the return.96 As with taxpayers,
practitioners can escape penalty if they provide adequate disclosure and
establish a reasonable basis for an otherwise “unreasonable position.”97
Current law further defines “substantial authority” as “less stringent than
the more likely than not standard (the standard that is met when there is a
greater than 50-percent likelihood of the position being upheld), but
more stringent than the reasonable basis standard”98 (with the latter stan-
ard generally reflecting a 10–20% likelihood of success on the merits,99
or a level of support that although arguable is “fairly unlikely to prevail in
court upon a complete review of the relevant facts and authorities”).100
Thus, while it is possible to reach “substantial authority” for a position at
low levels of confidence, most practitioners would peg the requisite level
of certainty as substantially closer to 50% than 10–20%.101

In determining whether substantial authority exists, taxpayers and
practitioners must demonstrate that the “weight of the authorities support-
ing the treatment is substantial in relation to the weight of authorities sup-
porting contrary treatment.”102 It is possible that substantial authority
exists for more than one interpretation of a particular tax issue. However,
the substantial authority standard is an objective standard such that a tax-
payer’s subjective belief that there is substantial authority for the tax treat-
ment of an item “is not relevant in determining whether there is
substantial authority for that treatment.”103 The objective authorities to

95. Id. § 6662(d)(2)(B)(ii).
96. Id. § 6694(a)(1)–(2).
97. Id. § 6694(a)(2)(B).
99. See Sheldon I. Banoff, Dealing with the “Authorities”: Determining Valid Legal
Authority in Advising Clients, Rendering Opinions, Preparing Tax Returns and Avoiding
(defining “reasonable basis” as “a relatively high standard of tax reporting, that is,
significantly higher than not frivolous or not patently improper. The reasonable
basis standard is not satisfied by a return position that is merely arguable or that is
merely a colorable claim.”).
101. In fact, some authorities state that the level of certainty to achieve sub-
stantial authority “should approach” 51% and can extend only as low as 45%. See
EXEC. TASK FORCE, IRS, COMMISSIONER’S PENALTY STUDY, REPORT ON CIVIL TAX PEN-
ALTIES, 45 (1989). It is worth noting that under no circumstances may a taxpayer
or practitioner consider the possibility that a return will not be audited (or that an
item not be raised on audit) in determining whether a tax position or transaction
possesses either substantial authority or reasonable basis. See Treas. Reg. § 1.6662-
4(d)(2) (2014). That is, the position must be evaluated on its merits, as if it were
litigated to a final conclusion in a court of law.
103. Id.
be considered (rather than one’s sincere though unreasonable belief in a position) include the IRC and other statutory provisions, Treasury Regulations, Revenue Rulings, IRS Memoranda, Notices and other publications, case law, and congressional intent. There is no substantial authority for positions or transactions lacking in economic substance.

The Internal Revenue Code provides a limited defense to the above penalties pertaining to “negligence and disregard of rules and regulations” and “substantial understatement.” Under section 6664, a taxpayer can mitigate or overcome penalties by demonstrating reasonable cause for the underpayment of tax and, furthermore, acting in good faith in taking the position associated with the underpayment. The taxpayer can meet these requirements by demonstrating reasonable reliance on professional tax advice, with the reasonableness inquiry turning on the practitioner’s standard of care in rendering the advice. In particular, the practitioner’s advice must itself be reasonable. The relevant inquiry depends on whether the taxpayer knew or had reason to know that the prac-

104. Id. § 1.6662-4(d)(3)(iii).
105. See, e.g., Fidelity Int’l Currency Advisor A Fund, LLC v. United States, 747 F. Supp. 2d 49, 240 (D. Mass. 2010) (finding no substantial authority “where the transactions lack economic substance or must be recharacterized under the step transaction doctrine”); Long Term Capital Holdings v. United States, 330 F. Supp. 2d 122, 204–05 (D. Conn. 2004) (holding that for transaction lacking economic substance, taxpayer cannot cite authority, much less substantial authority, to support claimed tax benefits); Stobie Creek, Invs., LLC v. United States, 82 Fed. Cl. 636, 706 n.64 (2008) (stating that where taxpayers’ “transactions lack economic substance, or must be disregarded pursuant to the step transaction doctrine, plaintiffs cannot contend successfully that substantial authority supported the tax treatment claimed based on the form of their transactions rather than their substance”).
107. See Treas. Reg. § 1.6664-4(c) (2003); see also United States v. Boyle, 469 U.S. 241, 251 (1985) (“When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice.”); Stobie Creek, 82 Fed. Cl. at 717 (“[T]he concept of reliance on the advice of professionals is a hallmark of the exception for reasonable cause and good faith”).
108. Indeed, the relationship between the reasonableness of professional advice as defined in section 6664 and the standard of care for advisors in other areas of the IRC and in Circular 230 is so interrelated that the Treasury Regulations for section 6664 explicitly cross-reference “rules applicable to advisors,” and include Treas. Reg. §§ 1.6694-1 through 1.6694-3 (regarding preparer penalties), and Circular 290 §§ 10.22 (regarding diligence as to accuracy) and 10.34 (regarding standards for advising with respect to tax return positions and for preparing or signing returns). See Treas. Reg. § 1.6664-4(c)(3).
109. See Treas. Reg. § 1.6664-4(b)(1); see also Fidelity Int’l, 747 F. Supp. 2d at 243 (stating that taxpayer’s reasonable reliance on professional advice “requires that the advice itself be reasonable”); Stobie Creek, 82 Fed. Cl. at 717 (finding that reliance on advice of tax professional “does not necessarily demonstrate reasonable cause and good faith” and noting that “reliance on professional advice must, under all the circumstances, be reasonable.” (quoting Treas. Reg. § 1.6664-4(b)(1))).
tioner could not render competent, diligent, and independent advice;\textsuperscript{110} that the practitioner failed to base her advice on “all pertinent facts and circumstances and the law as it relates to those facts and circumstances[:];”\textsuperscript{111} or that the practitioner based the advice on “unreasonable factual or legal assumptions” or by “unreasonably rely[ing] on the representations, statements, findings, or agreements of the taxpayer or any other person.”\textsuperscript{112} Nor can the taxpayer reasonably rely on an opinion or advice that states a final or temporary regulation is invalid.\textsuperscript{113}

Therefore, through section 6664, a taxpayer can escape tax penalties by showing reasonable reliance on professional tax advice unless the taxpayer exhibits behavior that would also trigger liability under false claims statutes. Taxpayers cannot show reasonable reliance on advice when they know or have reason to know (i.e., not just actual knowledge but also deliberate ignorance or reckless disregard of the truth or falsity of the information) that they are entering into a transaction primarily for tax avoidance purposes; that the transaction lacks sufficient business purpose; that the transaction has no pre-tax profit potential; or that they signed off on false or misleading representations.\textsuperscript{114} Nor can a taxpayer show reasonable reliance on professional advice to mitigate or escape penalties when the taxpayer knows or has reason to know that the tax professional had a conflict of interest and thus was not providing independent advice.\textsuperscript{115} Exemplary disqualifying conflicts of interest about which taxpay-

\textsuperscript{110} See Treas. Reg. § 1.6664-4(c)(1).
\textsuperscript{111} Id. § 1.6664-4(c)(1)(i).
\textsuperscript{112} Id. § 1.6664-4(c)(1)(ii); see also I.R.C. § 6664(d)(4)(B)(iii) (2012) (identifying opinions on which taxpayer can never reasonably rely in good faith, including those based on unreasonable factual or legal assumptions, those that unreasonably rely on representations, statements, findings, or agreements of taxpayers or any other person, and those that fail to identify and consider all relevant facts).
\textsuperscript{113} Treas. Reg. § 1.6664-4(c)(1)(iii).
\textsuperscript{114} See id. § 1.6664-4(c)(1)(i)–(ii).
\textsuperscript{115} See I.R.C. § 6664(d)(4)(B)(ii) (listing characteristics of “disqualified advisors,” all of which involve conflicts of interests); see also Am. Boat Co., LLC v. United States, 583 F.3d 471, 482 (7th Cir. 2009) (“What exactly constitutes an ‘inherent’ conflict of interest is somewhat undefined, but when an adviser profits considerably from his participation in the tax shelter, such as where he is compensated through a percentage of the taxes actually sheltered, a taxpayer is much less reasonable in relying on any advice the adviser may provide.”); Neonatology Assocs., P.A. v. Comm’r, 299 F.3d 221, 234 (3d Cir. 2002) (finding that taxpayer’s “reliance itself must be objectively reasonable in the sense that . . . the professional himself does not suffer from a conflict of interest or lack of expertise that the taxpayer knew of or should have known about”); Chamberlain v. Comm’r, 66 F.3d 729, 732 (5th Cir. 1995) (“The reliance must be objectively reasonable; taxpayers may not rely on someone with an inherent conflict of interest . . . .” (footnote omitted)); Pasternak v. Comm’r, 990 F.2d 893, 903 (6th Cir. 1993) (“[T]he purported experts were either the promoters themselves or agents of the promoters. Advice of such persons can hardly be described as that of ‘independent professional.’”); Illes v. Comm’r, 982 F.2d 163, 166 (6th Cir. 1992) (finding no reasonable reliance where accountant was “not a disinterested source” but rather promoter of shelter at issue); Fidelity Int’l Currency Advisor A Fund, LLC v. United States, 747
ers are expected to know or should know include advisors participating in the planning, promotion, or sale of the tax avoidance transaction;\textsuperscript{116} advisors receiving compensation from the planners or promoters of such a transaction rather than from the taxpayer-client;\textsuperscript{117} advisors whose compensation is contingent upon the taxpayer receiving some or all of the intended tax benefits of a transaction;\textsuperscript{118} and advisors with any other disqualifying financial interest in the transaction, such as being compensated based on how many opinions they churn out rather than on the quality and independence of their professional advice (such behavior, by the way, also violates Circular 230’s prohibition against “unconscionable fees” under section 10.27 and the ABA’s prohibition on “unreasonable fees” under Model Rule 1.5).\textsuperscript{119}

Elements of the defense bar do not only want practitioners to be able to engage in behavior under false claims statutes that would otherwise subject taxpayer-clients and their advisors to liability under the IRC. They also want a lower standard of care for tax advisors than is currently demanded under Circular 230, the prevailing standard governing tax practitioners nationwide. For those readers who think that the strictures of Circular 230 only apply to tax professionals with federal tax practices and not state and local practices, think again. For starters, while Circular 230 provides rules “relating to the authority to practice before the Internal Revenue Service,”\textsuperscript{120} such practice is defined broadly and includes any communication with the IRS or any written advice that influences a taxpayer’s federal tax liability,\textsuperscript{121} including state tax liability. Second, no other practice standard provides such detailed rules of behavior for tax practitioners nationwide, not only for lawyers and accountants, but also for enrolled agents, enrolled actuaries, enrolled retirement plan agents, and registered tax return preparers.\textsuperscript{122} In addition, no other standard garners

\textsuperscript{117} See id. § 6664(d)(4)(B)(ii)(II).
\textsuperscript{118} See id. § 6664(d)(4)(B)(ii)(III).
\textsuperscript{119} See id. § 6664(d)(4)(B)(ii)(IV).
\textsuperscript{120} 31 C.F.R. § 10.0(a) (2011).
\textsuperscript{121} See id. § 10.2(a)(4).
\textsuperscript{122} See id. § 10.3(a)–(f). A recent U.S. Court of Appeals decision challenged the authority of the Treasury Department to regulate “tax return preparers” under Circular 230. See Loving v. IRS, 742 F.3d 1013, 1021–22 (D.C. Cir. 2014) (invalidating CLE and certification requirements, which IRS had imposed in effort to tackle widespread fraud, on hundreds of thousands of unregulated tax return preparers on grounds that authorizing statute provides insufficient authority); see also Brief Amici Curiae of Former Commissioners of Internal Revenue in Support of Defendants-Appellants, Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2014) (No. 13-5061), 2013 WL 1386248, at *16–17 ("In 1884, Congress empowered the Treasury to regulate the conduct of claims agents pursuing financial benefits from the government; and in 2013 Treasury retains that authority to regulate the conduct of tax return preparers who similarly assist in preparing and filing tax returns that present to the
as much respect from tax professionals\textsuperscript{123} or imposes such strictly enforced\textsuperscript{124} and mandatory\textsuperscript{125} disciplinary rules\textsuperscript{126} rather than loosely enforced\textsuperscript{127} aspirational and permissive guidelines.\textsuperscript{128} Finally, no other standard has had as great an influence on the development of the other

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\textsuperscript{123} As legal scholar Michael Lang has written, “when tax practitioners think of who addresses substandard behavior by their colleagues they think of the IRS Office of Professional Responsibility [which enforces Circular 230] and they are right to do so.” Michael B. Lang, \textit{Thinking About Tax Malpractice}, 32 ABA Section of Taxation News Quarterly 1 (2012).


\textsuperscript{125} See 31 C.F.R. § 10.20–10.38 (pertaining to “duties and restrictions relating to practice before the Internal Revenue Service”). The only exception to the mandatory rules under Circular 230 is § 10.33, pertaining to “best practices for tax advisors.” \textit{Id.} § 10.33.

\textsuperscript{126} See, e.g., \textit{id.} § 10.50 (pertaining to penalties and other sanctions for violating regulation); \textit{id.} § 10.51–10.52 (pertaining to prohibited behavior); \textit{id.} § 10.60–10.82 (pertaining to adversarial disciplinary proceedings for tax practitioners charged with violating its rules).

\textsuperscript{127} Disciplinary boards of state bar associations, for example, are “notoriously underfunded” and fail to police the behavior of their members with any consistency or enthusiasm. See Susan P. Konizk & George M. Cohen, \textit{Under Cloak of Settlement}, 82 Va. L. Rev. 1051, 1121 (1996) (finding also that state bar disciplinary boards are “unable or reluctant to mount the effort needed to do battle with wealthy class action lawyers and powerful members of the defense bar”).

\textsuperscript{128} See, e.g., \textit{Model Rules of Prof’l Conduct} R. 1.2(c) (2009) (pertaining to limiting scope of representation); \textit{id.} R. 1.6(b) (pertaining to revealing information relating to representation of client); \textit{id.} R. 1.13(c) (pertaining to “reporting out” information of organizational misconduct after failing to receive “timely and appropriate” internal response); \textit{id.} R. 1.14(b) (pertaining to clients with diminished capacity); \textit{id.} R. 1.16(b) (pertaining to declining or terminating representation); \textit{id.} R. 2.1 (pertaining to acting as “advisor” to client); \textit{id.} R. 3.1 (pertaining to meritorious claims and contentions); \textit{id.} R. 3.6(b)–(c) (pertaining to trial publicity); \textit{id.} R. 3.7(b) (pertaining to lawyer as witness); \textit{id.} R. 6.1 (pertaining to voluntary pro bono public service); \textit{id.} R. 6.4 (pertaining to law reform activities affecting client interests); \textit{id.} R. 8.3(c) (pertaining to reporting professional misconduct).
standards of care governing tax practitioners\textsuperscript{129} or has been adopted as widely as the standard of care in both state\textsuperscript{130} and federal courts.\textsuperscript{131}

Like the Internal Revenue Code, Circular 230 adopts the "knowing and knowingly" standard for liability contained in false claims statutes. Section 10.34 of Circular 230 forbids practitioners from "willfully, recklessly, or through gross incompetence" preparing or advising a position that lacks "reasonable basis" or substantial authority or that amounts to a willful attempt to understate a client’s tax liability or "a reckless or intentional disregard of the rules or regulations."\textsuperscript{132} Moreover, Circular 230 sanctions practitioners with censure, suspension, or disbarment\textsuperscript{133} for "willfully" violating any of its sections (other than its rules on "best practices" contained in section 10.33) or for "recklessly or through gross incompetence" violating a handful of sections, including section 10.34.\textsuperscript{134}

\textsuperscript{129} These other standards include the ABA Formal Ethics Opinions interpreting the ABA Model Rules of Professional Conduct as applied to tax lawyers, the AICPA Code of Professional Conduct and the Statements on Standards for Tax Services, and the IRS penalty provisions and corresponding regulations, including most prominently sections 6662, 6664, and 6694. For a detailed discussion of the Circular’s influence on these standards, see Dennis J. Ventry, Jr. & Bradley T. Borden, \textit{Probability, Professionalism, and Protecting Taxpayers}, 68 Tax L. 1 (2014).

\textsuperscript{130} See Lang, supra note 123, at 28 (writing that “breaches of Circular 230 rules that either parallel state bar ethics rules or are designed to protect clients are likely to be treated like breaches of such state bar ethics rules” and “are likely to be allowed to be offered in court as evidence of the breach of a duty to the client”); see also Carberry v. State Bd. of Accountancy, 28 Cal. App. 4th 770, 790 (1994); Agran v. Shapiro, 127 Cal. App. 2d Supp. 807, 820–21 (1954); N.Y. State Soc’y of Enrolled Agents v. N.Y. State Div. of Tax Appeals, 161 A.D.2d 1, 7 (N.Y. App. Div. 1990); N.Y. State Ass’n of Enrolled Agents, Inc. v. N.Y. State Dep’t of Taxation and Fin., 29 Misc. 3d 332, 334–38 (N.Y. Sup. Ct. 2010); Estate of Heinz, 2006 N.Y. Misc. LEXIS 4230, at *2 (N.Y. Sur. Ct. Dec. 29, 2006).


\textsuperscript{132} See id. § 10.34(a)(1)–(2) (2011).

\textsuperscript{133} Id. § 10.52(a)(1)–(2).
Practitioners also face discipline for “knowingly, recklessly, or through gross incompetence” providing a “false opinion,” which includes “intentionally or recklessly misleading” opinions.135

As these examples indicate, the standards of care under Circular 230 and the IRC very clearly reflect the “knowing and knowingly” standard under false claims statutes that elements of the defense bar have roundly criticized. Even if the critics succeed in persuading states to prevent tax claims under FCAs, tax practitioners falling below the knowing and knowingly standard would still be subject to liability for advising impermissible positions and transactions, while taxpayers would still be liable for underpayments of tax. Practitioners would also still be liable for claims of professional misconduct if a taxpayer-client were made to pay back taxes, interest, and penalties based on a return position made in reliance on the substandard advice.

III. THE SPECIOUS ARGUMENT THAT TAX IS SPECIAL

Critics of using false claims statutes to uncover and prosecute tax cheats insist that tax is different than other areas of the law. Complying with the tax law is “confusing, ambiguous, and difficult.”136 Due to tax law’s complexity and uncertainty, these critics argue that submitting false or fraudulent information in the tax context should be given a pass and treated differently than submitting false or fraudulent information in, say, healthcare or government procurement.

This Part demonstrates that tax law is no more complex, ambiguous, or uncertain than other areas of the law. In so doing, it exposes as nonsense the argument that “tax is different” and thus entitled to special treatment under false claims statutes. Furthermore, it exposes these arguments as self-serving attempts to preserve the status quo. While some members of the defense bar rail against “confusing, ambiguous, and difficult” tax laws, many of them add to the confusion by exploiting the ambiguities and making enforcement of the law that much more difficult. As described in Part III.C, the bluster of the “tax is different” argument—which also falsely asserts that tax whistleblowing is at odds with traditional tax administration—appears to reflect the desire among elements of the defense bar to preserve tax law’s ambiguities and to control the flow of information from

135. Id. § 10.51(a)(13). “False opinions” are further defined as:
[T]hose which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading.

Id.

136. Hamilton, supra note 33, at 158 (summarizing Timothy Noonan of Hodgson Russ questioning wisdom of permitting tax claims under state-level FCAs).
taxpayers to tax agencies. Tax whistleblowers—by unveiling and detailing exploited gray areas in the law—threaten both of those goals.

A. Tax Law Is No More Complicated Than [Fill in the Blank]

The argument that tax is different is really three related arguments. First, tax law is more complicated and uncertain than other areas of the law. Second, tax liability should generally not attach when it is premised on violations of unsettled areas of the law, because the accused taxpayer cannot be said to have acted with sufficient culpability. Third, and more specifically, as a result of tax law’s unique complexity and uncertainty, it is inappropriate to permit claims of noncompliance that originate outside of traditional tax administration channels, and especially not from whistleblowers.

As to the first argument, that tax law is more complex and uncertain than other areas of the law, its proponents offer no evidence, empirical or otherwise, to verify the repeated injunction. To be sure, tax law, though not as complex as rocket science, is hardly intuitive; understanding, interpreting, and complying with it often requires the assistance of paid experts and professionals. The law is constantly changing, moreover, both at the federal and state level. But the same can be said of other areas of the law, including securities law, environmental law, health law, and corporate law.

As to the second argument, that tax liability should not attach when the law is uncertain because taxpayers cannot be said to possess the requisite mens rea, its proponents seem to have forgotten that the very nature of the common law results in potentially capricious results. They also seem to have overlooked the thousands of cases, both civil and criminal, in which a defendant was found liable for wrongdoing in one jurisdiction even though the same behavior would not have subjected the defendant to liability in another jurisdiction.

As to the third argument, that tax law’s unique complexity and uncertainty militates against allowing anyone but tax officials to uncover and prosecute noncompliance, its adherents ignore other areas of complex law with regimes that not only permit the participation of whistleblowers in enforcement efforts, but encourage and protect it. Two prominent examples of active whistleblower regimes include the informant programs run through the Securities and Exchange Commission’s (SEC) Office of the
Whistleblower\textsuperscript{137} and the Environmental Protection Agency’s (EPA) Office of Inspector General (OIG).\textsuperscript{138}

An example from securities law exposes the speciousness of all three arguments. The law pertaining to liability under section 10(b) of the Securities and Exchange Act and SEC rule 10b-5 is all over the place, often unclear, and typically evaluated on a case-by-case basis. Defendants are held to an evolving standard, adjudged innocent or guilty by what amounts to a moving target. The only thing we know for certain is that it takes more than mere negligence to be found liable of a securities violation. And while the statute has never contained a private right of action as an enforcement mechanism,\textsuperscript{139} judges have created and reaffirmed implied causes of action under section 10(b) and rule 10b-5 for more than sixty-five years.\textsuperscript{140} As importantly, Congress has effectively endorsed these judicial remedies by refraining from amending or reforming section

\textsuperscript{137.} In 2010, section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act authorized the establishment of the SEC’s Office of the Whistleblower to provide “whistleblower incentives and protections.” See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-205, § 922, 124 Stat. 1376 (2010). In practice, the Office handles whistleblower tips and complaints, and provides guidance to the SEC Enforcement Division staff based on relevant information received from whistleblowers. According to its website, the SEC whistleblower program embraces whistleblowers as partners in the effort to uncover securities violations and to protect capital markets:

> Assistance and information from a whistleblower who knows of possible securities law violations can be among the most powerful weapons in the law enforcement arsenal of the Securities and Exchange Commission. Whistleblowers can help the Commission identify possible fraud and other violations much earlier than might otherwise have been possible. That allows the Commission to minimize the harm to investors, better preserve the integrity of the United States’ capital markets, and more swiftly hold accountable those responsible for unlawful conduct.

\textsuperscript{138.} The EPA’s OIG operates a hotline to help whistleblowers recognize and report fraud, waste, and abuse “in EPA programs and operations including mismanagement or violations of law, rules, or regulations by EPA employees or program participants. Complaints may be received directly from EPA employees, participants in EPA programs, or the general public.” Office of Inspector Gen., EPA, OIG Hotline, \url{http://www.epa.gov/oig/} (last visited Apr. 21, 2014).


\textsuperscript{140.} For the first decision implying a private right of action under section 10(b) and rule 10b-5, see Kardon v. Nat’l Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946) (“[T]he mere omission of an express provision for civil liability is not sufficient to negative what the general law implies.”).
Indeed, as a young Justice William Rehnquist wrote in 1974, “[w]hen we deal with private actions under rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.”

Tack on another forty years of growth, and the judicial oak contains a lot more lumber.

For a specific example, consider United States v. O’Hagan, an insider trading case. Under the “traditional” theory, liability for insider trading attaches when a corporate insider trades in the securities of the corporation on the basis of material, nonpublic information. That kind of trading, the Supreme Court held prior to the events in O’Hagan, qualifies as a “deceptive device” under section 10(b), due to the “relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.” The “relationship gives rise to a duty to disclose [or abstain from trading] because of the ‘necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of [. . . ] uninformed [. . . ] stockholders.’” Officers, directors, and other insiders are held accountable under the traditional theory, as are attorneys, accountants, consultants, and other temporary fiduciaries. By comparison, under the “misappropriation theory,” which was still evolving at the time of the events in O’Hagan, a person violates section 10(b) and rule 10b-5 when “he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information.” The fiduciary’s undisclosed use of the information “defrauds the principal of the exclusive use of that information.”

In O’Hagan, a defendant “outsider” got caught in the crosshairs of the still uncertain misappropriation theory. Despite the uncertainty, the Supreme Court found Defendant O’Hagan criminally liable for insider trading. O’Hagan was a partner in a law firm retained by a corporation to advise on a tender offer for the common stock of another corporation.

141. See Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983) (unanimously finding that “[t]he existence of this implied remedy is simply beyond peradventure”).
145. Id. at 228–29 (second and third alterations in original) (quoting Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951)).
148. Id.
149. Id. at 652–53.
O’Hagan did no work on the matter but learned of the potential tender offer, at which time he began purchasing call options for the target corporation’s stock as well as shares of its common stock. After the acquiring corporation publicly announced its tender offer, the price of the target’s stock soared, O’Hagan sold his call options and common stock of the target, and made a sizeable profit.

In applying the misappropriation theory of liability under section 10(b) and rule 10b-5 to corporate “outsiders,” the Court wrote that when a “misappropriator [ ] trades on the basis of material, nonpublic information,” the trader “gains his advantageous market position through deception; he deceives the source of the information and simultaneously harms members of the investing public.” O’Hagan’s actions made him a “misappropriator” and criminally liable under section 10(b) and rule 10b-5. In so holding, the Court reinstated O’Hagan’s forty-one month sentence.

Importantly, the Court did not let O’Hagan off the hook notwithstanding the uncertainty swirling around the application of the misappropriation theory at the time of O’Hagan’s actions. In retrospect, and for our purposes, if O’Hagan can be found liable and sent to jail under an ambiguous standard in a supremely complex area of the law, the argument that a taxpayer should not be held liable for violations of unsettled areas of the law—and required to pay back taxes, interest, and penalties—is considerably less persuasive. Loss of undeserved, ill-gotten tax benefits does not compare to loss of liberty. And while O’Hagan’s misconduct was not discovered and reported by a whistleblower, other forms of misconduct under unsettled areas of the law could certainly be the subject of a whistleblower claim submitted to the SEC’s current Office of the Whistleblower and subsequently prosecuted to conclusion.

Two additional examples underscore that tax is certainly not the only area of the law that suffers from ambiguity and uncertainty in outcome. In fact, the following two cases describe an ambiguous area of the law (securities law) that effectively enforces other ambiguous and substantively difficult areas of the law (here, municipal public finance and taxation).

In *SEC v. Dain Rauscher, Inc.*151 the Securities and Exchange Commission had charged an investment banker for an underwriter of municipal offerings with multiple securities violations. According to the SEC, the defendant failed to conduct a proper investigation and omitted material information related to the offering statements of taxable municipal notes.152 At the time of the offering, taxable municipal notes were new to the industry and used solely for investment purposes and interest arbitrage opportunities rather than for infrastructure improvement, debt reduction,

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150. Id. at 656.
151. 254 F.3d 852 (9th Cir. 2001).
152. Even more specifically, the SEC charged the defendant with violating section 17(a) of the Securities Act as well as section 10(b), rule 10b-5, and section 15(B)(c)(1) of the Securities Exchange Act. See id. at 853–54.
or capital projects. The gambit involved the issuer of the notes planning to pay back bondholders at a certain rate of interest while investing the proceeds from the notes at a higher rate of return to make a profit equal to the spread between the rates.

The defendant argued that he met the standard of care for the securities profession by satisfying the industry standard in preparing and drafting the offering statements. He also reminded the court that it had found similar conduct as satisfying the standard of care in the context of accounting professionals.\textsuperscript{153} The court distinguished its earlier holding respecting accountants, however, and found that meeting the industry standard was just one factor to consider in applying the broader standard of “reasonable prudence.”\textsuperscript{154} Unlike the industry standard for accountants, the industry standard for investment bankers and underwriters pertaining to these new securities was “sparse and not particularly helpful.”\textsuperscript{155} Even more importantly, it was “set, in part, by [the defendant] himself who was one of the first of the securities professionals to participate in such an offering.”\textsuperscript{156} and who might be motivated to develop a standard falling short of ordinary reasonable care.\textsuperscript{157} Viewing under an objective standard, the defendant’s conduct—which included failing to describe the investment purpose of the notes, further failing to disclose that the proceeds would be invested in Orange County investment pools (the same pools that hastened the county’s bankruptcy), and making no inquiry into the investments and securities held by the pools\textsuperscript{158}—the court held in favor of the SEC and remanded for further proceedings.\textsuperscript{159}

Five years later, in Weiss v. SEC\textsuperscript{160} the court evaluated whether bond counsel for a school district made material misrepresentations and deceitful acts in providing an unqualified legal opinion on a bond issuance.\textsuperscript{161} Section 103 of the Internal Revenue Code excludes interest on local government bonds from gross income of bond purchasers.\textsuperscript{162} At the same time, it places limits on the use of “arbitrage bonds,”\textsuperscript{163} bonds offered at,
say, a 3% rate of interest with bond proceeds invested in U.S. Treasuries earning a 4% rate of return. If structured in compliance with detailed regulations, issuers can earn a risk-free profit. On the other hand, failure to meet the regulatory requirements turns the tax-exempt bonds into taxable “arbitrage bonds.” Given the importance of meeting the requirements, local government entities hire bond counsel to ensure that the issuance satisfies a series of tests to evaluate whether the issuer possesses a “reasonable expectation” it will spend a certain amount of the bond proceeds on capital projects (rather than on arbitrage opportunities) within a certain period of time.

The court endorsed the SEC’s finding that the defendant failed “to look for even minimal objective indicia of the School District’s reasonable expectations to spend Note proceeds on projects . . . .” The extent of his due diligence involved examining a “wish list” of projects that the school district was considering, “not a list of the projects the Board had decided to undertake.” And while Weiss argued that his client merely had to “intend” to undertake the project before issuing the bonds, an interpretation of the rules that reflected industry practice, the court held that “the question is not whether the Board intended to do projects, but whether a reasonable person would have expected the Board to follow through on those projects.” Weiss neglected to conduct a reasonably diligent and objective inquiry to make that determination, and thus “failed to provide investors with full information concerning the substantial risk that the IRS would find the Notes to be taxable.” The court upheld the SEC’s determination.

As these examples indicate, tax is not uniquely complex, ambiguous, or uncertain as compared to other areas of the law. By the same token, violations of the tax law do not deserve special treatment vis-à-vis other equally complex, ambiguous, or uncertain legal contexts. In other words, tax cheats do not deserve lesser enforcement or liability than, say, Medicaid cheats, under either applicable black letter law or under false claims acts.

B. Whistleblowers Are Not Bad for Tax Administration

As part of the specious “tax is different” argument, critics of permitting tax claims under false claims statutes assert that tax whistleblowers are bad for tax administration. Allowing citizens to act as pseudo-revenue agents creates an “alternative tax administration process” that erodes tradi-
tional taxpayer rights of process, privacy, and confidentiality. Moreover, according to the critics, whistleblower regimes circumvent tax agencies and expert tax officials trained in identifying noncompliance and instead substitute inexpert citizens looking for a quick settlement or a cut of the larger tax enforcement pie. Citizen enforcement of the tax law also encourages frivolous and harassing claims, whether prosecuted by citizen whistleblowers or overzealous attorneys general acting on information provided by whistleblowers, a result that can sully innocent taxpayers’ reputations and drain resources spent on baseless litigation. Such a parallel tax administration process, moreover, conflicts and overlaps with existing (or likely) tax investigations, creating additional expense for taxpayer defendants and duplicative investigations for state tax agencies and attorneys general’s offices.

These claims are unnecessarily alarmist. Moreover, they seem to stem from fear of the unknown rather than from practical experience. Many of the assertions reveal critics’ lack of familiarity with false claims statutes and how the statutes already address and mitigate the asserted cataclysms. Part III.B.1 addresses these gaps between perception and reality. As importantly, critics exhibit a fundamental misunderstanding of why whistleblowers report alleged misconduct in the first place. Rather than simply reflecting disgruntled employees looking for a quick settlement, study after study reveals that the vast majority of whistleblowers are “motivated more by principle—that is to say, wanting to do the right thing—than by money.” Part III.B.2 addresses this misunderstanding.

1. Whistleblowing Does Not Threaten Taxpayer Rights of Process, Privacy, or Confidentiality

Elements of the defense bar have charged tax whistleblower laws, particularly qui tam statutes permitting tax claims, with eliminating “many of the rights that exist in the normal tax administration process.” Prominent on the list of endangered rights are administrative procedure, tax privacy, and taxpayer confidentiality. “We are used to litigating tax cases in private,” one practitioner has said, “and we’re used to taxpayer confidentiality.” In the qui tam context, “otherwise confidential tax return

171. Hamilton, supra note 25, at 112 (quoting Jim Wetzler, former commissioner of New York’s Department of Finance and Taxation, now partner with Deloitte).
172. Dolan & McCormally, supra note 70, at 1542.
173. Hamilton, supra note 25, at 112 (quoting Wetzler, who further concludes that New York’s recently amended FCA is “not good for tax administration . . . and certainly not [good] for taxpayer rights.”).
174. Walreese Carroll, Panelists Question FTB Rationale in Gillette Appeal, 66 STATE TAX NOTES 623, 623 (2012) (quoting Hollis Hyans of Morrison & Foerster LLP). Ms. Hyans overstates her case: once a tax matter reaches formal litigation (unless it is subject to a court-issued protective order or proceeds under the cloak of arbitration rather than in a courtroom), confidentiality protections for tax return information quickly disappear. See I.R.C. § 6103(h)(4) (2012) (expressly per-
information will become available for public inspection. Additional rights are jeopardized under some FCAs by longer statutes of limitations for actions brought under false claims statutes versus actions originating under a state’s revenue statutes, as well as retroactive application of FCAs that have been amended to allow tax claims.

The critics make it sound as if accused taxpayers will have their tax returns published on the front page of the Wall Street Journal and fully searchable in online databases. Such impressions lack reality. It is certainly possible that a taxpayer’s aggressive tax avoidance transaction(s) (and not its entire tax return, which could run thousands of pages) could be exposed to the court of public opinion, an outcome that would, on the one hand, publicize the taxpayer’s knowing submission of false or fraudulent information to the government (which should elicit little sympathy) or, on the other hand, illuminate an area of the law that needs clarification to avoid further knowing exploitation by overaggressive taxpayers. In either event, false claims statutes contain procedural mechanisms (discussed below) that significantly minimize potential harms from publicly disclosing tax records or tax return information in federal and state judicial or administrative proceedings. Ms. Hyans may have been referring to pretrial dispute resolution procedures or administrative appeals; in that event, she inappropriately extends the litigation model to proceedings that, though perhaps adversarial in the mind of taxpayers and counsel, possess few of the trappings of litigation and reflect an administrative process rather than a judicial process. See Gustafson et al., supra note 70, at 54 (“[U]nlike most administrative audits and appeals, qui tam proceedings are public.”); James W. Wetzler, New York’s False Claims Act—Good or Bad Tax Administration?, 60 STATE TAX NOTES 165, 169 (2011) (“[M]ost FCA legal proceedings will be publicly disclosed.”).

175. Gustafson et al., supra note 70, at 54.

176. See Martire & Ferrante, supra note 70, at 130 n.1 (discussing New York’s FCA); Trachtenberg et al., supra note 29, at 375–76; Wetzler, supra note 174, at 169. In general, New York’s Tax Law provides a three-year statute of limitations on tax enforcement actions, “except in the case of a willfully false or fraudulent return with intent to evade the tax . . . .” N.Y. TAX LAW § 1147(b) (McKinney 2013). For knowing submissions of false and fraudulent tax information, the state imposes a ten-year statute of limitations. See N.Y. STATE FIN. LAW § 192(1).

177. See Trachtenberg et al., supra note 29, at 375–76; Wetzler, supra note 174, at 169. Effective August 13, 2010, the New York Legislature amended the state’s False Claims Act. Among other changes to the statute, the legislature expressly applied the FCA to knowing violations of the New York Tax Law. See 2010 N.Y. Sess. Laws 379 (McKinney), available at http://ssl.csg.org/dockets/2012cycle/32B/32Bills/1332b06ntwhistleblowerfraud.pdf. The legislature also made the 2010 amendments retroactive to “apply to claims, records or statements made or used prior to, on or after April 1, 2007.” Id. § 13. In June 2013, a New York court upheld the retroactive application of the amendments pertaining to knowing violations of New York’s tax law. See People ex rel. Schneiderman v. Sprint Nextel Corp., 970 N.Y.S.2d 164, 176 (N.Y. Sup. Ct. 2013) (finding that section 189(1)(g) of FCA, pertaining to reverse false claims—whereby persons are liable for avoiding paying or transmitting money or property to government, including tax payments—“is not sufficiently punitive in nature and effect as to warrant preclusive application of the Ex Post Facto Clause to [taxpayer’s] alleged conduct prior to August 10, 2010, when the Act was amended to expressly apply to knowing violations of the State’s Tax Law”).
airing a taxpayer’s dirty laundry. Meanwhile, for taxpayers who genuinely take a good faith position in an unsettled area of the law, the fear that confidential tax return information will be a news item is remote. Only a fraction of qui tam complaints (which universally proceed under seal) evolve into live actions. Moreover, all false claims statutes limit public access to private or confidential tax return information. And, as further protection for taxpayers, courts have the authority to fashion additional remedies to protect tax return information from undue disclosure.

Under all FCAs, qui tam complaints are filed in camera and remain under seal for a specified period of time. During this period, the government (either state attorneys general or the U.S. Department of Justice) investigates the allegations. The government may request additional time to investigate the matter, while the complaint remains under seal with any supporting affidavits or submissions made in camera. Generally, the seal is lifted once the government notifies the court that it intends to proceed with the action or, alternatively, once the government notifies the court that it declines to proceed and the qui tam plaintiff assumes responsibility for prosecuting the matter.

Even if a court lifts the protective seal, thereby technically making the proceedings “public,” additional means are available to restrict access to confidential tax return information. For example, current FCAs provide avenues for the government to dismiss the action (notwithstanding objections of the whistleblower initiating the action), settle the action with the defendant (again, notwithstanding objections of the whistleblower),

178. It is worth noting that the burden of proof in false claims actions, unlike in administrative tax actions, is on the person or the state agency prosecuting the suit. Thus, as one knowledgeable commentator has observed, “it’s possible to argue that taxpayers will have even greater [procedural] protections in the false-claims area than they do in issues before state tax administrators.” Hamilton, supra note 25, at 112 (quoting William Comiskey, former deputy commissioner of Office of Tax Enforcement with New York Department of Taxation and Finance).

179. See, e.g., 31 U.S.C. § 3730(b)(2) (2012) (at least sixty days); CAL. GOV’T CODE § 12652(c)(2) (West 2014) (up to sixty days); 740 ILL. COMP. STAT. 175/4(b)(2) (2012) (at least sixty days); N.Y. STATE FIN. LAW § 190(2)(b) (at least sixty days).

180. See 31 U.S.C. § 3730(b)(2); CAL. GOV’T CODE § 12652(c)(2); 740 ILL. COMP. STAT. 175/4(b)(3); N.Y. STATE FIN. LAW § 190(2)(b).

181. See, e.g., 740 ILL. COMP. STAT. 175/4(b)(2) (providing no explicit directive for when court unseals complaint, but indicating that complaint is in fact unsealed once it is served on defendant); see also 31 U.S.C. § 3730(b)(3) (same as Illinois’s FCA); CAL. GOV’T CODE § 12652(b)(6)(A)–(B).

182. The statutes require that the person initiating the action be notified of the motion to dismiss and provided an opportunity for a hearing on the motion. See 31 U.S.C. § 3730(c)(2)(A); CAL. GOV’T CODE § 12652(c)(2)(A); 740 ILL. COMP. STAT. 175/4(c)(2)(A); N.Y. STATE FIN. LAW § 190(5)(b)(ii).

183. The statutes require that a court determine the settlement is “fair, adequate, and reasonable under all the circumstances.” 31 U.S.C. § 3730(c)(2)(B); 740 ILL. COMP. STAT. 175/4(c)(2)(B); see also CAL. GOV’T CODE § 12652(c)(2)(B); N.Y. STATE FIN. LAW § 190(5)(b)(ii); State ex rel. Beeler, Schad & Diamond, P.C. v. Burlington Coat Factory Warehouse Corp., 860 N.E.2d 423, 427 (Ill. App. Ct.)
with any settlement hearing being held in camera upon a showing of good cause,184 and impose limitations during the course of litigation on the participation of the whistleblower.185 The statutes also permit defendants to request restrictions on a qui tam plaintiff’s participation by showing that such participation “would be for purposes of harassment or would cause the defendant undue burden or unnecessary expense.”186 Moreover, if a qui tam plaintiff ends up prosecuting the action rather than the government, at least one state’s FCA requires the plaintiff to obtain approval from the attorney general before even submitting a motion to compel the state’s tax agency to disclose a defendant’s tax records,187 a requirement that could be adopted in all jurisdictions. Finally, at their discretion, courts can craft protective orders and require in camera review or redaction of documents and materials to prevent unnecessary disclosure of tax return information.188

2006) (holding that action could be dismissed by state’s attorney general over relator’s objections so long as relator was given notice and opportunity to be heard).


185. The statutes require the government to show that unrestricted participation during the course of litigation by the person initiating the action would “interfere with or unduly delay the prosecution of the case, or would be repetitious or irrelevant.” N.Y. STATE FIN. LAW § 190(5)(b)(iii). Enumerated limitations include restricting (i) the number of witnesses the person may call, (ii) the length of witness testimony, and (iii) the person’s cross-examination of witnesses. See 31 U.S.C. § 3730(c)(2)(C); 740 ILL. COMP. STAT. 175/4(c)(2)(C); N.Y. STATE FIN. LAW § 190(5)(b)(iii).

186. 740 ILL. COMP. STAT. 175/4(c)(2)(D); see also 31 U.S.C. § 3750(c)(2)(C); N.Y. STATE FIN. LAW § 190(5)(b)(iii).

187. See, e.g., N.Y. STATE FIN. LAW § 189(4)(b).

188. The general rule under section 6103(h)(4) of the Internal Revenue Code provides for disclosure of tax returns and tax return information in judicial and administrative tax proceedings. In this and other ways, the protections afforded tax return information are less absolute than most people think. In 2012, for instance, the IRS made more than eight billion disclosures of tax returns and return information to authorized recipients under section 6103, with the majority of the disclosures constituting government-to-government requests for information, as well as requests from Congressional committees and the U.S. Census Bureau. See Joint Comm. on Taxation, IRS, Disclosure Report for Public Inspection Pursuant to Internal Revenue Code Section 6103(p)(3)(C) for Calendar Year 2012, JCX-8-13 (2013), available at https://www.jct.gov/publications.html?func=startdown&id=4514. During the course of investigating false or fraudulent behavior under the New York FCA, for instance, that state’s Office of the Attorney General regularly obtains tax return information from the federal government. See Hamilton, supra note 33, at 156 (reporting that the New York Attorney General “follows the federally prescribed process for obtaining tax return information”); Letter from Eric T. Schneiderman, supra note 38, at 1 (describing “the right of state officials to obtain and utilize information that may appear on tax returns in carrying out [ ] law enforcement functions”).
2. **Whistleblowers Do Not Threaten Expert Tax Administration or Lead to Frivolous Claims**

Critics of tax whistleblowers and qui tam for tax overstate their case even more dramatically when it comes to perceived threats to expert tax administration. “Tax administrators are often relegated to the sidelines in these suits,” the critics allege, “and have limited input as to how the tax law is applied."¹⁸⁹ Moreover, whistleblower cases disrupt tax enforcement processes in that the misconduct alleged in a whistleblower complaint might already be under government review or would eventually be flagged and investigated.¹⁹⁰ Furthermore, in some states, officials with no tax expertise and motivated more by politics than tax enforcement can “override the tax administrator’s decisions about enforcement priorities and how to interpret the law.”¹⁹¹ And, the argument goes, under FCAs that permit tax claims, “taxpayers immediately get branded in the press as ‘tax frauds’ and ‘tax cheats.’”¹⁹² Elements of the corporate bar even charge that “people who do not understand tax—but understand false claim acts and qui tam actions—are being allowed to decide who gets punished and who does not.”¹⁹³ Interpreting and enforcing the tax law requires “specialized knowledge” and “ought to remain within the authority and expertise of the state’s taxing authority,”¹⁹⁴ rather than with private persons who sim-


¹⁹⁰. *See Carroll*, supra note 174, at 623 (quoting Lynn Gandhi, of Honigman Miller Schwartz and Cohn LLP, with respect to New York’s FCA permitting tax claims, saying “I don’t know why we need this,” and suggesting that traditional tax administration process works just fine); *Houghton et al.*, supra note 70, at 596 (recommending that state legislatures “enact clear and explicit safe harbors for those corporations that are engaged with the appropriate governmental agency regarding the subject matter of the false claim (for example, as part of a state audit examination, whether conducted by state personnel or retained contract auditors, or as part of a voluntary disclosure process)”; *Houghton et al.*, supra note 72, at 458 (“[A]llowing a [whistleblower] to initiate a lawsuit when the company has already alerted the government to the matter, in any form, contradicts the public policy and stated purpose underlying the qui tam statutory regime.”); *Wetzler*, supra note 174, at 167 (discussing potential situations where “a whistleblower simultaneously files claims under the IRS whistleblower program and the FCA, the information provided under the FCA would have eventually been received by the department when the IRS reports federal audit changes to the department through the fed-state information exchange program,” and “[c]ases in which the ordinary tax administration process would have a high probability of uncovering tax underpayments would include . . . allegations based on tax return positions disclosed on the tax return”).


¹⁹³. *Id.* (summarizing comments by Jordan Goodman of Horwood Marcus & Berk).

¹⁹⁴. *Carr*, supra note 45, at 38 (summarizing practitioner concerns).
ply initiate whistleblower complaints and then “say that it is fraud—with headline-grabbing allegations against the company.”

The critics craft a tale of elected officials misusing and misapplying false claims statutes for personal gain; of ill-informed citizens (usually disgruntled employees or former employees) out for financial windfalls bringing baseless, frivolous, and harassing lawsuits; of innocent taxpayers being accused of cheating on their taxes without due process; and of tax officials completely shut out or circumvented. It all sounds terrible. But it distorts the truth.

For starters, agencies and officials with tax expertise will be as involved in FCA actions as the underlying statute allows (and as it should allow). In New York, for instance, the FCA requires the attorney general to “consult with the commissioner of the department of taxation and finance prior to filing or intervening in any action . . . based on the filing of false claims, records or statements made under the tax law.” The statutory requirement for consultation with the tax agency was one of the reasons that the state’s Department of Taxation and Finance supported the 2010 amendments permitting tax actions to be brought under the FCA. Section 7623 of the Internal Revenue Code also guarantees that tax experts will decide the fate of all whistleblower submissions. In the words of Dan Bucks, former Executive Director of the Multistate Tax Commission, under existing federal and state tax whistleblower regimes, “[c]itizen actions are referred first to the government for the application of the tax agency’s special expertise. The government may then proceed with the case” or allow the whistleblower to prosecute the action. “That general process of combining the information and initiative of the citizen with the established knowledge and expertise of the tax agency,” Bucks concludes, “is appropriate in the realm of taxation.”

Even in states without a directive requiring attorneys general to consult with their state’s tax agency, tax experts can (and should) be involved in evaluating and investigating a whistleblower’s complaint. As a matter of prudence, due diligence, and competence, state attorneys general will want to involve their tax agencies in tax-related false claims actions. Moreover, many attorneys general offices enjoy in-house tax expertise. For example, the California Office of the Attorney General includes a Business...
and Tax Section that investigates and litigates complex tax cases. In addition, attorney general offices can leverage the expertise of whistleblowers themselves to understand the true nature of positions or transactions on a taxpayer’s 1000-page return. Indeed, according to Gregory Krakower, senior advisor and counselor to the New York Attorney General, the list of persons submitting tax claims under New York’s FCA includes potential “accountants, bookkeepers, employees of banks, accounting firms, and other businesses that handle tax matters.” 200 These insiders are essential to uncovering and then deciphering tax noncompliance “hidden in a complex web of structured transactions,” in the opinion of William Comiskey, a former deputy commissioner of the Office of Tax Enforcement with the New York Department of Taxation and Finance. 201 “The False Claims Act,” Comiskey says, “will provide the state with the best tool available to expose these schemes,” namely the knowledgeable insider. 202

Concerns over duplicative and premature enforcement investigations due to whistleblower actions are equally unconvincing. Just because a tax agency may be auditing a company’s tax return, for instance, does not mean that the investigating agents will flag the transaction that is the subject of a whistleblower submission or, in the event the transaction has been flagged, will understand what is really going on with the transaction beyond what the taxpayer has chosen to reflect on the return. 203 We cannot forget that abusive tax avoidance deals such as LILOs and SILOs resembled plain vanilla leveraged-lease transactions on corporate tax returns, while fraudulent inflated-basis transactions were made to look like run-of-the-mill high-basis, low-value partnership interests. Whistleblowers can illuminate tax-motivated transactions that revenue agents will continue to misinterpret or fail to uncover. And, in fact, insiders rather than revenue agents alerted government officials and members of the press to the inflated-basis transactions in the late 1990s 204 as well as other mass-marketed shelter schemes. 205 Thus, calls for safe harbors for taxpayers “engaged with the appropriate governmental agency regarding the subject matter of the false claim” could halt otherwise fruitful inquiries into a taxpayer’s

200. Hamilton, supra note 25, at 111.
201. Id. at 112 (quoting William Comiskey).
202. Id. (quoting William Comiskey).
203. The observation that traditional audit and tax administration procedures miss or misunderstand items on tax returns also applies to claims that whistleblower complaints are inappropriate because “the ordinary tax administration process would have a high probability of uncovering tax underpayments” associated with disclosed positions (unless, of course, the position is one that had a high probability of being flagged by computer scoring programs such as the IRS Discriminant Function System (DIF) or Unreported Income DIF (UIDIF)). Wetzel, supra note 174, at 167.
204. See infra note 271 and accompanying text.
hidden noncompliance, precisely the kind of misconduct that false claims statutes are designed to reveal.\(^{206}\) If anything, the investigating units (that is, the agents conducting the audit and the unit or agency assigned to investigate the whistleblower submission) should share information and, if appropriate, coordinate their efforts for a more streamlined, thorough investigation. Where a whistleblower submission is deemed valid but in fact duplicative or unripe, a false claims statute could require that the FCA action be stayed while the administrative action proceeded.\(^{207}\)

Finally, some commentators have suggested that state-level whistleblower actions are unnecessary when a whistleblower has also filed a claim under the federal whistleblower statute.\(^{208}\) These arguments assume that the IRS will eventually alert the state to any audit changes when the case closes, at which point the state can piggyback on the work performed by the feds. But the whistleblower’s claim may include complex issues of state taxation with which the federal examiners are unfamiliar or lack sufficient expertise such that the federal examination would fail to uncover or comprehend issues relevant to the states. Moreover, it takes years for the IRS Whistleblower Office to process and close cases. In 2006, the Treasury Inspector General for Tax Administration reported that whistleblower claims under the federal program languished in administrative and judicial processes for, on average, seven and a half years between the filing of a claim and the payment of a reward, the point at which cases are closed administratively.\(^{209}\) In 2013, six years after Congress significantly enhanced and improved the program, the IRS Whistleblower Office was still advising whistleblowers that the time to process claims could “take five to seven years and longer.”\(^{210}\) In the intervening period, states reliant

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206. Houghton et al., supra note 70, at 596.

207. In Illinois, a 2013 attempt to amend the state’s FCA by giving the attorney general sole authority to prosecute false claims involving taxation (which would have had the effect of prohibiting qui tam plaintiffs from prosecuting tax claims) adopted a slightly different tact. Upon the submission of a whistleblower complaint, the state’s tax department would have the authority to process the allegations through its usual administrative channels. However, if the attorney general decided to turn what would otherwise be an administrative proceeding into a civil action by filing suit, the administrative processes—excepting a tax department audit or investigation—would be stayed until resolution of the judicial action. The bill died in the General Assembly’s Rules Committee. See supra notes 42–47 and accompanying text.

208. See Wetzler, supra note 174, at 167.


on the federal program would continue to leak revenue due to noncompliance that state-level FCAs or standalone whistleblower statutes could have long since identified and prosecuted.

Part of the argument that tax experts will be cut out of the process for deciding which tax claims to prosecute under FCAs involves concerns over frivolous or harassing lawsuits. As discussed above, however, false claims statutes contain numerous procedural mechanisms that act to filter out such claims: filing complaints in camera and under seal; keeping complaints in camera and under seal while the government investigates the underlying claims; and allowing courts to fashion additional remedies to prevent harassment, undue burden, or unnecessary expense of defendants. Add to that list the fact that the burden of proof in false claims actions, unlike in administrative tax actions, is on the person or the state agency prosecuting the suit. Furthermore, FCAs can (and do) include threshold levels on (i) the income or sales of the taxpayer against whom the action is brought and (ii) on damages pled, both of which, when combined, mitigate small-dollar claims involving small-time taxpayers; FCAs can (and do) provide that courts may award costs to defendants (in the event they prevail in the action) if a court finds that “the claim of the person bringing the action was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment”; states could enact additional and more onerous penalties on frivolous and harassing claims; and, finally, experience indicates that “a decision by the government not to intervene [in a whistleblower complaint] is a signal to plaintiffs’ lawyers that their claim has little merit.”

under section 7623(b), which Congress enacted in 2006. Id. at 1. Further consider that the majority of awards paid during fiscal year 2012 involved claims filed under pre-2006 law. Id. at 16.

211. See supra notes 179–88 and accompanying text.

212. See supra note 178.

213. See, e.g., N.Y. STATE FIN. LAW § 189(4)(a)(i)–(ii) (McKinney 2013) (limiting claims to taxpayers with net income or sales over $1 million and damages pleaded over $350,000). The federal tax whistleblower statute also includes monetary thresholds to concentrate claims on high-income taxpayers and businesses. See I.R.C. § 7623(b)(5)(A)–(B) (2012) (limiting claims to taxpayers with gross income over $200,000 and the sum of tax, penalties, interest, additions to tax, and additional amounts in dispute over $2,000,000).

214. N.Y. STATE FIN. LAW § 190(6)(d) (applying only to qui tam plaintiff); see also 31 U.S.C. § 3730(d)(4); CAL. GOV’T CODE § 12652(g)(9)(A)–(B) (West 2014); 740 ILL. COMP. STAT. 175/4(d)(4) (2012).

215. Such a strategy would be particularly appropriate in jurisdictions such as Illinois, where some law firms are improperly submitting nuisance claims under the state’s FCA. See supra notes 40–47 and accompanying text.

216. Trachtenberg et al., supra note 29, at 375. Data from the U.S. Department of Justice’s fraud statistics reflect the stunningly low rate of return for whistleblowers on claims where the government declines to proceed, the actions are not dismissed for good cause, and qui tam plaintiffs take over prosecutorial responsibilities. In 2013, in qui tam actions where the government declined to proceed, whistleblowers received a meager 0.5% of total qui tam collections (and an equally paltry 3.5% of total qui tam awards), compared to 12.6% of collections
Notwithstanding these protections, members of the defense bar continue to beat the drum of whistleblower abuse. In fairness, the zealous defense lawyer construes any lawsuit, meritorious or otherwise, as frivolous and harassing. But based on the persistent, outsized fear over whistleblowing run amok, the unavoidable conclusion is that some members of the defense bar are either engaging in purposefully inflammatory resistance to whistleblower laws or they are inappropriately (and to their clients' distinct detriment) stereotyping who blows the whistle and why. The distorted, broad-brush view of whistleblowers states that they are merely puppets deployed by puppeteering, avaricious trial lawyers;217 that they are motivated only by the lure of financial gain rather than exposing fraudulent behavior;218 that they possess a rolodex of invalid claims, and will move on to the next innocent victim if met with sufficient resistance;219 that they are primarily disgruntled employees or former employees;220 and that unlike the virtuous defenders of frivolous and harassing claims, whistleblowers enjoy too many protections under the law (particu-

when the government intervened or prosecuted the action itself. See Civil Div., U.S. Dep't of Justice, Fraud Statistics—Overview (2013), available at http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf. Over a longer time horizon, the discrepancy persists: between 2009 and 2013, in actions where the government declined to proceed, whistleblowers received 1% of qui tam collections (and 6.4% of total awards), compared to 14.1% of collections when the government intervened or prosecuted the action itself. See id. (providing fraud statistics from October 1, 1987 through September 30, 2013).

217. See Hamilton, supra note 25, at 109 (quoting Jim Wetzler as saying that ability to bring tax claims under NY's FCA would "open[ ] up the prospect of qui tam lawsuits against large taxpayers who a trial lawyer thinks might have underpaid state tax").

218. See Carr, supra note 45, at 39 ("[A]llowing tax prosecution under the state's FCA gives some individuals a considerable financial interest in bringing in as much revenue for the state as possible. . . . There is always a significant potential for abuse when enforcers of the law are given a personal financial incentive."); Hamilton, supra note 25, at 113 (writing that while "we've always admired the people who step bravely forward to expose wrongdoing by the powerful. . . . [I]t seems to me that the issue becomes far more ambiguous when the whistleblowing turns on the prospect of outsized financial reward"); Martire & Ferrante, supra note 70, at 130 ("Many whistleblowers file these suits hoping for a quick settlement."); Noonan & Comiskey, supra note 73, at 353 ("[A]most anyone may become a whistleblower with a financial incentive to report questionable transactions . . . ."); Neil Weinberg, The Dark Side of Whistleblowing, Forbes (Mar. 14, 2005, 12:00 AM), http://www.forbes.com/forbes/2005/0314/090.html (writing, with respect to whistleblower laws generally, "[i]n this hell-bent pursuit of jackpot justice, the prospect of a big payoff draws would-be whistleblowers 'like moths to the flame'").

219. See, e.g., Martire & Ferrante, supra note 70, at 130 (counseling would-be defendants of whistleblower or qui tam complaints, "[i]f you make it apparent that you intend to aggressively defend your litigation, the whistleblower may back away, focusing instead on less bothersome opponents").

220. See, e.g., Hamilton, supra note 25, at 113 (relaying his experience with Texas' tax bounty statute as former deputy comptroller for Texas Office of the Comptroller of Public Accounts: "Informants often turned out to have a grudge to settle or simply wanted to use the information they had to reap a payday at a former employer's expense").
larly in the form of anti-retaliation statutes) and thus should be forced to exhaust all internal remedies with employers before blowing the whistle.221

There is some truth to these perspectives. To be sure, a limited number of attorneys have abused qui tam and whistleblower statutes.222 Moreover, financial awards surely motivate some whistleblowers to report alleged misconduct, while other whistleblowers would qualify as disgruntled employees or persons who see fraudulent behavior where none exists.

Upon close inspection, however, the reality looks considerably different than the portrait of whistleblowers painted by elements of the defense bar. A 2012 report published by the Ethics Resource Center, a non-profit that has compiled and analyzed organizational ethics and compliance data since 1922, investigated whether potential financial bounties encouraged employees to go outside their company to report misconduct directly to law enforcement agencies.223 The results were eye-opening. Respondents reported being considerably more motivated by the nature of the misconduct (82% would report if the crime were “big enough”) as well as its potential harm to others (76% would report if failing to do so might harm people), compared to any financial reward (only 43% would report for the “potential to receive a substantial monetary reward”).224 Nor are whistleblowers necessarily low-level employees looking for a big payday: the likelihood of reporting to the government increases with seniority (56% of top-management say they would go to the government, compared to 41% of non-management employees)225 and among employees who consider themselves influential within the company (76% compared to 52% of those who feel unlikely to be heard).226 Even more surprising, particularly in light of the misimpressions of whistleblowers, only 18% of

221. See Houghton et al., supra note 72, at 457 (arguing that whistleblowers “should be required to affirmatively notify the potential defendant of the relator’s belief in writing and provide the potential defendant a three-month window to remedy the issue”); Noonan & Comiskey, supra note 73, at 353 (stating, while criticizing whistleblower protections under New York’s false claims statute, that “an employee who pilfers documents from his employer to establish a false claim is protected from retaliation even if the employee violated a rule, contract, or duty owed to his employer when he took the documents”).

222. See, e.g., supra notes 40–51 and accompanying text (describing improper nuisance suits in Illinois).


225. ERC 2012, supra note 223, at 16.

226. Id. at 5.
respondents reported the observed misconduct outside their company,\(^ {227} \) while 92% of those did so only after first attempting to report internally.\(^ {228} \) A mere 3% of all whistleblowers went outside their company as a first resort.\(^ {229} \) Finally the report found that victims of retaliation are far more likely to report misconduct outside the company,\(^ {230} \) a cautionary finding for those offering less than enthusiastic support to anti-retaliation measures.\(^ {231} \)

The takeaway is clear and summarized thoughtfully by two practitioners advising corporate compliance officers and tax executives on how to create a culture conducive to uncovering internal fraud while also mitigating whistleblower risk. “Providing employees with the means of raising concerns remains a best practice even when a company is not legally required to [do so] because whistleblowers are often motivated more by principle—that is to say, wanting to do the right thing—than by money.”\(^ {232} \) The same source reminds us that whistleblower Bradley Birkenfeld\(^ {233} \) reported UBS’s misconduct to the federal government only after the company’s compliance office repeatedly ignored his internal complaints.\(^ {234} \) Organizations should embrace whistleblowers, studies em-

\(^ {227} \) Id. at 2; see also Ethics Res. Ctr., National Business Ethics Survey of the U.S. Workforce 29–30 (2013) [hereinafter ERC 2013], available at http://www.ethics.org/downloads/2013NBESFinalWeb.pdf (finding that only 20% of whistleblowers ever reported outside company).


\(^ {229} \) ERC 2011, supra note 223, at 43. Just 2% of whistleblowers went outside the company without ever reporting the misconduct to their employers. ERC 2012, supra note 225, at 2.

\(^ {230} \) See ERC 2011, supra note 223, at 37 (reporting that 90% of employees considered reporting outside company after experiencing retaliation for reporting misconduct, compared to 69% who did not experience retaliation).

\(^ {231} \) The anti-retaliation statute contained in New York’s FCA has received particular attention of late. Section 191 protects whistleblowers from retaliation (and provides corresponding relief) due to “lawful acts . . . in furtherance of an action brought under this article or other efforts to stop one or more violations of this article . . . .” N.Y. State Fin. Law § 191(1) (McKinney 2013). The definition of “lawful act,” moreover, permits whistleblowers to “violate a contract, employment term, or duty owed to the employer or contractor, so long as the possession and transmission of such documents are for the sole purpose of furthering efforts to stop one or more violations” of the FCA. Id. § 191(2).

\(^ {232} \) Dolan & McCormally, supra note 70, at 1542.

\(^ {233} \) See supra notes 1–17 and accompanying text.

\(^ {234} \) Dolan & McCormally, supra note 70, at 1542; see also KPMG Audit Comm. Inst., Is Governance Keeping Pace? Challenges and Priorities Shaping the Audit Committee Agenda 1 (2012), available at http://www.kpmg.com/BM/en/IssuesAndInsights/ArticlesPublications/Documents/Advisory/IsGovernancekeepingpace.pdf (“Escalation of complaints outside of the company happens when employees feel like they’re being ignored . . . .”); Alex MacLachlan,
phasize, as they represent a uniquely potent tool to combat fraud and economic crime, both of which erode employee integrity, business reputation, and the bottom line.

Additional obstacles discourage whistleblowers from doing the right thing, including high emotional and economic costs. Universally, whistleblowers face tremendous risks. “There is a 100 percent chance that you will be unemployed,” says Patrick Burns of Taxpayers Against Fraud, “the question is, [w]ill you be forever unemployable?” Whistleblowers experience “fear of bodily harm, loss of professional license, loss of employment, loss of career, loss of family” in addition to “bankruptcies... home foreclosures, divorce, suicide and depression,” any of which might reasonably muzzle a would-be whistleblower.

Some members of the defense bar express as much concern that the government will initiate and prosecute frivolous suits as disgruntled employees. These practitioners worry that under state-level FCAs, “the attorney general will issue press releases accusing the taxpayer of fraud (even though fraud does not have to be shown),” thereby imposing undue harm on taxpayer-defendants, including “significant reputational risks.” Others acknowledge that provisions like the one contained in New York’s FCA requiring the attorney general to consult with state tax authorities on whistleblower complaints “ostensibly gives the commissioner—the custodian of most tax records—some authority as a gatekeeper to influence the attorney general in deciding whether to proceed with a case.” These same voices express concern, however, that the attorney general, “who is

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235. See Ass’n of Certified Fraud Examiners, 2008 Report to the Nation on Occupational Fraud & Abuse 18, 23 (2008), available at http://www.acfe.com/uploadedFiles/ACFE_Website/Content/documents/2008-rttn.pdf (finding that 46% of all frauds perpetrated against U.S. corporations were detected by tip or employee complaint and that 57% of all tips came from whistleblowers); PriceWaterhouseCoopers, Economic Crime: People, Culture and Controls 12, 23 (2007) [hereinafter PWC Report], available at https://www.pwc.com/gx/en/economic-crime-survey/pdf/pwc_2007gecs.pdf (reporting from global survey of 5,400 firms that 43% of corporate fraud was uncovered by whistleblowers and tips, and that “whistle-blowing systems that are both well designed and properly implemented can play a decisive role in uncovering criminal activity”).
240. Gustafson et al., supra note 70, at 54.
241. Trachtenberg et al., supra note 29, at 375.
an independently elected official in New York," may nevertheless "advance
a case over the objection of the Department of Taxation and Finance." 242

These concerns are unpersuasive. It is certainly possible that an attorney
general’s office could interpret a tax statute differently than a state tax
agency and choose to proceed with a whistleblower claim where the tax
agency would have declined to prosecute. But that possibility seems re-

to. Prosecutors do not like losing cases of any kind (tax or otherwise),
and if a state’s tax experts believe that the chances of successfully challeng-
ing a tax position or transaction are slim, there is very little to gain and
much to lose by proceeding headlong toward likely defeat. As one practi-
tioner put it, “[i]t would be very irresponsible to use [prosecutorial au-
thority under a false claims statute] as a tool for political gain, other than
to do a good job and get headlines for that reason. . . . You’re not going
to risk a case and embarrass yourself for personal political purposes.” 243

Indeed, there is a difference between diligently enforcing the law and
abusing one’s power, just as there is a difference between advocating fair
and effective law enforcement and slipping into conspiracy theories about
prosecutorial abuses.

C. The Positive Case: Whistleblowers Can Bridge the Information Gap and
Shrink the Tax Gap

Part of the claim that tax noncompliance is an inappropriate subject
of whistleblower actions (especially actions initiated under FCAs) involves
the attempt to control the flow of information from taxpayer to tax
agency. Currently, taxpayers and their advisors dictate the sharing of in-
formation, a reality that puts tax agencies at a significant disadvantage in
enforcing the tax laws. In fact, as I have written elsewhere, tax enforce-
ment “is so severely handicapped by informational asymmetries that tax-
payers can engage in abusive tax planning, accurately report transactions
associated with that planning, yet still provide [ ] no indication of abusive
activity.” 244 Private enforcement of the law—through private attorney
general statutes, whistleblower laws, and qui tam statutes—can shrink sig-
ificantly the information deficits faced by tax officials at all levels of gov-
ernment. 245 Such forms of enforcement can rebalance the flow of

242. Id.
243. Hamilton, supra note 33, at 156 (quoting David Koenigsberg of Menz
Bonner Komar & Koenigsberg LLP).
244. Dennis J. Ventry, Jr., Cooperative Tax Regulation, 41 CONN. L. REV. 431, 458
(2008).
245. See id. at 453–62 (examining resource and information deficits faced by
tax officials and discussing private enforcement of law as partial solution); Dennis
J. Ventry, Jr., Whistleblowers and Qui Tam for Tax, 61 TAX LAW. 357, 376–82 (2008)
(same, with particular reference to qui tam actions for tax noncompliance); see also
William E. Kovacic, Private Monitoring and Antitrust Enforcement: Paying Informants to
Reveal Cartels, 69 GEO. WASH. L. REV. 766, 767, 774 (2001) (writing, in context of
private enforcement of cartels, “[o]ne way to counter greater efforts at conceal-
ment is to establish mechanisms for inducing [ ] insiders to disclose their miscon-
information, recalibrate the compliance playing field between taxpayers and their advisors versus tax officials, shift the cost of compliance to the party or parties with the lower cost of monitoring,246 and clarify (rather than exploit) “unsettled” or “uncertain” areas of the law by shining a light on practices that would otherwise remain in the shadows.

For precisely these reasons—transparency, lifting the veil of secrecy, and settling “unsettled” areas of the law—members of the defense bar oppose tax administration regimes that include private enforcement. “Corporate interests favor a process that allows them to raise tax questions for resolution,” writes Dan Bucks, longtime head of the Multistate Tax Commission, “but they do not want citizens to raise questions. . . . In the end, the issues about citizen participation in compliance actions are simply about power and control of the tax agenda. Corporations have that power now, and they prefer not to share it with citizens.”247 Yet there is “no question” that allowing “citizens an incentive to report tax fraud will likely lead to more revenue collection and less undetected fraud,” tax journalist Jennifer Carr has said.248 “Increasing the ability of the state to detect and

246. Scholars have shown that private enforcement of the law can provide a particularly efficient form of regulation. Modern economic theory, in particular, holds that the optimal solution to allocating compliance burdens often involves shifting the cost of compliance to those with lower monitoring costs, such as to insiders or knowledgeable outsiders with intimate knowledge of potentially noncompliant behavior. As former FTC Commissioner William Kovacic stated the proposition: “The chief virtue of private monitoring is that it gives monitoring tasks to individuals closest to the relevant information.” Kovacic, supra note 245, at 774; see also Jonathan B. Baker, Antitrust in the 1990s, FTC HISTORY: BUREAU OF ECONOMICS CONTRIBUTIONS TO LAW ENFORCEMENT, RESEARCH, AND ECONOMIC KNOWLEDGE AND POLICY 103–12 (2003), available at http://www.ftc.gov/sites/default/files/documents/public_events/roundtable-former-directors-bureau-economics/directorstablegood.pdf. See generally Gary S. Becker & George J. Stigler, Law Enforcement, Malfeasance, and Compensation of Enforcers, 3 J. LEGAL STUD. 1, 1–15 (1974) (concluding that private enforcement of public laws can be more efficient than public enforcement).

247. Bucks, supra note 198, at 287. Bucks served for nearly twenty years as the Executive Director of the Multistate Tax Commission and subsequently as the longest serving Director of Revenue for the state of Montana.

248. Carr, supra note 45, at 39; see also Hamilton, supra note 25, at 112 (quoting William Comiskey, former Deputy Commissioner of Office of Tax Enforcement with New York Department of Taxation and Finance, in context of enhanced New York FCA authorizing tax claims: “It’s a law that should be welcomed by honest taxpayers and businesses”).
eliminate tax fraud is a positive for law-abiding taxpayers whose tax burdens are bigger because of scofflaws.\textsuperscript{249} In addition to leading to “significant recoveries,” expanding tax enforcement regimes to allow citizen participation “will shine a light on major tax abuses that are unknown to government, and it will change taxpayer behavior for the better.”\textsuperscript{250} In fact, as former New York tax official William Comiskey has observed, private tax enforcement amounts to “the most powerful tool that government has for penetrating complex schemes to defraud the government.”\textsuperscript{251}

Tax agencies are totally outgunned. They “need all the help they can get from the public” due to the severe resource and information deficiencies under which they operate.\textsuperscript{252} Without “access to all the reasonable information they need,” tax agencies simply cannot collect all taxes owed.\textsuperscript{253} Whistleblowers can close the information gap by bringing to light complex and hidden interpretations of the law, turning them over to tax officials for investigation, and allowing dispute resolution procedures and the judicial process to “settle” unsettled areas of the law.

Meanwhile, elements of the defense bar argue that some areas of the tax law are so cutting-edge that they should be allowed to develop before being put under the microscope by either tax authorities or courts.\textsuperscript{254} But, in the words of Dan Bucks, that “is not a credible argument.”\textsuperscript{255} For one thing, the more complex the law, “the more critical it is to have people with inside knowledge explain what is going on to the taxing authorities.”\textsuperscript{256} For another, enforcement regimes that get the hard cases in front of tax officials and judges for scrutiny “will clarify the application of the law in more cases, bringing greater certainty and transparency to the entire tax system,” a result all interested parties—taxpayers, tax advisors, tax officials, and regular citizens—should embrace.\textsuperscript{257} In the event the hard cases involve sufficiently significant ambiguities in the law that militate against attaching liability to an alleged underpayment of tax, courts should be trusted to filter out those situations and concentrate on the

\textsuperscript{249.} Carr, \textit{supra} note 45, at 39.
\textsuperscript{250.} Hamilton, \textit{supra} note 25, at 112 (quoting William Comiskey); \textit{see also} Carr, \textit{supra} note 45, at 39 (noting, while endorsing public participation in tax enforcement, that “the state and its auditors can only do so much because of the number of taxpayers and the complexity of potential tax evasion schemes”).
\textsuperscript{251.} Hamilton, \textit{supra} note 25, at 112 (quoting William Comiskey).
\textsuperscript{252.} Bucks, \textit{supra} note 198, at 287.
\textsuperscript{253.} \textit{Id}.
\textsuperscript{254.} \textit{See id.} (writing that these voices argue that “state tax matters are simply too ambiguous to be reviewed by tax agencies and courts”).
\textsuperscript{255.} \textit{Id}.
\textsuperscript{256.} Carroll, \textit{supra} note 54, at 442 (summarizing comments of Peter Wilson Chatfield of Phillips & Cohen LLP); \textit{see also id.} (quoting Monica Navarro, professor and whistleblower attorney, “[b]ecause the tax laws are complex, insiders are often needed to expose those people who are ‘gaming the system’”).
\textsuperscript{257.} Bucks, \textit{supra} note 198, at 287.
cases that reflect truly culpable behavior. If taxpayers and their advisors genuinely believe in good faith that their “ambiguous” or “uncertain” tax position is correct, they can afford themselves of the numerous procedures for resolving the disagreement: seeking a private letter ruling or some other formal or informal advanced guidance; challenging the agency’s interpretation of the position (if the agency has one) by paying the tax and suing for refund; or disclosing the position.

In any event, we should remain suspicious of voices that, on the one hand, criticize ambiguities and uncertainties in the tax law and, on the other hand, undermine efforts to clarify the law. Or, as Dan Bucks has observed, “[i]nterests that thrive on creating, amplifying, and preserving ambiguities in the laws are not well positioned to use those same ambiguities as an argument against allowing citizens to file cases to request and require equitable tax compliance.” Over the years, practitioners have exploited “ambiguous” and “uncertain” areas of the tax law to create and endorse tax avoidance transactions for the benefit of taxpayer-clients and for themselves. Many of these transactions were fraudulent and invalidediated by courts.

Consider the leveraged-lease and inflated-basis shelters of the late 1990s and early 2000s. Prominent members of the tax bar argued that excessively leveraged-lease transactions—including LILOs, SILOs, and QTEs—were innocuous variants of leveraged-lease deals endorsed by the U.S. Supreme Court in Frank Lyon Co. v. United States. The transactions were blessed by “decades of settled law,” practitioners insisted, “including decisions of the U.S. Supreme Court and Treasury regulations.” A number of well-respected law firms vouched for the transactions’ legitimacy, rendering opinions that, when examined closely, flouted statutory and regulatory rules, defied regulatory guidance; contrived to

258. See, e.g., State ex. rel. Beeler Schad & Diamond, P.C. v. Ritz Camera Ctrs., Inc., 878 N.E.2d 1152, 1158 (Ill. App. Ct. 2007) (ruling, in analyzing alleged false claim under Illinois FCA, that liability cannot attach when it is premised on violation of unsettled area of law because taxpayer cannot be said to have made “knowingly” false claim).


261. Kenneth J. Kies, “Leave Us A Loan”: A Rebuttal to Claims that Defeasance Invalidates Lease Transactions, 102 Tax Notes 763, 765 (2004); see also Michael J. Flemming, Equipment Leasing Association Unhappy with LILO Revenue Ruling, 83 Tax Notes 477, 477 (1999) (saying that challenges to LILOs were “inconsistent with the fundamental tax principles that have governed similar issues in leasing transactions for more than 30 years”); William A. Macan, IV, Good vs. Evil? Not this Time: SILO’s Bad Rap, 103 Tax Notes 241, 242 (2004) (“SILO transactions present no issues on the transfer-of-control front that have not been a part of leasing from the outset 40 years ago.”).

262. See Kies, supra note 261, at 771 (“At least 11 major law firms are understood to have issued tax opinions regarding LILO transactions.”).

263. Despite an onslaught of IRS guidance attacking heavily leveraged-lease deals, leasing shelter lawyers were undeterred and continued to plan, advise, and consummate LILOs, SILOs, and QTEs. The guidance that these shelter lawyers
avoid legislative attempts to curb abusive leasing deals; and virtually ignored longstanding anti-abuse doctrines created by the courts, particularly the economic substance doctrine. These deals crumbled once under the judicial microscope, but not before costing the U.S. Treasury billions of dollars. Courts eventually found that the transactions contained none of the efficiencies present in traditional leveraged finance, and invalid-

largely ignored included most prominently: Rev. Rul. 99-14, 1999-1 C.B. 835 (disallowing tax benefits for interest and rent in connection with a LILO transaction that failed to transfer the indices of ownership and that ultimately lacked economic substance); I.R.S. Notice 2000-15, 2001-1 C.B. 826 (naming LILOs and ‘transactions that are the same as or substantially similar’ as ‘listed’ tax avoidance transactions); Rev. Proc. 2001-28, 2001-1 C.B. 1338 (modifying and superseding Rev. Proc. 75-21, 1975-1 C.B. 367); Rev. Rul. 2002-69, 2002-2 C.B. 760 (modifying Rev. Rul. 99-14 and adding future interest argument for invalidating LILOs and substantially similar transactions); IRS, COORDINATED ISSUE PAPER—LOSSES CLAIMED AND INCOME TO BE REPORTED FROM LEASE IN/LEASE OUT TRANSACTIONS (2003); Memorandum from Deborah Butler, IRS Assistant Chief Counsel, to Dist. Counsel, Ohio Dist. (June 30, 2000), available at F.S.A. 2000-45-002.

264. I describe these activities in a forthcoming article, entitled, A Tale of Two Shelters: What Tax Advisors Knew or Should Have Known (examining behavior of tax practitioners in two tax shelter case studies, one involving leveraged-lease transactions and another involving inflated-basis transactions).

265. Commentators and observers had long recognized the sharp distinctions between permissible and impermissible leveraged-lease transactions, even while leasing practitioners blurred the line. See, e.g., Tax Shelters: Who’s Buying, Who’s Selling, and What’s the Government Doing About It?, Hearing Before the S. Comm. on Fin. 108th Cong. 3–5 (2003), available at http://www.finance.senate.gov/imo/media/doc/102103janettest.pdf (statement of “Mr. Janet,” witness pseudonym) (testifying on LILO and SILO deals, and reporting “the leasing industry has not always been this way, nor are all leasing companies involved in this scam. . . . It is mostly [members of the Equipment Leasing Association] belonging to the ‘Big-Ticket Leasing Group’ . . .”); U.S. DEP’T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2005 REVENUE PROPOSALS 124 (2004), available at http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2005.pdf (concluding that SILOs “have no meaningful financial or economic utility other than the transfer of tax benefits to a U.S. taxpayer (by means of a purported ‘sale’ of property) in exchange for the payment of an accommodation fee to the tax-indifferent party”); Letter from Edmund S. Cohen to Pamela Olson, Assistant Treasury Sec’y for Tax Policy, Re: Tax-Exempt Leasing Budget Proposal (Jan. 30, 2004), available at 2004 TAX NOTES TODAY 29-25 (differentiating between legitimate transactions meeting “‘true-lease’ requirements” and illegitimate “‘defeased’ debt structures” such as “‘SILO’ or ‘LILO’ transactions”); Letter from Pamela F. Olson, Assistant Treasury Sec’y for Tax Policy, to Norman Y. Mineta, Secretary, Dep’t of Transp. (Nov. 26, 2003), available at 2005 TAX NOTES TODAY 40-49 (noting that while sale-leasebacks were “a time-honored method of raising capital to finance or refinance acquisition or construction,” SILOs were “fundamentally different”); Lee A. Sheppard, Lease In, Lease Out: Safe Harbor Leasing Revisited, 81 TAX NOTES 1167, 1167, 1170 (1998) (“Business and economics have been stripped out [of LILOs and SILOs] so only the purchase of tax benefits remains. . . . In contrast [to Frank Lyon deals], a LILO transaction has no business reason to exist. The real owner of a large and unwieldy asset may want to borrow against it but, as a borrower, it would want the unfettered use of the borrowed funds, which the European government clearly does not have in a LILO deal.”).
dated them as prohibited transfers of tax benefits designed and propped up by over-reaching practitioners. But the damage was done.266

The story was much the same for inflated-basis shelters. Planners and promoters of these deals played even looser with the rules than the leasing shelter lawyers, creating an assembly line of notoriously abusive tax avoidance products including “BOSS” (bond and options sales strategy), which the IRS considered the corporate precursor to its partnership progeny: “Baby Boss”267 or “Son or Boss,” “OPS” (option partnership strategy), “SOS” (short option strategy), and “MLD” (market-linked deposits). As with the leasing shelters, prominent law firms and accounting firms endorsed the inflated-basis deals with legal opinions that circumscribed statutory and regulatory rules, scorned regulatory guidance,268 disdained legislative attempts to curb inflated-basis deals,269 placed undue and unreasonable reliance on a single, inapposite Tax Court case,270 and reck-

266. See, e.g., BB&T Corp. v. United States, 523 F.3d 461 (4th Cir. 2008); Altria Grp., Inc. v. United States, 694 F. Supp. 2d 239 (S.D.N.Y. 2010), aff’d, 658 F.3d 276 (2d Cir. 2011); Local 295/Local 851 IBT Emp’r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp., 731 F. Supp. 2d 689 (S.D. Ohio 2008); AWG Leasing Trust v. United States, 502 F. Supp. 2d 933 (N.D. Ohio 2008); Hoosier Energy Rural Elec. Coop., Inc. v. John Hancock Life Ins., Co., 588 F. Supp. 2d 919, 921, 928 (S.D. Ind. 2008) (calling aggressively leveraged lease deal at issue “blatantly abusive tax shelter” and “rotten to the core”), aff’d, 582 F.3d 721 (7th Cir. 2009); Wells Fargo & Co. v. United States, 91 Fed. Cl. 35, 38 (2010) (“Although well disguised in a sea of paper and complexity, the SILO transactions essentially amount to a purchase of tax benefits for a fee from a tax-exempt entity that cannot use the deductions.”). The only case involving aggressive leveraged-lease deals in which the taxpayer prevailed (and only temporarily) involved unique facts that the court took pains to differentiate from other deals. See Consol. Edison Co. of N.Y., Inc. v. United States, 90 Fed. Cl. 228, 232 (2009) (emphasizing that “[t]he conclusions of the court offered in this opinion are based on the specific and unique facts which led to, and were part of, the [ ] transaction”), rev’d, 703 F.3d 1367 (Fed. Cir. 2013).


268. The guidance that these shelter lawyers brushed aside included most prominently I.R.S. Notice 99-59, 1999-2 C.B. 761 (warning practitioners and taxpayers that losses generated by BOSS transactions lacked economic substance, were subject to challenge under IRC sections, would be disallowed for federal income tax purposes, and that persons who participated in or promoted transactions would face significant penalties); see also I.R.S. Notice 2000-15, 2000-1 C.B. 826 (identifying BOSS deals as “listed” transactions); I.R.S. Notice 2000-44, 2000-2 C.B. 255 (disallowing inflated-basis, contingent liability transactions on statutory, regulatory, and economic substance grounds); I.R.S. Notice 2001-17, 2001-1 C.B. 730 (identifying inflated-basis, contingent liability tax shelters as “listed” transactions).


270. The impertinent case was Helmer v. Comm’r, 34 T.C.M. (CCH) 727 (1975), which purportedly established the rule allowing the planners and promoters of inflated-basis transactions to argue that a partner need not account for cer-
lessly disregarded longstanding judicial doctrines, particularly the economic substance doctrine. Even more spectacularly than the leasing shelters, these schemes collapsed when scrutinized by courts: to date, the government has not lost a single case litigated to conclusion involving inflated-basis, contingent liability shelters. Once more, however, the damage had been done with the national exchequer losing tens of billions of dollars.

tain contingent liabilities when determining outside basis. As one practitioner recently put it, the inflated-basis, contingent-liability shelter “was based on taxpayers misapplying a government victory in a case that should not have been precedential . . . .” Andrew Velarde, *Supreme Court Applies Valuation Misstatement Penalty in Woods*, 141 TAX NOTES 1014, 1016 (2013) (quoting Jasper L. Cummings, Jr., of Alston & Bird LLP). *Helmer* should have been further irrelevant for shelter lawyers authoring opinions propping up these deals due to proposed retroactive regulations that were part of President Clinton’s fiscal year 2001 budget proposal pertaining to the assumption of liabilities that sought to invalidate the basis arguments allegedly blessed by *Helmer*. See *Joint Comm. on Taxation, Description of Revenue Provisions Contained in the President’s Fiscal Year 2001 Budget Proposal* 317–22 (2000), *available at* https://www.jct.gov/publications.html?func=startdown&id=1224. *Helmer* should have been still further inapposite as precedent when Congress enacted the Community Renewal Tax Relief Act in December 2000, which fulfilled the long-running effort to prevent “duplication of loss through assumption of liabilities giving rise to a deduction,” and also authorized the Treasury Department to prescribe similar anti-abuse rules for partnerships and S corporations with prospective changes made retroactive to October 18, 1999. See *Community Renewal Tax Relief Act of 2000*, Pub. L. No. 106-554, § 309, 114 Stat. 2763. Together, the provisions “effectively ended the BOSS transactions.” *Clearmeadow Invs., LLC v. United States*, 87 Fed. Cl. 509, 513 (2009). And, according to subsequent court decisions, they put an end to the Son of Boss deals as well. See *Cemco Investors, LLC v. United States*, 515 F.3d 749, 752 (7th Cir. 2008) (concluding that retroactive section 752 regulations “apply[d] to this [Son of Boss] deal and prevent[ed] Cemco’s investors from claiming a loss”); Maguire Partners—Master Invs., LLC v. United States, No. CV 06-07371-JFW(RZx), 2009 U.S. Dist. LEXIS 8361, at *59–62 (C.D. Cal. Dec. 11, 2009) (agreeing with *Cemco* court that section 752 regulations should be applied retroactively to contingent partnership liabilities). But see *Murfam Farms, LLC v. United States*, 88 Fed. Cl. 516 (2009) (refusing to apply section 752 regulations retroactively). Finally, *Helmer* transactions were already vulnerable to attack under the partnership anti-abuse rules and the economic substance doctrine, even before Congress authorized the Treasury Department to promulgate retroactive regulations. According to two legal scholars:

The controversy over the *Helmer* rule amounted to little more than a distraction because the *Helmer*-based technical arguments advanced by shelter counsel could not survive scrutiny under the economic substance doctrine. Stated differently, shelter counsel invoked the *Helmer* rule to justify rendering penalty-shield opinions while discounting the contrary position of revenue rulings and Notice 2000-44 as well as the lack of economic substance in the contingent-liability shelters.

These schemes “worked” so long as they were in the shadows. Promoters pitched the “cutting edge” deals individually to potential clients but prohibited anyone from leaving the secretive marketing presentations with even a shred of paper describing the schemes. Taxpayer-clients signed confidentiality agreements that prevented them from discussing the deals with personal lawyers and accountants. Banks colluded with promoters to set up defeasance arrangements and circular cash flows (for the leveraged-lease deals) and offsetting options trades (for the inflated-basis deals) that generated the phony tax benefits. And lawyers and accountants devised ways to hide the schemes on their clients’ tax returns.

It was precisely the environment where the government needed the help of an insider to have any idea what was happening. A lawyer or accountant in one of the firms, a bank official, a member of the promoter’s covert syndicate of tax shelter participants, anyone could have provided information to end the deception and enormous revenue loss. And while a sufficient number of anonymous packages made their way to government officials and members of the press containing confidential transaction documents that described some of these deals, officials were slow to respond, the deals were opaque, and the IRS whistleblower law at the time was ineffective and virtually invisible to the public, several years away from the 2006 amendments that would invigorate the statute. A viable whistleblower regime that afforded knowledgeable insiders a process to turn over information to the government and its army of tax experts could have blown the lid off the shelter shenanigans. In the process, such a program could have saved untold billions of dollars in lost revenue, slashed the number of shelter cases on overloaded court dockets, and allowed officials to allocate resources to core tax administration.

Whistleblowers can do more than just uncover and report knowing violations of the law. They can also prevent noncompliance from happening in the first place. An effective whistleblower program (run either


through a state’s FCA or as a standalone statute) would add significant risk to noncompliance by increasing the probability of detection and the likelihood of potential penalties, the two most important variables in traditional tax deterrence models.273 In turn, increased aversion to noncompliance—due to increased fear of detection and palpable penalties274 as well as additional variables such as moral, ethical, and reputational inputs275—would result in increased revenue collection and, by


extension, reductions in the tax gap at both the federal and state levels. At the federal level in 2006 (the year for which we have the most recent data), the gap between what taxpayers owe and what they pay on time exceeded $450 billion,276 which, adjusted for inflation, amounts to more than half a trillion dollars in 2014.277 States, too, are leaving money on the table. In California, the Franchise Tax Board (FTB) reports that the state’s tax gap surpasses $10 billion annually,278 a figure that the FTB hopes to shrink through, among other measures, information provided by whistleblowers.279

It cannot be said enough: “[T]ax agencies need all the help they can get from the public.”280 Whether a revenue agent or a whistleblower identifies tax noncompliance should be irrelevant. The point is to stop cheating, in both “settled” and “unsettled” areas of the law.281

IV. EASY ANSWERS TO INFLATED CONCERNS OVER TAX WHISTLEBLOWERS

This final Part embraces current tax whistleblowing regimes, while at the same time acknowledging their shortcomings. It offers recommendations for improving whistleblower statutes at both the state and federal level. Moreover, it highlights thoughtful contributions from members of the defense bar suggesting compliance and cultural changes within business organizations designed not only to reduce risks associated with tax whistleblower laws but also to help whistleblower programs succeed in rooting out misconduct. Finally, it offers tax whistleblower alternatives for

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280. Bucks, supra note 198, at 287.

281. Some members of the defense bar appear reluctant to embrace tax claims under FCAs, even for settled areas of the law. In a 2011 State Tax Notes article expressing a dubious opinion of the New York false claims statute, Timothy Noonan and William Comiskey provide six hypothetical scenarios under which “whistleblowers might find fertile ground.” Noonan & Comiskey, supra note 73, at 350. With one possible exception, all of the authors’ hypotheticals reflect instances where the taxpayer knowing or knowingly (as defined under false claims statutes, the Internal Revenue Code, and its underlying regulations) submitted false or fraudulent information to the tax agencies, exactly the situations where traditional tax administration desperately needs help from insiders to uncover and prosecute noncompliance. The one hypo that presented a moderately murkier situation involved an aggressive interpretation of a purported “unclear and ambiguous” state sales tax issue; even here, as Part III.C described, exposing the aggressive interpretation to the light of day would clarify rather than exploit any ambiguities.
states to consider beyond permitting tax claims under their FCAs, especially standalone whistleblower statutes based on section 7623 of the Internal Revenue Code.

As others have observed, “[t]he developments in false claims laws [and, I would add, in section 7623] provide an opportunity for designing a broader set of reasonable policies for citizen complaints and actions regarding tax noncompliance.”282 Rather than simply rejecting these policies or attempting to beat them back, the time is ripe to “work out the details of how citizen actions can become a regular part of the compliance process,” to engage in a constructive debate on tax whistleblowing, and “to choose to be on the right side of history.”283

283. Id. Some commentators remain on the wrong side of history. See, e.g., Martire & Ferrante, supra note 70, at 128 (“Be a strong voice against the enactment of FCA litigation in the tax arena. Emphasize the powerful enforcement mechanisms that already are present and available for use by state tax departments against tax cheats. Explain the risks created when private citizens, with no tax experience, are armed with legislation that gives them the power to drive tax policy by filing whistleblower claims.”); id. at 129 (“Speak up in favor of the amendment of existing state FCAs to exclude tax claims, or other modifications designed to limit a whistleblower’s right to file tax-related claims.”); id. (“In all likelihood, the state did not initiate the FCA litigation. The state’s attorneys may even agree with you, at least privately, that the whistleblower’s claim lacks merit. Despite this fact, the state may not have the resources to take an active role in the matter. It may simply decline to intervene, which frees the whistleblower to proceed with the litigation on its own. This is cheaper for the state, but it does not relieve the litigation expense for the taxpayer defendant.”). The authors make these observations without any substantive analysis or evidence to support their claims. Moreover, and with respect to the authors’ last assertion, data from the federal False Claims Act (reliable state-level data is not available) clearly indicates that when the government declines to intervene in a whistleblower action, its decision is reinforced by the phenomenally high probability that its enforcement dollars are better spent elsewhere. Indeed, between 1988 and 2013, in instances where the government declined to intervene in a qui tam action, whistleblowers generated just 0.8% of total qui tam collections (and only 4.8% of total qui tam awards). See Civ. Div., U.S. Dep’t of Justice, supra note 216. There is also substantial evidence that state governments routinely seek dismissal of whistleblower complaints that lack merit or that, in the eyes of the state, should be handled administratively by the tax department. See, e.g., State ex rel. Beeler, Schad & Diamond, P.C. v. Burlington Coat Factory Warehouse Corp., 860 N.E.2d 423 (Ill. App. Ct. 2006) (affirming dismissal of action on motion brought by state attorney general over whistleblower’s objections); Int’l Game Tech., Inc. v. Second Judicial Dist. Court, 127 P.3d 1088, 1105 (Nev. 2006) (granting state’s motion to dismiss for good cause, including “consistent interpretation and application of the tax statutes”); see also Carroll, supra note 174, at 623 (quoting Lynn Gandhi of Honigman on New York’s FCA, “I don’t know why we need this”); Houghton et al., supra note 70, at 595 (stating that FCA claims “waste[ ] valuable resources of the states, the courts, and the defendants forced to defend themselves against overreaching”); Noonan & Comiskey, supra note 73, at 350, 353 (exclaiming “Holy smokes!” at three different points in article while purporting to rigorously analyze New York’s FCA).
A. Constructing a Model False Claims Act Permitting Tax Whistleblower Claims

The following recommendations do not constitute a “model” false claims statute authorizing tax whistleblower claims, at least not in the traditional sense of the word. Instead, they outline essential threshold components of a model statute. The distinction is important. Jurisdictions need comprehensive baseline provisions to reflect the lessons of past experience, but they also need flexibility to craft a tax whistleblower statute that reinforces their own priorities. Part IV.C, on the other hand, examines how a “model” standalone tax whistleblower statute might look. The recommendations below attempt to offer a standardized yet flexible starting point, while at the same time accounting for the criticisms of FCAs discussed in previous sections of the Article:

- The most important recommendation involves defining who can bring an action under false claims statutes. Too restrictive a definition will quash potentially valid actions, while too permissive a definition will encourage nuisance actions. The definition should reflect the policy foundations of permitting citizens to sue on behalf of the government: To leverage and reward inside or otherwise unique information or knowledge that uncovers, interprets, or helps prosecute misconduct that, in other respects, would go undetected.

  Several caveats are worth noting. The definition should not be restricted to pure insiders—that is, persons employed or contracted by the person or entity against which the action is brought—because it might be interpreted to exclude persons with inside or unique information about, say, an industry practice across many firms. Moreover, the definition should follow existing false claims statutes and embrace whistleblowers with “knowledge that is independent of and materially adds” to allegations or transactions that have already been publicly disclosed.284 Such a definition would shut the door on “parasitic lawsuit[s]” where informants “possess no substantive information at all.”285 Similarly, it would prevent situations where whistleblowers

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284. 31 U.S.C. § 3730(e)(4)(B) (2012); CAL. GOV’T CODE § 12652(d)(3)(C)(i)–(ii) (West 2014); 740 ILL. COMP. STAT. 175/4(e)(4)(B) (2012); N.Y. STATE FIN. LAW § 188(7) (McKinney 2013). In perceiving a “threatened relaxation of the public disclosure bars,” members of the defense bar have recommended that the definition be further refined (though not necessarily restricted) to interpret “materially adds” to refer to information “which is derived from inside knowledge, notwithstanding that the information is not inconsistent with that which is already known within the public domain and is necessary to allow suits that have elements which are publicly known.” Houghton et al., supra note 70, at 599.

“did relatively little to no work to uncover the alleged wrongdoing; they simply relied on publicly available information to develop a claim.”

It would also prohibit the kind of nuisance suits currently being filed in Illinois where law firms (not insiders) are mass-compiling complaints based purely on publicly available (not undetected) information.

- Make persons liable for “knowingly” presenting false or fraudulent claims both to obtain money or property and to avoid paying or transmitting money or property to the government. Furthermore, define “knowing” and “knowingly” to include “actual knowledge” as well as “deliberate ignorance” and “reckless disregard” of the truth or falsity of the information. Such a definition reflects the current understanding of liability under all existing false claims statutes. In addition, it reflects the standard to which both taxpayers and tax advisors are already held under the Internal Revenue Code and Circular 230; it thus closes a perverse loophole whereby taxpayers and practitioners would be immune from liability for tax noncompliance under a state’s FCA but liable under substantive tax law at both the federal and state level.

- Make innocent mistakes a defense to liability. Follow the New York FCA and exempt from liability “acts occurring by mistake or as a result of mere negligence.”

- Impose monetary thresholds on claims, both with respect to income or sales of the taxpayer (depending on whether the state wishes to include claims under the state income tax, if any, the state sales tax, or any other tax) as well as on the damages pled. For instance, New York requires the net income or sales of the taxpayer to exceed $1 million and the damages pled to exceed $350,000. Use “gross” income or sales rather than “net” income or sales, because a net figure could be manipulated below the threshold by the kind of ill-

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286. Houghton et al., supra note 70, at 598.
287. See Trachtenberg et al., supra note 29, at 377 (criticizing claims merely reporting information “that was publicly available on the taxpayers’ websites. Arguably, this does not comport with the intent of FCA statutes, which are supposedly designed to give government a tool to uncover fraud that might otherwise go undiscovered”).
288. See supra note 60 and accompanying text.
289. See supra notes 61–62 and accompanying text.
290. See supra notes 52–135 and accompanying text.
291. N.Y. STATE FIN. LAW § 188(3)(b) (McKinney 2013); see also supra notes 78–79 and accompanying text.
292. N.Y. STATE FIN. LAW § 189(4)(a)(i)–(ii). The federal whistleblower law also uses thresholds: more than $200,000 in gross income and more than $2,000,000 in “tax, penalties, interest, additions to tax, and additional amounts in dispute.” I.R.C. § 7623(b)(5) (2012).
gotten tax benefits that the statute is trying to uncover. These thresholds will help prevent nuisance actions, and focus the statute on significant noncompliance.

- Require whistleblowers to file complaints in camera and keep them under seal for a specified period of time.\(^{293}\) Permit the state to request additional time to investigate allegations and to support such motions with affidavits and other submissions, also made in camera.\(^{294}\) Consider requiring whistleblowers to sign a declaration under penalty of perjury that the information contained in the complaint is true, as is the practice under the SEC’s whistleblower program.\(^{295}\) These recommendations will help prevent the unnecessary disclosure of confidential tax return information.

- Require the court to dismiss any action if it is “based on allegations or transactions which are the subject of a pending civil action or an administrative action in which the state . . . is already a party.”\(^{296}\) This recommendation can be thought of as a “government party bar” analogous to the “public disclosure bar,”\(^{297}\) and discourages complaints involving matters the taxpayer is already attempting to resolve or that the state is already investigating. It does not contemplate covering matters under audit, because an administrative audit proceeding does not rise to the level of an “action” and thus the government cannot be considered a “party” to the action. If the state desired, the statute could contain an exception for complaints by whistleblowers possessing unique information not already in the state’s possession that might assist the state in pending administrative actions or litigation. This recommendation will help thwart parasitic actions.

- Require the attorney general to consult with the state tax agency or tax department during its investigation and assessment of the complaint, and prior to filing or intervening in any false claims action.\(^{298}\) This recommendation addresses concerns

\(^{293}\) See supra note 179 and accompanying text.
\(^{294}\) See supra note 180 and accompanying text.
\(^{295}\) See Sullivan, supra note 237 (quoting Sean McKessy, Chief of SEC Office of the Whistleblower, as calling requirement “a control” to help avoid being “inundated with nonsense”). For a discussion of the SEC whistleblower program, see supra note 137.
\(^{296}\) 31 U.S.C. § 3730(e)(3) (2012); see also CAL. GOV’T CODE § 12652(d)(2) (West 2013); 740 ILL. COMP. STAT. 175/4(e)(3) (2012); N.Y. STATE FIN. LAW § 190(9)(a)(i)–(ii).
\(^{297}\) Telephone Interview with Gregory Krakower, senior advisor and counselor to the N.Y. Attorney Gen. (Jan. 20, 2014). For a discussion of the public disclosure bar, see supra note 284 and accompanying text.
\(^{298}\) See supra notes 196–99 and accompanying text.
that FCA actions might proceed without the expertise and experience of state tax officials.

• If the subject matter of the complaint is already under review in the state’s tax department, require the attorney general and tax department to decide jointly whether to proceed with the action and, if so, whether it should proceed as an administrative or judicial action. If the state decides that the attorney general should prosecute the action, the administrative action would be stayed until resolution of the judicial action. In 2013, a bill in the Illinois Assembly proposed such a procedure for transforming a false claims complaint from a tax administrative action into a judicial action. This recommendation further addresses concerns that FCA actions might proceed without the expertise and experience of state tax officials.

• If the jurisdiction wished to rely even more heavily on its tax department than the attorney general to process FCA complaints, it could authorize the tax department to take over primary responsibility for investigating the allegations. It could further provide the tax department a right of first refusal to process the allegations through tax administrative channels before permitting the attorney general to undertake a judicial proceeding. And it could give the tax department additional discretion in determining whether the complaint should proceed at all, effectively giving it veto power.

• The statute should include an explicit expectation that the state will communicate with the whistleblower throughout its investigation, assessment, and prosecution of complaints. In order to ameliorate concerns over undue disclosure of taxpayer and tax return information, the state should immediately enter into a confidentiality agreement with the whistleblower similar to a “contracts for services” agreement described in IRC section 6103(n). In addition to preserving the confidentiality protections of defendant-taxpayers, this recommendation permits the state to leverage a whistleblower’s knowledge and information and to conduct sufficiently thorough investigations.

• If the state declines to prosecute the action and the qui tam plaintiff decides to conduct the action, grant the court discretion in sealing or unsealing the complaint (and have it served on the defendant). Alternatively, authorize the court to seal or unseal the complaint (and have it served on the defendant) if either the state or the qui tam plaintiff prosecutes the

299. See supra notes 42–47 and accompanying text.
300. See infra notes 376–80 and accompanying text.
action. Direct the court to keep the complaint sealed in the event neither the state nor the qui tam plaintiff prosecutes the action. These recommendations—subject to the jurisdiction’s rules respecting case files as public records—will help prevent the unnecessary disclosure of confidential tax return information.

• Upon declining to prosecute an action, a jurisdiction might consider permitting the state to make a motion to transform the action into an administrative proceeding (run through the tax department) before giving the whistleblower a chance to assume responsibility for prosecuting the action. If the motion is granted, the state would serve the taxpayer with the complaint, provide the taxpayer an opportunity to review the allegations contained in the complaint, and give the taxpayer a chance to enter into the regular tax administration process. The original whistleblower would be entitled to an award for information that led to the collection of proceeds recovered in the action or in settlement of the action. If the motion is not granted, the state could still submit a motion for dismissal of the action. This recommendation allows the state to pursue tax noncompliance that, in its estimation and in consultation with the state tax department, does not meet the requirements of a false claims action but conflicts with the state’s interpretation of the tax law. It also diminishes the chance for unnecessary disclosure of confidential taxpayer information, and avoids the expense of litigation for all parties.

• If the state declines to prosecute the action, permit it to move for dismissal of the action or to settle the action with the defendant notwithstanding the objections of the person initiating the action, provided that the person is provided an opportunity to be heard. These recommendations will help, respectively, prevent nuisance actions and restrict disclosure of confidential tax return information.

• If the action proceeds to litigation, allow the court to impose limitations on the whistleblower’s participation in the litigation either upon a showing by the state that such participation would “interfere with or unduly delay the prosecution of the case, or would be repetitious or irrelevant,” or upon a showing by the defendant that the action would “be for purposes of harassment or would cause the defendant undue

301. See supra note 181 and accompanying text.
302. See supra notes 182–84 and accompanying text.
303. See supra note 185 (quoting N.Y. STATE FIN. LAW § 190(5)(b)(iii) (McKinney 2013)).
These recommendations will help prevent nuisance actions and restrict unnecessary disclosure of confidential tax return information.

- If the qui tam plaintiff prosecutes the action, courts should craft protective orders prohibiting the plaintiff from disclosing the defendant’s tax return information. To achieve the same end, the statute could require qui tam plaintiffs to sign confidentiality agreements upon submitting a complaint. In the event a qui tam plaintiff wished to obtain the defendant’s tax return information during the course of litigation, the plaintiff should be required to obtain approval from the attorney general before submitting a motion to compel disclosure. These recommendations will help prevent the unnecessary disclosure of confidential tax return information.

- If the defendant prevails in a FCA action and if the court further finds that “the claim of the person bringing the action was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment,” the court should award the defendant reasonable attorney’s fees and expenses. If the jurisdiction has been experiencing particularly troublesome nuisance suits, as in Illinois, it could also enact additional penalties to discourage such actions.

- If, after adopting the above statutory recommendations to reduce the prevalence of nuisance suits, a jurisdiction wishes to take additional precautions against frivolous actions, it might consider the proposal contained in a 2013 Illinois Assembly bill. In response to a spate of frivolous tax-related suits filed under the Illinois FCA, the bill would have given the state attorney general sole authority to prosecute tax-related matters originating under the false claims statute. Stated differently, it prohibited qui tam plaintiffs from prosecuting tax claims under the state’s FCA. If a state wished to pursue a similar prohibition (which, under a properly drafted and implemented false claims statute, would not be needed to address the problem of nuisance suits), it might consider as an alternative removing tax claims altogether from being brought under the state’s FCA, while simultaneously enacting

304. See supra note 186 and accompanying text (quoting 740 ILL. COMP. STAT. 175/4(c)(2)(D) (2012)).
305. See supra note 187 and accompanying text.
306. See supra note 214 (quoting N.Y. STATE Fin. LAW § 190(6)(d)).
307. See supra notes 40–51 and accompanying text.
308. See supra note 215 and accompanying text.
309. For a description of the bill and the suits that motivated it, see supra notes 40–51 and accompanying text.
a standalone tax whistleblower statute similar to IRC section 7623.310

- Keep whistleblower awards sufficiently high. In an ideal world, we want whistleblowers to report misconduct internally within organizations that have instituted robust informant processes and protections.311 But in the event a whistleblower’s internal reporting is ignored or disregarded by the whistleblower’s organization (as was the case with Bradley Birkenfeld312), sufficiently high awards could induce external reporting of otherwise meritorious claims and “provide incentives for [whistleblowers] to incur the risks and costs associated with an action.”313 For the same reasons, if a defendant is found liable under a false claims statute, the court should award reasonable expenses and attorney’s fees connected to “a civil action brought to recover any such penalty or damages.”314

- Keep penalties sufficiently high on defendants found liable under false claims statutes. These penalties include treble damages based on total damages incurred because of the defendant’s actions as well as civil penalties for each false claim.315 Stiff penalties can serve as a deterrent for “knowing” violations of a state’s FCA and, along with bad publicity and reputational harms, can induce taxpayers and advisors to rethink the inputs that influence the taxpayer’s compliance calculus.316 Finally, it should be noted that robust

310. For discussion of such an alternative, see infra notes 351–88 and accompanying text.

311. For discussion of such internal procedures, see infra notes 320–48 and accompanying text.

312. See supra notes 1–17, 228, 234 and accompanying text.

313. Bucks, supra note 198, at 288. Currently, FCAs provide largely similar award ranges, though with some notable variation. See 31 U.S.C. § 3730(d)(1)–(3) (2012) (providing 15–30% if state prosecutes action and up to 10% for less substantial contributions, 25–30% if whistleblower prosecutes action, and discretionary reductions if whistleblower “planned and initiated” violation); CAL. GOV’T CODE § 12652(g)(2)–(3) & (5) (West 2014) (providing 15–33% if state prosecutes action, 25–50% if whistleblower prosecutes action, and discretionary judicial reductions if whistleblower “planned and initiated” violation); 740 ILL. COMP. STAT. 175/4(d)(1)–(3) (2012) (awarding between 15–25% if state prosecutes action and up to 10% for less substantial contributions, 25–30% if whistleblower prosecutes action, and discretionary judicial reductions if whistleblower “planned or initiated” violation); N.Y. STATE FIN. LAW § 189(3); see also supra notes 273–75 and accompanying text.

314. N.Y. STATE FIN. LAW § 190(b); see also supra notes 1–17, 228, 234 and accompanying text.

315. See supra note 69.

316. See Ventry, supra note 245, at 376–82; see also supra notes 273–75 and accompanying text.
whistleblower award programs do not correlate with higher rates of employees reporting out misconduct (in search of a potential award) versus reporting internally.317

- Include strong anti-retaliation measures and equally strong relief from retaliation. Forms of relief already contained in FCAs include: injunctions to restrain discrimination; reinstatement to the same or equivalent position and seniority status; reinstatement of full fringe benefits; at least two times back pay plus interest; and compensation for special damages sustained as a result of the discrimination (including litigation costs and attorney’s fees).318 Beyond protecting whistleblowers from reprisal, robust anti-retaliation provisions can help employers. To the extent employers respond to the statute by evaluating current whistleblower procedures and instituting programs that effectively intake and process internal reporting of misconduct—and, that further assess and respond to that misconduct and recognize the organizational contribution of whistleblowers—companies can experience fewer employees reporting out misconduct, less reputational harms, less litigation, and a culture of compliance built on trust and respect.319

B. Creating an Organizational Culture of Compliance with Internal Whistleblower Procedures

Some members of the defense bar have responded to the proliferation of tax whistleblower actions and statutes with constructive advice to employers. They offer practical and specific suggestions designed to assess, address, manage, and reduce risks associated with tax whistleblower laws. In the words of two commentators, it “behooves” tax executives and compliance officers “to understand the applicable statutory [whistleblower] provisions . . . to confirm that their companies’ processes and procedures for handling whistleblower activity satisfy core legal requirements; and perhaps most critically, to adopt best practices to mitigate the risks associated with tax whistleblowers.”320 These recommendations emphasize not only managing whistleblower activity but also rewarding

317. See NWC, supra note 228, at 5 (“The existence of a qui tam whistleblower reward program has no impact on the willingness of employees to internally report potential violations of law, or to work with their employer to resolve compliance issues.”).

318. See, e.g., 31 U.S.C. § 3730(h); CAL. GOV’T CODE § 12653(a); 740 ILL. COMP. STAT. 175/4(g); N.Y. STATE FIN. LAW § 191.

319. For the benefits of a culture of compliance, see Part IV.B. and supra notes 232–36 and accompanying text.

320. Dolan & McCormally, supra note 70, at 1537; see also PwC REPORT, supra note 235, at 24 (delineating “best practice tips” for internal whistleblower programs).
whistleblowers for reporting misconduct as part of creating an organizational culture of compliance.\textsuperscript{321} Moreover, they recognize that the combination of substantive regulation and responsive internal controls can alter compliance norms within organizations and at the same time improve the long-term health of firms, an insight that tax scholars have made in the context of corporations adopting a new tax shelter compliance norm in the wake of the Sarbanes-Oxley Act of 2002.\textsuperscript{322}

1. Assessing and Managing Tax Whistleblower Risk

“A first crucial step,” a group of practitioners recently suggested, “is to undertake a review of past practice and future compliance determinations in light of the new risk environment created by” tax whistleblower litigation.\textsuperscript{323} Such a review would involve assessing procedures for reporting misconduct internally, including fulfilling Sarbanes-Oxley requirements for instituting processes to handle whistleblower allegations and to maintain the confidentiality of whistleblowers.\textsuperscript{324} Central to this obligation is establishing an ethics or whistleblower hotline. Beyond generally assessing whistleblower procedures, in-house tax and accounting departments “should confirm that their company’s ethics reporting system can deal effectively with tax matters.”\textsuperscript{325}

Once instituted, employees throughout the organization should receive regular training in how to handle and resolve internal reports of misconduct. The first order of business should be reminding all employees to avoid misconduct themselves by requiring them to acknowledge and certify adherence to a company’s code of ethics or code of conduct.\textsuperscript{326} Employees should be further advised of their responsibility to report observed misconduct internally and of the various avenues for confidentially in alerting the company of perceived wrongdoing. Within tax departments, all personnel should receive periodic training of, at a minimum, their ethical responsibilities under a company’s code of conduct as well as under Circular 230 and the IRC. This training should cover “every employee’s right and, indeed, obligation to raise questions . . . confidentially via the SOX/ethics hotline” or through in-person conversations with supervisors and the chief tax officer (CTO); “the right against retaliation” for reporting observed misconduct; and, finally, “the company’s commit-
ment to and procedures for correcting errors . . . and making disclosures.\textsuperscript{327}

Instituting whistleblower procedures and educating employees as to proper processes can lay the groundwork for creating an open and participatory culture of compliance. Proper implementation of the procedures is critical to animating a policy of best practices to mitigate and manage risks associated with tax whistleblowers. First and foremost, employers “should endeavor to establish an ethos of professionalism and compliance that encourages employees to ask questions about transactions or other issues that might otherwise become the subject of an external whistleblower claim.”\textsuperscript{328} Within a company’s tax department, moreover, the leadership “should build a culture of trust and respect by emphasizing that if any member of the tax department staff has concerns about a transaction or other matter, then the CTO [chief tax officer] himself has concerns.”\textsuperscript{329} To this end, the CTO should engage staff members directly on tax strategies, particularly those involving “unsettled” or innovative areas of the law. The idea is to “demystify tax,” not just with respect to procedures within the tax department but also with respect to how tax planning and compliance is perceived and understood among senior management and the audit committee.\textsuperscript{330}

A final—and crucial—component of implementing effective whistleblower procedures involves how companies respond to reported misconduct. “Don’t make matters worse,” a thoughtful commentary recently advised, and take every measure to “avoid actual or perceived retaliation.”\textsuperscript{331} Indeed, retaliating against whistleblowers “misses the point about why the whistleblowing occurred—possible misconduct—and can compound the reputational risk associated with whistleblowing.”\textsuperscript{332} It is also illegal,\textsuperscript{333} and can result in costly litigation and high-dollar settlements. Thus, employers should internally evaluate, reinforce, and publicize the company’s existing protections against retaliation. Furthermore, they should emphasize to employees that even in an open and transparent environment, any perceived slight or hint of retaliation—however seemingly innocuous or unintended—could be the basis for a cause of action.
against the company. Supervisors and managers, in particular, “should be taught to welcome employee questions openly and respectfully, to affirm employees’ right against retaliation, to act expeditiously in addressing concerns, [ ] to document and communicate resolution of the matter both to management and affected employees,” and to communicate clearly an “employee’s right to escalate the matter within the company.”

2. Reducing Tax Whistleblower Risk

Furthering an open and participatory culture of compliance will, in itself, help reduce risks associated with tax whistleblowing. But additional measures should be considered. First, companies could evaluate employees (and reward them, if appropriate) on how they respond to whistleblower reports and concerns. In particular, they could assess “how well [employees] foster the company’s culture of compliance and, specifically, how well they handle any matters falling within the ambit of the whistleblower statute.”

Second, companies could seek advance guidance from tax authorities on “unsettled” areas of the law or on specific tax positions and transactions. At the federal level, they could take advantage of a number of pre-filing and dispute resolution programs while at the state level, they could “consider using state advisory opinion and private letter ruling processes to obtain written guidance when there are gray areas of law.”

Third, tax departments might consider modifying their policies of making regular disclosures to the tax authorities in the event such adjustments could “mitigate the risks associated with whistleblower activity.” Pursuing “defensive disclosure of information” to state or federal tax agencies could reduce potential economic exposure under state-level

334. See Dolan & McCormally, supra note 70, at 1541 (“[I]f an employee has raised concerns about a transaction or other matter . . . the company must remain sensitive to how any subsequent transfer or any aspect of an employee’s performance review (that is, raise, bonus, or promotion decision) might be interpreted by the employee.”).

335. Id. at 1543–44.
336. Id. at 1544.
339. Gustafson et al., supra note 70, at 56.
340. Dolan & McCormally, supra note 70, at 1544.
341. Id.
NCAs as well as under IRC section 7623, both of which base awards on how much the whistleblower “substantially contributed” to the action.\textsuperscript{342} Adopting a strategy of defensive disclosure could also “reinforce the company’s credibility,” strengthen its relationship with tax authorities, and “underscore its commitment to transparency and compliance.”\textsuperscript{343}

3. Ameliorating Future Risk by Managing Current Risk

In the event that a company establishes the validity of an internal whistleblower report alleging misconduct, it might consider several restorative courses of action. First, it could voluntarily disclose the misconduct to tax authorities in a good faith attempt to reveal and remedy the misconduct and perhaps limit liability and penalties. In fact, some states facilitate such a preemptive move with voluntary disclosure programs. New York, for example, has established a voluntary disclosure and compliance program that provides for penalty abatement, minimum statutory interest, and a chance to qualify for a limited look-back.\textsuperscript{344}

In the context of state sales and use taxation, where a company may be vulnerable to a class action lawsuit due to overcollecting tax from consumers,\textsuperscript{345} two remedial options are worth considering. First, the company could notify its customers of the overcollection and of their right to request a refund from the state.\textsuperscript{346} For another option, the company might choose to “make its customers whole by repaying the overcollected tax and seeking a refund itself.”\textsuperscript{347} This second alternative has the benefit of potentially staving off expensive, frivolous class action suits as well as reinserting “the substantive tax question back in the traditional administrative process” where expert administrators rather than plaintiffs’ lawyers and the uncertainty of the judicial process determine the company’s proper tax treatment.\textsuperscript{348}


343. Dolan & McCormally, supra note 70, at 1544.

344. See Gustafson et al., supra note 70, at 57. For information on New York’s voluntary disclosure program, see N.Y. STATE DEP’T OF TAXATION AND FIN., VOLUNTARY DISCLOSURE AND COMPLIANCE PROGRAM—GENERAL PROGRAM INFORMATION (Sept. 19, 2012), http://www.tax.ny.gov/enforcement/vold/program_info.htm.

345. For a discussion of these circumstances, see supra notes 48–51 and accompanying text.

346. See Gustafson et al., supra note 70, at 56.

347. Id. at 57.

348. Id.
standalone whistleblower statutes as an alternative to qui tam for tax. 349

Presumably, the appeal of removing qui tam plaintiffs from participating in state tax enforcement involves the perceived benefits of fewer nuisance suits as well as assurances that tax experts (rather than popularly-elected attorneys general with no tax expertise) will investigate and evaluate tax whistleblower allegations. Keeping tax claims within traditional tax administration processes and procedures—that is, in familiar territory and under conditions over which taxpayers and their tax advisors can exert some control—also contributes to the desire to cut out qui tam plaintiffs from the whistleblower process as early as possible. 350

While a standalone tax whistleblower statute could further some of these goals—reducing frivolous suits, guaranteeing expert review of tax claims, and restricting the participation of qui tam plaintiffs after submission of a whistleblower complaint—a properly drafted and implemented false claims statute (as discussed throughout this Article and summarized in Part IV.A) could just as readily achieve these aims. 351 Moreover, standalone tax whistleblower statutes suffer from their own shortcomings, including a lack of funding and staffing; significant delays in processing claims; and protecting the confidentiality of tax return information without fatally interfering with the investigation, evaluation, and resolution of whistleblower allegations.

The remainder of this Part uses the federal tax whistleblower statute, section 7623 of the Internal Revenue Code, as the best current model of a standalone tax whistleblower program. 352 It discusses the program’s successes as well as its failures. It offers a number of suggestions for states wishing to leverage inside information pertaining to tax noncompliance

349. See Wetzler, supra note 174, at 170 ("An alternative to a whistleblower program operated by the attorney general would be a program within the [tax] department. The federal tax whistleblower program, for example, is operated by the IRS outside the purview of the federal False Claims Act.").

350. See supra note 348 and accompanying text; see also supra notes 171–243 and accompanying text (discussing efforts by elements of defense bar to rely solely on traditional tax administration for enforcement); supra notes 244–81 and accompanying text (discussing efforts by elements of defense bar to control and influence tax administrative process).

351. Indeed, while I am not agnostic as to whether states should adopt tax whistleblower programs (they should), I have no preference as to whether such a program should be run through a state’s FCA or a standalone whistleblower statute. States should adopt whichever alternative best meets their jurisdiction’s needs and challenges. Other authors are less ambivalent. See, e.g., Franziska Hertel, Qui Tam for Tax?: Lessons from the States, 113 COLUM. L. REV. 1897, 1898 (2013) (concluding that “state schemes permitting qui tam provide the most effective enforcement mechanism against tax fraud” compared to IRS whistleblower program).

352. Several states have enacted their own tax whistleblower statutes, though not all of them are operational and none are nearly as robust as the IRS program. See, e.g., CAL. REV. & TAX. CODE § 7060 (West 2014); CAL. REV. & TAX. CODE § 19525; FLA. STAT. § 210.18(5)(b) (2015); FLA. STAT. § 210.18(11); FLA. STAT. § 213.30; KAN. STAT. ANN. § 79-3421 (2013); OR. REV. STAT. § 314.855 (2013). I will discuss two of these programs, both in California, in Part IV.D.
by deploying a standalone statute rather than a false claims statute that covers tax-related actions. And, it concludes by indicating that some states—particularly California—are closer to implementing a robust whistleblower statute than they might think.

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By most accounts, the federal tax whistleblower program is a success story. Ineffective and moribund as recently as 2006, Congress breathed life into section 7623 of the IRC with significant amendments to the program. Among other changes, it created a centralized Whistleblower Office within the IRS to process, investigate, and analyze informant submissions and to make award determinations; it defined information that qualified for a whistleblower award as that which assisted the IRS in “detecting underpayments of tax” or “detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or con-

353. An influential 2006 report from the Treasury Inspector General for Tax Administration (TIGTA) concluded that the program suffered from ineffective decentralized management, no standardized processing of informant tips or IRS payment of awards, and inefficient processing of claims, examinations, and award determinations. See TIGTA REPORT, supra note 209, at 7. Moreover, whistleblower claims got tied up in administrative and judicial bottlenecks. See supra notes 209–10 and accompanying text. In addition, the program offered paltry awards (if any were paid at all) to whistleblowers. In 1983, the IRS raised the cap on awards from $50,000 to $100,000. U.S. Gov’t Accounting Office, Administrative Changes Could Strengthen IRS’ Claims for Rewards Program iv (1985), available at http://www.gao.gov/assets/150/142661.pdf. The cap remained until 1996, when the IRS increased the ceiling to $2 million and then to $10 million in 2004. IRS Whistleblower Office, supra note 210, at 2. Even with the promise of more lucrative awards, payments to informants were ungenerous and infrequent. Between 1989 and 1998, only 6.6% of claims resulted in payments, while total payments only reached $29.3 million of the $1.45 billion recovered from whistleblower tips (or just 2% of collections). Terri Gutierrez, IRS Informants Reward Program: Is It Fair?, 84 Tax Notes 1203, 1205 (1999). Compared to qui tam payments and collections made under the federal False Claims Act, the record of the IRS informants program is particularly disappointing. Between 1989 and 1998, FCA qui tam recoveries totaled $2.3 billion, with $360 million paid out to informants, for a payout rate of nearly 15.7% (again, compared to only 2% under the IRS program). Civil Div., U.S. Dep’t of Justice, supra note 216. Also, while annual recoveries under the old IRS whistleblower program never topped $100 million, qui tam recoveries under the FCA hit $1.5 billion in 2006. Compare TIGTA REPORT, supra note 209, at 3 (providing IRS whistleblower program figure), with Civil Div., U.S. Dep’t of Justice, supra note 216 (providing figure for qui tam recoveries under FCA). Finally, whistleblowers had little recourse to challenge award determinations either administratively or judicially, losing, in fact, every court case between 1941 and 1998 that sought a redetermination of an award. Gutierrez, supra note 353, at 1205–06. For a fuller account of the pre-2006 history of the IRS whistleblower statute, see Ventry, supra note 245, at 360–68.


355. While the statute provides for investigative powers, the IRS Whistleblower Office does not currently investigate claims, but rather assigns them to appropriate IRS offices for investigation.
niving at the same," and that involved amounts in dispute exceeding $2 million and where the taxpayer had gross income exceeding $200,000 for at least one taxable year in question; and it mandated that whistleblowers be paid between 15% and 30% of the “collected proceeds” resulting from an administrative or judicial action or settlement, with the final award depending upon how much an informant’s submission “substantially contributed” to the detection and recovery of collected proceeds.

Emboldened by the prospect of a standardized and streamlined review of whistleblower claims—as well as sizeable award payments—submissions under the new program skyrocketed, jumping from 50 in 2007, to 377 in 2008, and 472 in 2009. Even more encouraging, amounts collected under the revamped program increased significantly, while amounts paid to whistleblowers rose disproportionately compared to amounts collected, such that the percentage of collections paid to informants multiplied. Over the five-year period between 2008 and 2012, payments to whistleblowers totaled $180.3 million, compared to amounts collected of $1.47 billion, or 12.3% of collections. By comparison, over the ten-year period between 1989 and 1998, payments totaled $29.3 million compared to amounts collected of $1.45 billion, or just 2% of collections. Such data prompted the program’s biggest supporter, and architect of the 2006 amendments, Senator Charles Grassley (R-IA), to declare that “[t]he potential for this program is tremendous, and it’s up to the IRS to continue paying awards and demonstrating to whistleblowers that the process will work and they will be heard and protected.”

In addition to leaps in collections and payments, the IRS whistleblower program has undergone significant improvements in terms of management. In 2012, IRS leadership—which whistleblower practition-

357. Id. § 7623(b)(5)(A)–(B).
358. Id. § 7623(b)(1).
359. See IRS Whistleblower Office, supra note 210, at 7. Submissions declined slightly between 2010 and 2012, but still averaged 356 submissions. These figures only reflect submissions under new section 7623(b) (described in the text) and not section 7623(a), the pre-amendment section that continues to co-exist alongside section 7623(b). The figures further undercount the number of actual “cases” contained within a single submission, which typically include allegations of underpayment pertaining to more than one taxpayer. Id. at 6 n.12. For instance, the IRS Whistleblower Office received 332 submissions under section 7623(b) in fiscal year 2012, identifying 671 taxpayers. Id. at 7.
360. Id. at 17.
361. Civil Div., U.S. Dep’t of Justice, supra note 216. It is important to note that the amount of dollars collected under section 7623 understates actual collections—perhaps by a significant degree—due to the government’s narrow reading of “collected proceeds,” which is used to calculate award determinations. See infra note 373 and accompanying text.
ers and other supporters of the program had consistently charged (not unreasonably) was “holding the whistleblower program back” expressed its commitment to “timely action” on whistleblower submissions, communicating with whistleblowers early and often during the evaluation process, expanding its use of confidentiality agreements with whistleblowers “to obtain a whistleblower’s insights and expertise into complex technical or factual issues,” and generally “improv[ing] the timeliness and quality of decisions as the Service evaluates and acts on whistleblower information.” The Whistleblower Office reiterated these goals while adding a few others. It planned expedited guidance for taxpayers and practitioners, particularly with respect to refining key definitions pertaining to award determinations, including “collected proceeds,” “amounts in dispute,” and a taxpayer’s “gross income.”

363. Jeremiah Coder, GAO Faults IRS Whistleblower Program for Award Delays, TAX NOTES TODAY 2011-19188 (2011) (quoting Dean Zerbe of Zerbe, Fingeret, Frank & Jadav and National Whistleblower Center), available at http://www.taxwhistleblower.com/articles/GAOFaultsIRSWhistleblowerProgramforAwardDelays.pdf; see also id. (quoting Sen. Charles Grassley, “I’m concerned that the IRS management still might have too many opportunities to say ‘no’ to a whistleblower, even when the whistleblower office believes a claim has merit”); id. (quoting Bryan Skarlatos of Kostelanetz & Fink LLP, “[t]here continues to be a sense among some IRS personnel that the whistleblower program is not a good idea.”); id. (summarizing commentary from Erika Kelton of Phillips & Cohen LLP as saying that IRS had demonstrated “institutional resistance to whistleblowers”). For additional practitioner criticism of the program, see infra notes 373–85 and accompanying text.

364. Memorandum from Steven T. Miller, Treasury Deputy Comm’r for Servs. & Enforcement, to Operating Div. Comm’rs, the Chief of Criminal Investigation, and the Director of the Whistleblower Office, IRS Whistleblower Program (June 20, 2012), 2012 TAX NOTES TODAY 121-15, at 1 [hereinafter Miller Memo]. The Miller Memo, as it came to be known, laid out shorter and explicit timelines for processing submissions, including (1) initial claim evaluation by the Whistleblower Office within ninety days, (2) review by subject matter experts within ninety days, and (3) notification of award decisions within ninety days after final determination of collected proceeds. Id. at 2.

365. Id. at 2 (committing IRS to “debriefings” with whistleblowers as “the rule not the exception,” and having an “interaction with a whistleblower during an examination [to] assist in timely and correct resolution of issues”).

366. Id.


368. IRS WHISTLEBLOWER OFFICE, supra note 210, at 12, 15–16. These suggested refinements were meant to spur Congressional action and came on the heels of final regulations promulgated under section 7623 that attempted to clarify “collected proceeds” and “proceeds of amounts collected.” See Treas. Reg. § 301.7623-1(a) (2012).
intake process and assessment of potential whistleblower claims, and strengthening whistleblower protections. For one final example, the Treasury Department sought public comment in December 2012 on proposed regulations providing “comprehensive” guidance on tax whistleblower submissions, administrative procedures on award determinations, additional refinement of key terms used in section 7623, and expanded use of disclosing tax return information “to the extent necessary to conduct whistleblower administrative proceedings.” In other words, the IRS had finally embraced the notion that whistleblowers could “provide valuable leads, and offer unique insights into taxpayer activity.”

Despite these notable advances in the structure and administration of the program, not insignificant problems persist. According to practitioners, the IRS still adheres to an overly restrictive definition of “collected proceeds,” by continuing to exclude tax attributes such as net operating losses as well as foreign bank account reporting penalties and criminal penalties under title 18 of the U.S. Code. In similar fashion, the IRS applies a narrow interpretation for when it must pay out awards based on useful information supplied by a whistleblower. The statute directs the IRS to pay an award if it “proceeds with any administrative or judicial action . . . based on information” provided by a whistleblower, but the IRS has interpreted the directive to apply only to situations where it initiates a new action or expands an existing action and not to where a whistleblower’s information increases the amount that would have been collected in an existing action, an interpretation that practitioners consider “illogical.”

369. IRS WHISTLEBLOWER OFFICE, supra note 210, at 12–13.
372. Miller Memo, supra note 364, at 1; see also Jeremiah Coder, ABA SECTION OF TAXATION MEETING: WHISTLEBLOWER PROGRAM HAS STRONG SUPPORT FROM IRS, 138 TAX NOTES 582, 582 (2013) (summarizing comments by Stephen Whitlock, Director of IRS Whistleblower Office, that IRS whistleblower award program “has strong support among senior IRS executives”).
373. See Jeremiah Coder, IRS WHISTLEBLOWER REGS CONTINUE TO FRUSTRATE PRACTITIONERS, 139 TAX NOTES 250, 250 (2013) [hereinafter IRS Frustrate Practitioners]; Coder, supra note 362, at 33; Jeremiah Coder, FIGHT CONTINUES OVER WHISTLEBLOWER AWARD ELIGIBILITY FOR FBAR PENALTIES, 137 TAX NOTES 1064 (2012).
375. IRS Frustrate Practitioners, supra note 373, at 250 (quoting Erica Brady of Ferraro Law Firm); see also Coder, supra note 362, at 33.
With equal rigidity, the IRS continues to “hid[e] behind section 6103” strictures protecting tax return information from disclosure, not only with respect to communicating with whistleblowers while investigating a submission and building a case against a taxpayer but also in keeping them informed of the status of submissions.\(^{376}\) The government’s overly broad reading of tax return confidentiality under section 6103 means limited use of the “contracts for services” exception under section 6103(n) that permits the government to enter into confidentiality agreements with persons not otherwise authorized to receive information pertaining to taxpayer returns.\(^{377}\) Practitioners believe that the agreements “should be mandated” and “entered into in every case.”\(^{378}\) Even without a mandatory requirement, practitioners rightly observe that the IRS should be able to distinguish between providing a status update on an award determination and disclosing confidential tax return information.\(^{379}\) The obvious point is that section 6103 does not cover every communication, the indisputable conspicuousness of which eludes the IRS and exasperates the program’s biggest supporters, including Senator Grassley, who has pled with the agency to “develop communication guidelines that fit within the privacy restrictions to communicate with whistleblowers at every step. At each of these stages the whistleblower should be given an estimate of the time to the next step and also [be] provided periodic updates as appropriate” regarding claim status.\(^{380}\)

Part and parcel of the government’s suffocating reading of section 6103 is the glacial pace of award determinations.\(^{381}\) More than seven

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\(^{376}\) *Regs Frustrate Practitioners*, supra note 373, at 251.

\(^{377}\) *Id.* Section 6103(n) provides for the disclosure of returns and return information “to the extent necessary in connection with the processing, storage, transmission, and reproduction of such returns and return information, the programming, maintenance, repair, testing, and procurement of equipment, and the providing of other services, for purposes of tax administration.” I.R.C. § 6103(n).

\(^{378}\) *Regs Frustrate Practitioners*, supra note 373, at 251 (quoting Thomas C. Pliske of the Tax Whistleblower Law Firm).

\(^{379}\) *See id.* (quoting Bryan C. Skarlatos of Kostelanetz & Fink LLP, “I think a distinction can be made” in those situations).


years have elapsed since Congress revamped the whistleblower program, yet the time between submission of information to determination of award (if any) still takes “five to seven years and longer.”\footnote{382} There are good reasons why years pass between submission of information to the Whistleblower Office and the payment or denial of an award: the issues involved are complex, murky, and hidden; the submissions are incomplete; and the IRS cannot make an award determination until the taxpayer exhausts all administrative and judicial appeals. But, there are no good reasons why the IRS cannot provide periodic updates on a submission or pay awards on unappealed portions of underpayments. Nor is there any good reason for the IRS to “stonewall[]” an award determination, eventually reject the submission, and then return years later to the information contained in the submission “to pursue leads regarding unpaid taxpayer liabilities free from any claims the whistleblower might have to an award.”\footnote{383} Yet that is exactly what it appears the IRS has been doing with some submissions, a practice for which the Tax Court recently “rebuke[d]” the Whistleblower Office.\footnote{384} “We do not know whether these failures were the result of bureaucratic confusion or ineptitude,” the court wrote, “[w]e do know, however, that the obfuscation surrounding this matter has either been caused or exacerbated by [the government].”\footnote{385}

If a state chose to enact a standalone whistleblower statute as part of its tax enforcement regime, it would need to address some of the same shortcomings that afflict the federal program. These issues—timely processing of submissions, communicating with whistleblowers to leverage knowledge and expertise, and making accurate award determinations without undue delay—are not insurmountable. States can learn from the federal government’s experience in terms of program design, administration, and implementation. The federal experience could also help states determine if they want to run the program through their tax department, attorney general office, or both, a determination that would be influenced by the size and agency location of a particular state’s tax administration apparatus. A state will also have to determine whether it wants to create a new, standalone tax whistleblower office to accompany its standalone stat-

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\footnote{382} IRS WHISTLEBLOWER OFFICE, supra note 210, at 16.
\footnote{384} See Jeremiah Coder, Tax Court Rebukes IRS for Hiding Whistleblower Information, 139 TAX NOTES 851, 851 (2013). According to Coder, one of the most knowledgeable and diligent observers of the IRS whistleblower program, the case was “emblematic of the IRS’s attempts to whipsaw informants by issuing de facto award denials and then later pursuing tax investigations arising from information contained in the whistleblower submissions.” Id. at 852.
ute—with its own staff, office space, and budget—or whether it wants to absorb the new program into existing administrative capacity.

D. The Case of California

Some states are closer than others to implementing a tax whistleblower program. California is such a state. In fact, it already has two tax whistleblower statutes on its books: one under the authority of the Franchise Tax Board (FTB), pertaining to the personal income tax law (PITL) and corporation tax law (CTL); and the other under the authority of the Board of Equalization (BOE), pertaining to the state’s sales and use taxes. Neither program has yet to open for business however.

In 1984, as part of California’s first tax amnesty program, the legislature authorized the FTB to administer a standalone whistleblower statute. Originally enacted as California Revenue and Tax Code section 19273 (located in the PITL) and 26427 (located in the bank and corporation tax laws), the state legislature consolidated the sections in 1993 under section 19525, where the authorization has remained undisturbed and neglected for the last twenty years. From the beginning, the FTB declined to proceed with its authority to administer the program, because (i) it required implementing regulations to establish, and (ii) in its view, the statute did not grant the FTB explicit authority to make payments under the program. Thus, in the eyes of the FTB, it could promulgate regulations to execute the statute, but it would still have no legal authority to pay rewards to whistleblowers. The statutory language reads as follows:

The Franchise Tax Board, under regulations prescribed by the Franchise Tax Board, may establish a reward program for information resulting in the identification of underreported or unreported income subject to taxes [under the Personal Income Tax Law] or [the Corporation Tax Law]. Any reward may not exceed

386. The budget for a standalone office, including personnel, could be allocated through the regular appropriations process or through proceeds of whistleblower collections, in the same way that some states pay for supporting their False Claims Acts. Under California’s FCA, for example, the state is entitled to “a fixed 33 percent of the proceeds of the action or settlement of the claim, which shall be used to support its ongoing investigation and prosecution of false claims made against the state or political subdivision.” CAL. GOV’T CODE § 12652(g)(1)(C)(2) (West 2014). A standalone whistleblower statute could be funded in the same manner.

387. See 1984 Cal. Stat. 5126-42. I am indebted to Doug Powers, Tax Counsel in the FTB’s Technical Resources Bureau, Legal Division, for educating me on the history of the FTB’s standalone whistleblower statute. I am further grateful to an opinion piece by Erika Kelton of Phillips & Cohen that first alerted me to these programs. See Erika A. Kelton, Bridge the Tax Gap: Bringing in the Whistleblowers, CAPITOL WEEKLY (May 6, 2010), http://capitolweekly.net/opinion-bridge-tax-gap-bringing-whistleblowers/ (proposing that California create “an effective tax whistleblower program” by “invigorat[ing]” the “mothballed” FTB and BOE whistleblower programs).

10 percent of the taxes collected as a result of the information provided. Any person employed by or under contract with any state or federal tax collection agency shall not be eligible for a reward provided for pursuant to this section.389

In 2004, the FTB sought the explicit authority it believed it lacked. Through a “Budget Change Proposal” related to “Tax Gap Enforcement Provisions,” the agency requested funding for the “Informant Reward Program.”390 Specifically, the agency asked the legislature “to unambiguously identify that FTB has the sole discretion to determine the amount of each reward paid to an informant” and, furthermore, to “provide a mechanism for FTB to actually pay informants” from taxes collected due to information provided by whistleblowers.391 The legislature failed to act on the request. But in 2010, renewed hope for explicit legislative authorization emerged in the form of a bill introduced by State Assembly member, Hector De La Torre. The proposed bill, modeled closely after section 7623 of the Internal Revenue Code, amended section 19525 by requiring the FTB to establish a reward program for tax whistleblowers and to make any payments from the “collected proceeds of the administrative or judicial action . . . or from any settlement in response to that action.”392 The bill never made it out of committee.

Nonetheless, the statutory scaffolding is in place for California to implement a whistleblower program (indeed, perhaps two such programs). The legislature could fund the program, either by explicit appropriation or through anticipated “collected proceeds” of the program and at the same time grant the FTB express statutory authority to pay rewards under the program, at which point the FTB could promulgate implementing regulations. Alternatively, the FTB could act on its own authority and interpret the statute as already authorizing the agency to pay awards to whistleblowers up to 10% “of [and from] the taxes collected as a result of the information provided.”393 Such an interpretation, already a fair reading of the statute, seems even more reasonable after considering that the analogous whistleblower program pertaining to California’s sales and use taxes—provided for in section 7060 and under the administrative authority of the BOE—contains an explicit provision stating that rewards paid under the program “shall be paid from amounts appropriated by the Leg-

393. CAL. REV. & TAX. CODE § 19525.
islature for that purpose,” while section 19525 contains no such limiting directive.

California’s FTB and BOE also run hotlines for, respectively, “tax fraud” and “tax evasion,” with the FTB linking to its “tax fraud” webpage from its “tax gap” webpage (which describes the state’s $10 billion tax gap). Both agencies alert would-be whistleblowers on their webpages that they “do not offer rewards for reporting this information.” Further, the BOE advises its audit personnel that although its “reward program” is not currently funded nor otherwise paying out awards, individuals might still offer information “that would enable the Board to recover sales tax revenues.” In these circumstances, auditors are instructed to say that no funding currently exists to pay awards, but they are also encouraged “to obtain such information by appealing to the person’s sense of duty as a good citizen.”

As we have seen, civic duty can motivate citizens to blow the whistle on tax noncompliance. But additional incentives to contribute to tax enforcement efforts may be necessary, and rewarding whistleblowers with a portion of the monies they help put back in state coffers might do the trick. Paying whistleblowers for inside, unique information would also reinforce the policies behind “hotlines” that encourage citizens to report tax noncompliance. And if policymakers in California—or in other states for

394. CAL. REV. & TAX. CODE § 7060(c). While the first paragraph of section 7060 is nearly identical to section 19525 (though pertaining to sales and use taxes), section 7060 contains additional provisions directing the BOE to provide a report to the legislature once the program is up and running that details: (i) the number of written and oral whistleblower submissions made to the BOE within its first two years of operation, (ii) the “amount of additional taxes and penalties assessed and collected as a result of this program and the amount of rewards distributed,” and (iii) the “administrative costs incurred in implementing and operating this program.” CAL. REV. & TAX. CODE § 7060(b).


399. Id.

400. For studies indicating that whistleblowers are motivated more by principle than money, see supra notes 223–32 and accompanying text.
that matter—preferred the qui tam approach to a standalone statute, “re-
moving a single sentence from the existing False Claims Act” that bars tax claims could immediately establish an avenue for whistleblowers to uncover tax cheating, assist (if appropriate) in the prosecution of the case, and shrink the state’s tax gap.

V. Conclusion

State tax agencies are outgunned in the fight against overaggressive tax avoidance and evasion. “Public participation,” either through false claims statutes or standalone whistleblower statutes, “can constructively contribute to the administration of taxes” by uncovering abuse and fraud that state governments may never detect or that they would detect only after considerable revenue loss and misdirected administrative resources. Authorizing citizens to bring tax claims under FCAs would be “good for tax administration.” It would help rebalance insidious information asymmetries between taxpayers and tax agencies, while closing the persistent tax gap. Moreover, the “evidence is overwhelming” that the federal FCA “has proven its value in other areas [besides taxation] and has helped government recover billions that would otherwise have been lost to fraud. There is every reason to think,” knowledgeable observers have opined, “that it will have a comparable impact in the tax area.”


402. See CAL. GOV’T CODE § 12651(f) (West 2014) (“This section does not apply to claims, records, or statements made under the Revenue and Taxation Code.”).

403. Authorizing tax claims under a false claims act would be particularly appropriate in the case of California, where its FCA already commands that the law “be liberally construed and applied to promote the public interest.” CAL. GOV’T CODE § 12655(c).

404. Bucks, supra note 198, at 287.

405. Whistleblowers can be particularly helpful in uncovering taxpayer abuse in areas with less rigorous reporting requirements, such as in the area of partnerships. See Cara Griffith, Are States Adequately Auditing Real Estate Partnerships?, 65 STATE TAX NOTES 119, 122 (2012) (writing, in context of real estate partnerships and New York’s FCA, “New York has an added advantage if it pursues potential tax delinquency by partnerships”).


same can be said of standalone tax whistleblower statutes, such as the IRS whistleblower program, which, despite its shortcomings,408 has brought in close to $1.5 billion over the last five years,409 spawned a vibrant and expert tax whistleblower bar,410 and significantly altered the compliance and risk calculus for taxpayers.

A properly drafted and implemented tax whistleblower program, run either through a state’s FCA or under a standalone statute, could address and overcome critics’ primary concerns pertaining to tax whistleblowers (including the proliferation of nuisance suits, undue disclosure of tax return information, and bypassing expert tax administrators) and bring to bear the invaluable knowledge of insiders on state tax enforcement efforts.

enhancements to the statute in 1986. Id.; see also CIVIL DIV., U.S. DEP’T OF JUSTICE, supra note 216.

408. See supra notes 373–85 and accompanying text.

409. See IRS WHISTLEBLOWER OFFICE, supra note 210, at 17.

410. See Hertel, supra note 351, at 1926 (“Since the institution of the current IRS whistleblower program, the number of plaintiffs’ attorneys specializing in the area of tax law has risen rapidly, and there is no reason to suspect that the tax attorneys’ bar will not grow into a similarly specialized and expert body as the plaintiffs’ bar as a whole.”); Ventry, supra note 244, at 461–62 (noting, in 2008, 15%–20% increase in size of tax whistleblower bar in two-year span since Congress revamped IRS whistleblower law).
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LOVING v. IRS: THE TREASURY DEPARTMENT’S AUTHORITY TO REGULATE TAX RETURN PREPARATION CONDUCT OF COMMERCIAL RETURN PREPARERS

LAWRENCE B. GIBBS

INDIVIDUAL taxpayers filed almost 143.6 million Federal Income Tax returns in 2011.1 Paid preparers prepared a majority of these returns.2 Paid preparers fall into two categories: regulated preparers (including certified public accountants, attorneys, enrolled agents, and enrolled actuaries) and unregulated commercial preparers. Regulated preparers prepared almost 36 million individual returns in 2011; unregulated commercial preparers, over 42 million returns.3 The Internal Revenue Service (IRS) has long and repeatedly exercised authority to regulate the tax return preparation conduct of regulated preparers.4 The District Court for

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2. See Nina E. Olson, More Than a ‘Mere’ Preparer: Loving and Return Preparation, 139 TAX NOTES 767, 769 n.14 (2013) (citing data from the IRS COMPLIANCE DATA WAREHOUSE, INDIVIDUAL RETURNS TRANSACTION FILE AND RETURN PREPARERS DATABASE from Tax Year 2011 to indicate that 78,088,554 returns—or more than 54% of the 143.6 million returns—were prepared by paid preparers).

3. See id. According to Olson, the IRS data indicates that of the 78,088,554 returns prepared by paid preparers, 35,934,027 (or 46%) were prepared by regulated preparers (attorneys, certified acceptance agents, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and state regulated preparers) and 42,154,527 (or 54%) were prepared by unregulated commercial preparers (that Olson defines as “individuals with preparer tax identification numbers who did not list a profession when registering with the IRS”). See id.

4. Circular 230 represents the authority by which the IRS has regulated the conduct of tax practitioners for over ninety-two years. See Practice Before the Internal Revenue Service, 31 C.F.R. pt. 10 (1921). For at least sixty-one years, Circular 230 has required practitioners to exercise due diligence in preparing or assisting in the preparation of, approving, or filing tax returns. See id. § 10.22. For at least nineteen years, Circular 230 has precluded a practitioner from charging a contingent fee for preparing an original tax return or for any tax advice rendered in connection with a position taken or to be taken on an original tax return and also has provided standards with respect to tax return positions and for preparing and filing or signing returns. See T.D. 8545, 1994-2 C.B. 415, 419–20 (1994) (amending sections 10.28 and 10.34 of Circular 230). In addition, for at least twenty-six years prior to the 2011 issuance of the regulations that are the subject of the litigation in the Loving case, Circular 230 has contained a specific grant of authority to prepare income tax returns to anyone who wished to do so. See 31 C.F.R. § 10.7(c).
the District of Columbia, in _Loving v. IRS_, held the IRS had no authority to regulate such conduct of unregulated commercial preparers and enjoined the IRS from enforcing the 2011 regulations that purported to do so. For reasons I will explain, I respectfully disagree with the district court’s holding and its analysis. If the district court’s decision is affirmed on appeal and the IRS is unable to regulate the conduct of unregulated commercial tax return preparers, I believe Congress will see the need to take steps to enable the IRS to do so.

The district court in _Loving_ based its decision primarily on its analysis of the language of the statutory authority that enables the IRS to regulate the conduct of tax practitioners under Circular 230. The statutory authority for Circular 230 is an 1884 statute, passed almost 130 years ago. The 1884 language was re-codified in 1982 as section 330 of title 31 of the United States Code, but the legislative history makes it clear there was no intention to change the meaning of the 1884 statute at the time of the 1982 re-codification.

After reviewing the language of the original 1884 statute and that of the 1982 re-codification, the district court in _Loving_ held that Congress intended to draw a bright line between the authority of the IRS to regulate the conduct of tax practitioners who advise and assist taxpayers in preparing their tax returns to be filed with the IRS and the conduct of tax practitioners who advise and assist taxpayers in dealing with the IRS on return-related issues after the returns are filed. The court held that the IRS has authority to regulate the conduct of tax practitioners who defend positions taken in returns after the returns are filed, but the IRS has no authority to regulate the conduct of unregulated commercial preparers who prepare the returns taking such positions before the returns are filed.

The 1884 statute was a rider on an annual appropriations bill to fund the War Department. The rider reflected congressional concerns about the unscrupulous conduct of representatives that were soliciting, advising, and assisting soldiers who were making claims against the Treasury Depart-

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6. Id. at 80–81 (“Defendants lack statutory authority to promulgate or enforce the new regulatory scheme for ‘registered tax return preparers’ brought under Circular 230 by 76 Fed. Reg. 32, 286.”). The _Loving_ court then granted the plaintiffs’ request to “permanently enjoin Defendants from enforcing this IRS registration scheme against tax-return preparers.” Id. at 80. See generally 76 Fed. Reg. 32, 286 (June 3, 2011) (regulating tax return preparation conduct of unregulated commercial preparers).
7. See _Loving_, 917 F. Supp. 2d at 74–75.
8. See Act of July 7, 1884, ch. 334, 23 Stat. 236, 258–59 (1884); see also Treas. Dep’t Circular 230, 1921-4 C.B. 408 (1921) (citing aforementioned act).
10. _Loving_, 917 F. Supp. 2d at 75, 79 (“Congress could well desire that those who represent taxpayers in examinations or appeals be more closely regulated than those who merely prepare returns. . . . [T]he Court concludes that together the statutory text and context unambiguously foreclose the IRS’s interpretation of 31 U.S.C. § 330.”).
ment for compensation for back pay or for lost property after the Civil War. Specifically, Congress was worried about unreasonable fees being charged to soldiers by the attorneys, claims agents, and other persons. The 1884 rider gave the Secretary of the Treasury authority to prescribe rules to regulate the conduct of representatives of the claimants before the Treasury.11

The concerns expressed in passing the 1884 rider piqued my curiosity because out of the 143.6 million individual income tax returns filed in 2011, about 80% involved claims by taxpayers for refunds.12 About 80% of the annual returns prepared by paid preparers (regulated and unregulated) in 2011 also involved refund claims.13 If Congress in 1884 was worried about regulating the conduct of those assisting claimants who were pursuing Civil War claims against the Treasury, I was curious why the district court in *Loving* felt that Congress, when it re-codified the law in 1982, would be any less concerned about the IRS regulating the conduct of unregulated commercial preparers. This interpretation seemed especially noteworthy, given the fact that those commercial preparers sometimes charged unreasonably high fees for incompetent or fraudulent tax advice, resulting in excessively high refunds.14

I realized, of course, that about 20% of taxpayers annually file balance due income tax returns instead of refund returns. Over the last forty years, the non-stop changes in, and the enormous complexity of, our tax laws have driven more and more taxpayers to use preparers to assist them in properly filing their returns. Over the same period, tax shelters and other overly aggressive tax planning transactions have made the IRS regulation of return preparation much more important to deter tax non-compliance. These trends are well-known. The point is that return preparers can help taxpayers claim all the tax benefits to which they lawfully are entitled, or return preparers can help taxpayers claim tax benefits to which they are not entitled, regardless of whether taxpayers wind up getting a refund or having to pay a balance due. Therefore, although it is easier to analogize today’s tax refund claims to the Civil War claims of the

12. See Olson, supra note 2, at 776 n.78 (citing data from IRS Compliance Data Warehouse, Individual Returns Transaction File).
13. See id. at 776 n.79.
14. See, e.g., Brief for Amici Curiae National Consumer Law Center and National Community Tax Coalition in Support of Defendants-Appellants and Arguing for Reversal of the District Court, *Loving* v. IRS, 742 F.3d 1013 (D.C. Cir. 2014) (No. 13-5061), 2013 WL 1386247 (discussing concerns over incompetent and even fraudulent conduct of some unregulated commercial tax return preparers); see also id. (expressing concern about unreasonable tax preparation fees charged to taxpayers by some commercial preparers); id. at 6 (“[L]ow-income consumers face tax preparation fees that are already very high, and inflated, in many instances. Mystery shopper testing, discussed below, has documented preparation fees of $400 or $500 in some cases. Government enforcement actions also have revealed fees up to $1,000 for as little as 15 minutes worth of work.”).
nineteenth century, it was hard for me to believe a court would conclude that Congress might intend to distinguish between the authority of the IRS to regulate the conduct of tax return preparers depending upon whether the returns they prepared were refund or balance due returns.

As I helped prepare an amicus brief of former IRS Commissioners supporting the government’s position on appeal in the Loving case,15 I reviewed the district court’s decision as well as the appellate briefs of the various parties.16 I was impressed by the remarkable abilities of the district court and the various advocates to carefully parse, and reach differing conclusions about, the meaning of statutory phrases in section 330 of title 31 of the United States Code.17 The statute in section 330(a)(1) gives the Treasury the authority to “regulate the practice of representatives of persons before the Department of the Treasury,” and section 330(a)(2)(D) also gives the Treasury the authority to require the representatives to demonstrate “competency to advise and assist persons in presenting their cases.”18

The government in the Loving case found ambiguity in the scope of the Treasury’s authority under section 330(a) because the phrase authorizing the Treasury to “regulate the practice of representatives” did not define what constituted “the practice of representatives.”19 The district court, however, found certainty in the scope of the Treasury’s authority under section 330(a), because the district court interpreted the grant of authority to “regulate the practice of representatives of persons before the Department of the Treasury” in conjunction with the Treasury’s authority to determine the representative’s “competency to advise and assist persons


17. 31 U.S.C. § 330(a) provides:
(a) Subject to section 500 of title 5, the Secretary of the Treasury may—
(1) regulate the practice of representatives of persons before the Department of the Treasury; and
(2) before admitting a representative to practice, require that the representative demonstrate—
(A) good character;
(B) good reputation;
(C) necessary qualifications to enable the representative to provide to persons valuable service; and
(D) competency to advise and assist persons in presenting their cases.


18. Id. §§ 330(a)(1), 330(a)(2)(D).

19. See Brief for Appellants, supra note 16, at 37–42.
in presenting their cases” to conclude that the Treasury’s authority was limited to regulating the conduct of representatives who were actually appearing before the IRS to defend taxpayers’ positions before the IRS Examination and Appeals functions. Therefore, the district court concluded that the preparation of tax returns by commercial preparers did not involve either the presentation of taxpayers’ “cases” or the “practice of representatives” before Treasury.

It is these specific conclusions of the district court with which I disagree. They seem to me to fail to properly apply the relevant statutory language, legislative history, and congressional intent in light of the changes that have occurred in the tax law, in tax administration, and in the representation of taxpayers not only over the last 130 years but even over the last thirty years since section 330 re-codified the original 1884 statute.

The conclusion that tax return preparers do not present taxpayers’ cases to the IRS when they prepare tax returns is simply not true, based on my experience over the last fifty years. A return preparer presents a taxpayer’s case each time the preparer makes specific decisions about how to reflect the taxpayer’s income, deductions, exemptions, and credits on the taxpayer’s return, or how to present tax benefits and the effects of tax planning transactions in the return, or when and how to make disclo-

21. See id.
22. A principal reason many, if not most, taxpayers use return preparers is to obtain the benefit of an experienced professional who can advise the taxpayer about how much tax must be paid, how such amount can legitimately be minimized, how any tax risks can be minimized, and how the return can be prepared in order to most effectively reflect the foregoing advice and assistance (i.e., to present the taxpayer’s case).
23. See generally MICHAEL I. SALTZMAN & ALAN W. SALTZMAN, IRS PROCEDURAL FORMS AND ANALYSIS 4.06(10), [11] (2013). Courts have advised on when and how to report income items for which the taxpayer has received a Form 1099 from a payor, or to reflect deductions for which the taxpayer has received a Form 1098 from a payee, in order to avoid or minimize adjustments that otherwise could be triggered by innocuous differences in descriptions when the IRS matches the income items reported to them by the payors, or the deduction items reported to the IRS by the payees. See, e.g., Portillo v. Comm’r, 932 F.2d 1128, 1133–35 (5th Cir. 1991); Santa Maria v. Comm’r, 68 T.C.M. (CCH) 1468, 1472–73 (1994); see also I.R.C. § 6201(d) (2012); id. § 170(f)(8) (giving advice about whether to claim and how to document deductions for cash charitable contributions in excess of $250); id. § 170(f)(11)(A)(i) (discussing non-cash charitable contributions in excess of $500); Treas. Reg. § 1.6695-2(b) (2011) (discussing how to minimize or avoid subsequent IRS audits—or adjustments during such audits—of these items; and providing advice and assistance to low income taxpayers about whether and how to appropriately claim, and to reflect such claim of, earned income tax credits to minimize risk of later IRS adjustments).
24. Because of the inherent uncertainty and complexity of the tax laws and because each taxpayer’s circumstances and appetite for tax risk may vary, the extent and type of the return preparer’s advice and assistance to taxpayers may vary, as may the amounts and the presentation of the items of income, deductions, exemptions, and credits reflected on each taxpayer’s return. Knowing when and how to use schedules and statements in a tax return to best and most effectively
sures in tax returns to minimize or avoid penalties\textsuperscript{25} or when and how to file amended tax returns to correct errors in previously filed returns.\textsuperscript{26} These are just a few examples of the key roles played by return preparers in presenting the cases of taxpayers to the IRS.\textsuperscript{27} Indeed, the failure of a preparer to properly present a taxpayer’s case in the preparation of the tax return can be grounds for malpractice.\textsuperscript{28}

One of the biggest changes in the federal tax area during the last twenty-five years has been the increasing number of socio-economic spending programs that have been run through the Internal Revenue Code.\textsuperscript{29} The economists have convinced the politicians that the most cost-efficient way to deliver the benefits of these programs is through the use of tax credits, many of them refundable credits. Other former IRS Commissioners and I, in helping to prepare our amicus brief to the D.C. Circuit Court of Appeals, decided to exemplify how tax return preparation enables taxpayers to make their cases to qualify for and obtain refunds attributable to these tax credits. The district court in \textit{Loving} had concluded that “[f]iling a tax return would never, in normal usage, be described as ‘presenting a case.’\textsuperscript{30} The former Commissioners disagreed. We explained refundable credits attributable to government assistance programs being run through the Internal Revenue Code, such as assistance for low-income families, health care, education, and homebuyers.\textsuperscript{31} We demonstrated why and how preparing a tax return is the best means to enable a taxpayer to qualify for the benefits under these programs and to obtain a refund from the IRS.\textsuperscript{32} We argued that a preparer who advises and assists a taxpayer to obtain these financial assistance benefits by preparing the taxpayer’s return for that purpose is representing the taxpayer in making present a taxpayer’s case to support the positions taken on these tax benefits in the return is part of the art of tax return preparation.

\textsuperscript{25} See I.R.C. §§ 6662(a), (b)(2) (2012) (noting individual can be penalized for substantial understatement of individual’s income tax liability, and amount of such penalty can equal 20\% or more of amount of understatement); see also id. § 6662(d)(2)(B)(ii) (discussing how under certain circumstances proper disclosure in individual taxpayer’s return may be sufficient to avoid the penalty).

\textsuperscript{26} See Bernard Wolfman, James P. Holden & Kenneth L. Harris, Standards of Tax Practice 120–30 (6th ed. 2004) (discussing various considerations a preparer should take into account in advising taxpayers whether or not to prepare and file an amended return).

\textsuperscript{27} For additional examples, see Olson, supra note 2, at 771–73.

\textsuperscript{28} See Paul J. Routh, Liabilities of Tax Preparers: An Overview, 13 CAP. U. L. REV. 479, 517–19 (1984) (discussing theories in tort and contract law under which return preparers may be held liable for failing to properly advise and assist taxpayers in preparing their tax returns).


\textsuperscript{31} See Brief of Former Commissioners, supra note 15, at 3–7.

\textsuperscript{32} See id. at 7–9.
the taxpayer’s case to the IRS, which qualifies the preparer as a “representative” within the meaning of section 330.33

The term, “representative,” has become a focal point for the plaintiffs and some of the commentators who have weighed in on the district court’s decision in Loving.34 They have pointed to dictionary definitions of “representative” as an agent who “stands for or acts on behalf of another.”35 They have insisted that a preparer cannot qualify as a representative of a taxpayer because the preparer can never act as an agent for the taxpayer to sign the taxpayer’s return on the taxpayer’s behalf. Therefore, they argue, preparers cannot be “representatives of persons before the . . . Treasury” within the meaning of section 330(a).36 I have no quarrel with the definition of a representative as someone who acts on behalf of another, but I disagree that the preparer must act as the agent for the taxpayer in a principal-agent relationship in order to be considered a “representative” for purposes of section 330(a). Let me explain why I disagree by comparing an attorney’s preparation of a will for a client with a preparer’s preparation of a tax return for a taxpayer.

The client could prepare his or her own will, but because of the importance of the will and the complexities involved, clients often choose to use an attorney to prepare their wills. The attorney reviews, among other things, the client’s assets and liabilities and determines the client’s objectives at the time of the client’s death. Then the attorney advises the client about ways to accomplish the client’s objectives, including ways to lawfully minimize taxes payable at the client’s death. Once the attorney understands the client’s objectives, the attorney prepares the will on the client’s behalf to reflect the client’s choices and to accomplish the client’s objectives. The client must sign the will because signing the will is a non-delegable duty of the client.

Similarly, a taxpayer could prepare his or her own income tax return, but because of the importance and complexities involved, many taxpayers choose to use a preparer to prepare their returns. The preparer reviews the taxpayer’s income, expenses, and other circumstances and determines the taxpayer’s objectives in filing the return. Then the preparer advises the taxpayer about ways to accomplish the taxpayer’s objectives, including ways to either minimize the tax payable or obtain a refund. Once the preparer understands the taxpayer’s objectives, the preparer prepares the return on the taxpayer’s behalf to reflect the taxpayer’s choices and to accomplish the taxpayer’s objectives. The taxpayer must sign the return because signing the return is a non-delegable duty of the taxpayer.

33. See id. at 12–16.
35. See Brief for Appellees, supra note 16, at 37 n.23.
36. See id.
Surely, the attorney is reasonably viewed as having represented the client in advising, assisting, and preparing the client’s will on the client’s behalf, and I submit that the preparer also may be reasonably viewed as having represented the taxpayer in advising, assisting, and preparing the taxpayer’s income tax return on the taxpayer’s behalf. No principal-agent relationship was established because none was needed to enable the representation to occur.

Finally, in recognition of the importance of the tax return preparer in the presentation of the taxpayer’s case in the tax return, the IRS now specifically permits taxpayers on the face of the Form 1040 income tax return to express a desire, when the return is filed, for the preparer to continue to represent the taxpayer before the IRS after the return is filed with regard to the information provided on the tax return. Importantly, the most recent data available from the IRS indicates that more than two-thirds of the taxpayers who use return preparers authorize their preparers to continue to represent them before the IRS to discuss any questions that the IRS may raise about the return information during the processing of the return by the IRS. The large number of commercial preparer returns containing preparer authorizations suggests that substantially all unregulated commercial return preparers are authorized by at least some, if not many, of their clients to represent the clients before the IRS after the returns are filed with the IRS.

37. See IRS Individual Income Tax Return Forms 1040, 1040A, & 1040EZ (2013), available at http://www.irs.gov/Forms-&-Pubs. On page two of Forms 1040, 1040A, and 1040EZ respectively, right above the line for the taxpayer’s signature, each taxpayer may check a “Yes” box and provide a preparer’s name, telephone number, and personal identification number in order to authorize the preparer to “discuss this return with the IRS.” Id. The instructions to the Form 1040 state: “If you check the ‘Yes’ box, you, and your spouse if filing a joint return, are authorizing the IRS to call the designee to answer any questions that may arise during the processing of your return.” IRS, Line Instructions for Form 1040 (2012), http://www.irs.gov/instructions/i1040/ar01.html#d0e1681 (last visited Apr. 16, 2014).

38. For the tax year 2010, taxpayers filing 81,107,021 individual income tax returns authorized 57,491,941 paid preparers (regulated and unregulated) to act on their behalf before the IRS during the processing of the returns after the returns were filed with the IRS. See IRS, 2010 ESTIMATED DATA LINES COUNTS INDIVIDUAL INCOME TAX RETURNS 15 (2012), available at http://www.irs.gov/pub/irs-soi/10inlinecount.pdf. Although taxpayers are permitted to designate family members, friends, or others to act on their behalf, I understand from my discussions with the IRS that substantially all of the authorizations are believed to be preparer related. Therefore, it would appear that between 66.6% and 71% of the paid-preparer returns contain such authorizations.

39. It has been estimated that 600,000 to 700,000 unregulated commercial preparers are affected by the provisions of the 2011 regulations. See Brief for Appellees, supra note 16, at 13–14 (“The IRS originally estimated that 600,000 to 700,000 tax preparers would be subject to this licensing scheme.”). Assuming that almost 44 million returns were prepared by unregulated commercial preparers in 2010 (i.e., by applying the 54% from Olson to the 81,107,021 returns prepared by paid preparers to determine the approximate number of returns prepared by unregulated commercial preparers in 2010), and assuming that two-thirds of the 44
Bearing all of the foregoing in mind, it is hard to believe the Treasury in 1884 would have concluded that anyone advising and assisting a claimant in the preparation and submission of a Civil War claim would be exempt from regulation simply because the representative did not make an actual appearance before the Treasury, especially if the representative unscrupulously collected a fee to pursue the claim and then failed or refused to follow up with the Treasury after the initial claim was filed. On the other hand, if the representative did such a good job in preparing and submitting the claim that the Treasury paid the claim, as submitted and without requiring any actual appearance, it would seem strange that anyone would suggest that the representative had not represented the claimant before the Treasury in obtaining the compensatory payment.\footnote{\textsuperscript{40}}

I see no difference between such a situation in 1884 and a situation today, in which a preparer advises and assists a taxpayer with regard to the information to be provided on an income tax return concerning the amount of income to be reported and the tax benefits in the form of personal exemptions, deductions, and credits to be claimed, which either result in a refund or reduce the balance due that the taxpayer must pay. When a preparer reflects such advice in the manner in which the preparer presents these tax items in the taxpayer’s return and when, on the face of the return, the preparer identifies himself or herself by name, address, telephone number, and PIN number as the person who has represented the taxpayer in preparing the return, knowing the return will be filed with the IRS, I submit that all of these combined actions should be sufficient to cause the preparer to be considered as being engaged “in the practice of representing persons before the Department of the Treasury,” within the meaning of the provisions of section 330(a).

If, in addition, the taxpayer authorizes the IRS to discuss with the preparer on the taxpayer’s behalf any questions the IRS may have about the information in the return after it is filed, I submit that not only has the preparer represented the taxpayer in presenting the taxpayer’s initial case to the IRS in the tax return but also, because of the specific authorization

\footnote{\textsuperscript{40} The legislative history to the 1884 statute makes reference to “applications” to be submitted by claimants to the Treasury Department. \textit{See} \textbf{48 CONG. REC. H5219} (1884) (clerk’s statement of proposed legislation) (“This act shall apply to pending as well as all future applications for allowance of claims for lost horses, bounty, and arrears of pay.”). Although there are references in the legislative history of the 1884 statute and in the related literature to appearances before the Treasury as a characteristic activity of claimants and their advisors, I have been unable to find anything that suggests that a personal appearance by a claimant or a claimant’s representative before the Treasury was actually required.}
made by the taxpayer, the preparer has made an initial appearance, on behalf of the taxpayer, before the IRS to answer questions and, if necessary, to explain and defend the accuracy of the return information when the IRS processes the return after it is filed. Therefore, such actions should be sufficient under the 1884 statute and under section 330 to enable a court to conclude that the promulgation by the IRS of the 2011 regulations under Circular 230 to regulate the return preparation conduct of previously unregulated commercial preparers constituted an authorized regulation of “the practice of representatives of persons before the Department of the Treasury.”

That a return preparer is so authorized to represent a taxpayer in dealing with the IRS during the processing of the taxpayer’s return by the IRS is significant. The IRS National Taxpayer Advocate, Nina Olson, in her excellent recent article has provided a detailed description of the many different ways the IRS may engage a return preparer in adversarial discussions about the accuracy of the taxpayer’s return during the time the IRS is processing a taxpayer’s return and before the IRS Examination function opens a formal audit of the return. For example, section


42. The plaintiffs in the Loving case have made a variety of other arguments to the contrary in their appeal to the Court of Appeals for the District of Columbia. They have argued that the attempted regulation of the conduct of commercial tax return preparers in the 2011 regulations either conflicts with or renders superfluous other specific statutes in the IRC. See Brief for Appellees, supra note 16, at 39–50. The IRS’s response has been that these other statutes were enacted for different purposes and are not inconsistent with the authority of the IRS under Circular 230 to regulate commercial return preparers. See Reply Brief for Appellants, supra note 16, at 16–23. The plaintiffs also argue that prior statements by the IRS to the effect that the IRS lacked the authority to regulate the conduct of commercial return preparers are inconsistent with and undercut the authority asserted by the IRS in the 2011 regulations. See Brief for Appellees, supra note 16, at 57–58. The IRS response has been that these prior statements were either legally incorrect or were policy statements made before the IRS decided to exercise its authority to regulate such conduct. See Reply Brief for Appellants, supra note 16, at 27–30. As Professor Bryan Camp has explained at length, the relevant IRS policies in this area have changed greatly over the last ninety-two years since Circular 230 was initially promulgated, as the role and importance of tax return preparers have changed. See Camp, supra note 34, at 457–66. Finally, the plaintiffs have argued that various congressional proposals to authorize the IRS to regulate commercial return preparers indicate that Congress did not believe it previously had granted the IRS authority to regulate commercial preparers. See Brief for Appellees, supra note 16, at 55–57. The IRS response has been to rely on the authority cited by the Loving district court in refusing to base its holding in any way on such failures and on other authority to the same effect. See Reply Brief for Appellants, supra note 16, at 26–27.

43. See Olson, supra note 2, at 773–75.
6213(g) provides the IRS with authority to summarily assess tax with respect to certain tax return related items that the IRS considers to be erroneous. The IRS document matching program—under which the IRS matches Forms 1099 received from certain third-party payors with amounts to be reported as income on taxpayer-payees’ returns—has led to litigation in which courts have upheld the right of the taxpayer-payee to overcome the presumption of correctness that normally attaches to amounts reflected on the payor’s Form 1099. There have been reports that the IRS is using its authority under section 6213(g) to summarily assess tax on income reported by a payor on a Form 1099 that is not reported on a taxpayer-payee’s return. The advice and assistance of the return preparer with respect to such income items during the return preparation process and during the processing of a taxpayer’s return can be important to minimize the time and expense of extended administrative hassles with the IRS and to avoid litigation in these situations.

In any event, based upon the analysis, arguments, and interpretations presented above, I submit that the meaning of the key statutory phrase of section 330(a), “the practice of representatives of persons before the Department of the Treasury,” is fairly susceptible to more than one interpretation and, therefore, is ambiguous. Any such ambiguity would appear to make the government’s position and argument in the Loving case credible and persuasive. The government on appeal in the Loving case has argued that:

Under Chevron, unless Congress has spoken to the precise issue presented, an agency’s regulation is valid if the regulation fills a statutory gap, or defines a term, in a reasonable fashion. “If a statute is ambiguous, and if the implementing agency’s construction is reasonable, Chevron requires a federal court to accept the agency’s construction of the statute, even if the agency’s reading differs from what the court believes is the best statutory interpretation.” As demonstrated below, the critical statutory term in 31 U.S.C. § 330(a)(1), i.e., “practice of representatives of persons before the Department of the Treasury” is ambiguous and there-

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44. See I.R.C. § 6213(g) (2012).
45. See, e.g., Portillo v. Comm’r, 932 F.2d 1128, 1133–35 (5th Cir. 1991); Santa Maria v. Comm’r, 68 T.C.M. (CCH) 1468, 1472–73 (1994); see also I.R.C. § 6201(d).
46. See Amy S. Elliott, Practitioners to Challenge IRS for ‘Overreaching’ with Math Error Exception, 2011 TAX NOTES TODAY 19-3 (2011). A preparer may be able to persuade the IRS not to make an erroneous assessment if the IRS contacts the preparer by telephone before making the assessment. If an assessment already has been made, the preparer may request an abatement of the assessment pursuant to the provisions of section 6404(a)(1) of the Internal Revenue Code. See Olson, supra note 2, at 773 (“For the 2012 filing season, the IRS issued 2,042,458 math error notices for individual returns. About 10 percent of the amounts assessed were later abated.” (footnote omitted)).
fore is a proper subject for interpretation by the Secretary of the Treasury.47

The district court in the Loving case rejected the government’s above argument on the basis that the plain meaning of the words in the critical phrase of section 330(a)(1), “practice of representatives of persons before the Department of the Treasury,” was clear and unambiguous. Based on my above analysis, I respectfully submit that the meaning of the words in the critical phrase is fairly susceptible to more than one interpretation and therefore is unclear and ambiguous. For that reason, I believe the 2011 regulations of the Treasury regulating the tax return preparation conduct of commercial preparers are authoritative and should be upheld.

LOVING AND LEGITIMACY: IRS REGULATION OF TAX RETURN PREPARATION

STEVE R. JOHNSON

I. Introduction

The validity of regulations promulgated by the Department of Treasury is a principal battleground in contemporary federal taxation. So far, the clash has had two phases: establishment and implementation. Phase one entailed the destruction of the citadel of tax insularity, the bastion within which tax specialists thought to keep themselves safe from having to learn and apply general administrative law. In cases such as Swallows Holding Ltd. v. Commissioner,1 Mannella v. Commissioner,2 Lantz v. Commissioner,3 Mayo Foundation for Medical Education & Research v. Commissioner,4 and the welter of cases culminating in United States v. Home Concrete & Supply, LLC,5 the old guard was defeated. It is now firmly established that tax, no less than other regulatory areas, is subject to the rules of administrative law.6 That proposition having been settled, we are now in phase two: implementation, the application of specific administrative law rules in particular tax contexts.

Loving v. IRS7 is the most recent major phase two case. In Loving, the Federal District Court for the District of Columbia—later affirmed by the D.C. Circuit—invalidated a major Department of the Treasury (Treasury) and Internal Revenue Service (IRS) initiative to regulate previously unreg-

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3. 607 F.3d 479 (7th Cir. 2010), rev’g 132 T.C. 131 (2009).


ulated tax return preparers. Alarmed by what it perceived as widespread incompetence and ethical lapses, in 2011, Treasury asserted authority to regulate such preparers without additional legislative support—despite having maintained for generations that it lacked such authority. The district and circuit courts concluded that the Government’s prior view—not its current view—of its authority is correct. The courts therefore invalidated the 2011 regulations.

The Government chose not to seek certiorari review of Loving by the Supreme Court, but legislation to reverse Loving is a possibility. Whichsoever view ultimately prevails, Loving is an important case, both practically and doctrinally. Practically, the regulatory initiative challenged in Loving involves hundreds of thousands of return preparers, millions of their customers, and millions or billions in annual revenues for the federal fisc.

Doctrinally, Loving bears on an issue of fundamental significance not just as to tax regulations but as to administrative law generally. Loving is a Chevron case. When Chevron applies, it is Step One, not Step Two, that typically poses the greater challenge for the agency. Thus, two matters become crucial: (1) what sources may a court legitimately consult at Step


9. In contrast, some other federal agencies have long asserted what the Treasury and IRS denied until 2011. For instance, regulations adopted by the Securities and Exchange Commission provided that practicing before the Commission includes: “Providing advice in respect of [securities laws and regulations] regarding any document that the attorney has notice will be filed with or submitted to . . . the Commission, including the provision of such advice in the context of preparing . . . any such document.” 17 C.F.R. § 205.2(a)(1)(iii) (2013).


12. Under Chevron’s Step One, the court applies the statute if the intent of the statute is unambiguous. See id. at 842–43. Step Two is reached if the statute is ambiguous; at Step Two, the agency’s interpretation is upheld unless it is unreasonable. See id.
One in its attempt to determine whether the statute is unambiguous, and (2) in what spirit—exacting or sympathetic to the agency—are these sources to be evaluated?

Thus far, the courts have hardly spoken with one voice as to these questions. The *Loving* opinions reflect what may be the central tendency of recent decisions: their approach to sources is principally textual, and their spirit is exacting, evincing no thumb on the scale in favor of the agency. Clashes as to these issues will continue for a long time, but the *Loving* opinions surely will have an impact on them.

This article has six principal parts. Part II describes the relevant statutory framework, the practical stakes at issue, and the challenged regulatory initiative.

Part III describes the district court’s decision in *Loving*. It notes that the district court viewed *Chevron*’s Step One as controlling and that the court took an exacting textual approach to conducting the Step One inquiry. The court focused on the statutory phrase “regulate the practice of representatives of persons before the [IRS].”13 Its rejection of the regulations was based on the court’s understanding of “practice,” reinforced by wider contextual considerations. Part III describes these aspects of the district court’s opinion and critiques the proffered wider contextual considerations.

Part IV critiques the “practice” rationale relied upon by the district court. It concludes that this rationale is weak and that the Government has the better position on this issue.

However, Part V maintains that the weakness of the district court’s “practice” rationale does not mean it reached the wrong decision. In my view, the district court failed to enlist the key portion of the statute. The superior objection to the regulations is that return preparers are not “representatives.” On that basis, I believe that the district court reached the right decision although on the wrong grounds. However, Part V acknowledges that the issue is close and that a court less wedded to a textual approach to *Chevron* Step One could reach the contrary holding.

Part VI takes the Step One statutory interpretation to a deeper level. It contends that *Loving* bears important similarities to *FDA v. Brown & Williamson Tobacco Corp.*,14 a 2000 decision by the Supreme Court invalidating at *Chevron*’s Step One a major initiative by a different agency. The *Loving* district court cited *Brown & Williamson* in passing, but the case deserves much more attention in this context. *Brown & Williamson* supports the invalidation of the *Loving* regulation in at least two ways not yet substantially explored in the literature on *Loving*: (1) the use of a hyper-contextual lens for analyzing Step One, and (2) the application of a “major question” exception to *Chevron* deference. Part VI develops these perspectives.

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Finally, the Epilogue describes the D.C. Circuit’s opinion. The circuit court’s approach resembles that of the district court in many respects. However, the circuit court made more of the “representatives” and Brown & Williamson arguments developed in Parts V and VI of this article.

II. Background

A. Statutory Framework

The key statute for Loving purposes is 31 U.S.C. § 330, which provides, in its current form, as follows:

(a) Subject to section 500 of title 5, the Secretary of the Treasury may—
    (1) regulate the practice of representatives of persons before the Department of the Treasury; and
    (2) before admitting a representative to practice, require that the representative demonstrate—
        (A) good character;
        (B) good reputation;
        (C) necessary qualifications to enable the representative to provide to persons valuable service; and
        (D) competency to advise and assist persons in presenting their cases.

(b) After notice and opportunity for a proceeding, the Secretary may suspend or disbar from practice before the Department, or censure, a representative who—
    (1) is incompetent;
    (2) is disreputable;
    (3) violates regulations prescribed under this section; or
    (4) with intent to defraud, willfully and knowingly misleads or threatens the person being represented or a prospective person to be represented.

The Secretary may impose a monetary penalty on any representative described in the preceding sentence. If the representative was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to such penalty, the Secretary may impose a monetary penalty on such employer, firm, or entity if it knew, or reasonably should have known, of such conduct. Such penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty and may be in addition to, or in lieu of, any suspension, disbarment, or censure of the representative.

(c) After notice and opportunity for a hearing to any appraiser, the Secretary may—
    (1) provide that appraisals by such appraiser shall not have any probative effect in any administrative proceeding
before the Department of the Treasury or the Internal Revenue Service, and
(2) bar such appraiser from presenting evidence or testimony in any such proceeding.
(d) Nothing in this section or in any other provision of law shall be construed to limit the authority of the Secretary of the Treasury to impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which the Secretary determines as having a potential for tax avoidance or evasion.15

Some history is in order. The original version of current section 330 was enacted in 1884, more than a generation before enactment of the modern federal income tax.16 All quarters appear to agree as to the reason Congress acted in 1884. In the aftermath of the War Between the States,17 and in the throes of westward expansion, there were “mounting complaints about misconduct by unscrupulous attorneys and claims agents [ ] represent[ing] military pensioners, persons with claims for lost horses, and others with claims for compensation from the federal government . . . .”18 Attorneys and others competed to solicit claimants. One Congressman described the situation this way:

While there are some very reputable gentlemen engaged in the business, who charge reasonable fees, there are many who are very disreputable, and who have been guilty of bad practices, and have victimized many a poor soldier who was unable to take care of himself. . . . The object of [the 1884 statute] is to protect soldiers against such practices.19

Against this background, Congress enacted the following statute:

[T]he Secretary of the Treasury may prescribe rules and regulations governing the recognition of agents, attorneys, or other persons representing claimants before his Department, and may require of such persons, agents and attorneys, before being recognized as representatives of claimants, that they shall show they

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16. This fact should have no bearing on the outcome in Loving. The federal government was levying non-income taxes—principally excise taxes—in 1884. Section 330 is plastic enough to cover the representatives of claimants of types of claims that arose after its date of enactment.
17. Before I moved to Florida, I would have said the “Civil War.”
are of good character and in good repute, possessed of the necessary qualifications to enable them to render such claimants valuable service, and otherwise competent to advise and assist such claimants in the presentation of their cases. And such Secretary may, after due notice and opportunity for hearing, suspend and disbar from further practice before his Department any such person, agent, or attorney shown to be incompetent, disreputable, or who refuses to comply with the said rules and regulations, or who shall with intent to defraud, in any manner willfully and knowingly deceive, mislead, or threaten any claimant or prospective claimant, by word, circular, letter, or by advertisement.20

Section 330 substantially took its current form in 1982,21 when the term “representative of persons” was substituted for “agents, attorneys, or other persons representing claimants.” A committee report states that the 1982 revision was stylistic, with no change in substance intended.22 This characterization appears to be uncontroversial.23

B. Practical Stakes

As described in greater detail below,24 some types of tax advisors25 are already subject to extensive regulation under authority other than the regulation challenged in Loving.26 As the district court acknowledged, Loving has no legal effect on such advisors.27 Instead, Loving and the regulations there at issue involve otherwise substantially unregulated tax return preparers.28

Such preparers are a major part of the tax reporting and compliance matrix. Of the approximately 150 million individual income tax returns filed annually, nearly 80 million are prepared by return preparers, and over 42 million of those returns were prepared by unregulated

21. Various minor changes have been made since 1982.
23. See Plaintiffs’ Motion for Summary Judgment, supra note 18, at 34; Olson, supra note 18, at 776.
24. For a further discussion of this topic, see infra notes 231–35 and accompanying text.
25. Chief among these types are attorneys, certified public accountants, and enrolled agents. Other types include certified acceptance agents, enrolled actuaries, and enrolled retirement plan agents.
The IRS puts the number of such preparers at 600,000 to 700,000. The Government is convinced that a sizeable number of these unregulated preparers are inadequately trained, incompetent, or crooked, hurting both the customers of these preparers and the federal fisc. Accordingly, Treasury promulgated the 2011 regulations in order:

[T]o improve the service provided by the tax-return-preparation industry, to protect taxpayers who use such services, and to enhance tax administration by reducing the considerable lost tax revenues that are attributable to the significant number of tax-return preparers who are incompetent and/or unscrupulous.”

Many persons of great experience, ability, and integrity inside the Government firmly believe in these purposes, and they are not alone. For example:

- In congressional hearings, the American Bar Association, the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, the National Society of Accountants, and the National Association of Tax Professionals all testified in support of regulating return preparers.
- As described in greater detail in subpart II.C below, the IRS submitted heightened return preparer regulation to an extensive comment process. According to the IRS, “commentators overwhelmingly expressed support for efforts to increase the oversight of tax return preparers,” including support ranging from 88% to 99% for particular aspects of enhanced regulation.
- Amici briefs were filed in Loving in support of the challenged regulation, including briefs by the National Consumer Law

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29. See Olson, supra note 18, at 767, 769 n.14 (citing IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers Database, TY 2011 (2013)).
33. IRS Publication 4832, supra note 28, at 2.
Center and National Community Tax Coalition\textsuperscript{34} and by five former Commissioners of Internal Revenue.\textsuperscript{35}

- Although the commentary is divided, many commentators support the desirability of increased regulation of return preparers.\textsuperscript{36}

One should think twice and be quite sure of the facts before disputing such collective wisdom. Nonetheless, I harbor some doubts. I do not doubt that there are problem areas. When the actions of hundreds of thousands of human beings of any walk of life are scrutinized, both incompetence and chicanery are sure to be found in abundance.\textsuperscript{37} Instead, my concerns relate to the efficacy of the cure and the possibility of side effects.

As to efficacy, it would be less than rigorous to simply assume that government regulation will sweep away all or most ills. Beyond count are the government regulatory programs which, though adopted with fanfare and enthusiasm, have failed to achieve their objectives or even have made things worse. The sentiment "there ought to be a law" may have prompted as many feckless or harmful laws as effectual and salutary laws.

Unregulated preparers do make errors, but so do already regulated preparers like enrolled agents, certified public accountants, and lawyers. And so do IRS employees. The error rate of information given to taxpayers by IRS taxpayer service representatives has been a problem for decades.\textsuperscript{38} Similarly, unregulated preparers do commit or abet fraud, but so do already regulated advisors. My co-authored text on tax crimes is strewn

\textsuperscript{34} Brief for \textit{Amici Curiae} Nat’l Consumer Law Ctr. and Nat’l Cmty. Tax Coal. in Support of Defendants-Appellants and Arguing for Reversal of the District Court, Loving v. IRS., 742 F.3d 1013 (D.C. Cir. 2014) (No. 13-5061), 2013 WL 1386247.

\textsuperscript{35} Brief \textit{Amici Curiae} of Former Comm’rs of Internal Revenue in Support of Defendants-Appellants, Loving v. IRS., 742 F.3d 1013 (D.C. Cir. 2014) (No. 13-5061), 2013 WL 1386248 [hereinafter Brief of Former Comm’rs].


\textsuperscript{38} See David Brunori, Government Power, Cronyism, and the IRS Running Amok, 134 TAX NOTES 1599 (2012) (“The irony of the IRS wanting to ensure preparer competency is palpable. The Service is notorious for handing out incorrect information to ordinary citizens who call for help.”).
with convicted accountants and attorneys, and “[l]awyer disbarment lists are littered with unethical individuals despite government regulation of their profession.” And IRS employees occasionally engage in criminal acts. In addition, it has been questioned whether the examination the IRS intends to use is sufficiently demanding to assure competence.

As to side effects, some have decried the challenged regulations as another step in the over-regulation of America. Others have noted the lamentable tendency of regulation to create or protect oligopolies by erecting barriers to entry. From this standpoint, support of the regulation by some organizations is seen as motivated less by the public interest and more by anti-competitive behavior.

It is unnecessary to ascribe sinister motives. The pervasiveness of the law of unintended consequences is enough to inspire caution. For instance, some critics fear that the regulations could raise return preparation costs to taxpayers and decrease the supply of preparers.

I take no position as to the competing arguments on the desirability of the challenged regulations. The IRS strongly argued the necessity of the new rule at the district court level. The district court properly ignored

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40. Brunori, supra note 38, at 1599 (emphasis added).
44. See, e.g., Complaint for Declaratory and Inquisitive Relief at 29, Loving v. IRS, 917 F. Supp. 2d 67 (D.D.C. 2013) (No. 13-5061). The fact that H&R Block, Jackson Hewitt, and other large companies would be exempt from some of the regulations, and that a former H&R Block executive helped write some of the rules, contribute to such concerns. See Brunori, supra note 38, at 1600; Kristan, supra note 42; Opinion, H&R Blockheads: The IRS Wants to Save You from Your Rogue Tax Accountant, WALL ST. J. (Jan. 7, 2010, 12:01 AM), http://online.wsj.com/article/SB1000142405274870536504574640572196836150.html.
45. See Buckley, supra note 43, at 294.
this contention. Loving is about the validity of the regulations, not their wisdom. Accordingly, for the remainder of this Article, I assume arguendo that the challenged regulations would advance the public good, and I focus solely on their legality.

C. Promulgation of the Regulations

It took over a decade of study and advocacy to produce the 2011 regulations. Before she became the National Taxpayer Advocate, Nina Olson identified shoddy return preparation as a problem in congressional testimony in 1997 and 1998. After taking office, her 2002 report to Congress urged adoption of rules requiring registration, testing, and continuing education of unenrolled return preparers.

In 2006 and 2008, auditors from the Government Accountability Office and the office of the Treasury Inspector General for Tax Administration visited small samples of a variety of return preparers. They discovered substantial errors in filed returns and tests on hypothetical fact patterns.

In June 2009, IRS Commissioner Doug Shulman announced a review to focus on the competency and conduct of paid tax return preparers. The review included a series of public hearings in which taxpayers, consumer groups, and preparers participated. The results of the review were announced six months later in a document entitled Return Preparer Review. It recommended the following changes:

- Mandatory registration and use of a Preparer Tax Identification Number (PTIN), for all persons paid to prepare, or to help prepare, all or substantially all of a federal tax return;

46. For a discussion of the current prevailing approach towards application of Chevron, see infra notes 74–83 and accompanying text.
47. Of course, a judge’s perception of where wisdom lays has influenced the outcome of more than one close issue of law.
52. See IRS Publication 4832, supra note 28.
Mandatory basic competence tests, but with exemptions for attorneys, certified public accountants, and enrolled agents (since they already have testing requirements to earn their credentials), certain non-signing preparers supervised by them, and non-Form 1040 preparers;

Continuing education obligation of fifteen hours per year, including ten hours in federal tax law, three in tax law changes, and two in ethics;

Ethics requirements in the form of compliance checks and being subject to the professional responsibility standards in Treasury Circular 230; and

A publicly searchable database and public education campaign.\(^{53}\)

The Review concluded that these changes could be effected through regulations and "do[ ] not require additional legislation."\(^{54}\) The regulations were proposed in 2010 and finalized in 2011.

III. DISTRICT COURT’S DECISION

Operatively, the district court’s invalidation of the challenged regulations proceeded through five stages. The court (1) identified *Chevron’s Step One* as controlling, (2) took a searching and textual approach to Step One, (3) found the definition of the statutory term “practice” to be decisive, (4) reinforced its conclusion through a wider contextual analysis, and (5) determined the appropriate remedies.

A. Step One as Controlling

The named plaintiffs in *Loving* are Sabina Loving, Elmer Kilian, and John Gambino. They all currently prepare tax returns for compensation without having obtained licenses or certification from the IRS, although they all had obtained or applied for Preparer Tax Identification Numbers. They were joined by the Institute for Justice, a national public interest law firm, which seeks to protect the rights of entrepreneurs.

The plaintiffs sued the IRS under the Administrative Procedure Act (the APA)\(^{55}\) and the Declaratory Judgment Act,\(^{56}\) challenging the validity of the 2011 regulations. Both sides moved for summary judgment.\(^{57}\)


57. The district court restyled the motions, finding that “the pleadings in this case more accurately seek the Court’s review of an administrative decision. [The
The district court identified *Chevron* as the standard controlling the challenge. Subsequent cases have established that *Chevron* does not apply to every case in which the agency’s action is challenged. The Government argued that the case should be resolved in its favor without resorting to *Chevron*, because every agency, including the Treasury Department and IRS, has inherent authority to regulate persons practicing before it. Commonly, however, statutes prescribe agencies’ authority to regulate admission to practice.

Language in some cases might be read to call into question the existence of inherent, non-statutory authority. However, the district court did not go so far. Instead, it rejected the Government’s contention because of the “specific controls over general” canon of construction. An agency “cannot rely on its general authority to make rules necessary to carry out its functions when a specific statutory directive defines the relevant functions of [the agency] in a particular area.” The district court held that section 330, by specifically defining Treasury’s authority to regulate practitioners before it, controls over Treasury’s inherent authority.

The issue in *Loving* is the extent of the agency’s authority. Questions sometimes have been raised as to whether *Chevron* applies to agencies’ determinations of their own jurisdiction, but those questions are no longer troubling. After the district court rendered its decision, the Supreme Court ruled that *Chevron* Step Zero issue because whether *Chevron* applies at all is logically anterior to application of Steps One and Two. See generally Cass R. Sunstein, *Chevron Step Zero*, 92 Va. L. Rev. 187 (2006).


61. This has been so since the founding of the Republic. See Act of July 27, 1789, ch. 4, 1 Stat. 28 (granting War Department authority “to prescribe regulations, not inconsistent with the law, for the Government of [the] Department” (quoting Rev. Stat. § 161, 5 U.S.C. § 22 (1952) (recodified at 5 U.S.C. § 301 (2012)))); see also Act of July 8, 1870, ch. 230, §§ 17, 19, 16 Stat. 200 (“The Commissioner [of Patents] . . . may from time to time establish rules and regulations, not inconsistent with law, for the conduct of proceedings in the Patent Office” and “[for] gross misconduct . . . may refuse to recognize any person as a patent agent, either generally or in any particular case.”).


Court decisively held that *Chevron* does indeed apply to issues of jurisdiction.\footnote{66. See City of Arlington v. FCC, 133 S. Ct. 1863 (2013).}

Having found that *Chevron* controls, the district court identified Step One as determinative because the plaintiffs offered “no independent argument” at Step Two.\footnote{67. *Loving*, 917 F. Supp. 2d at 73.} Strictly speaking, this conclusion does not follow from the premise. A party may present the same arguments at Step One and Step Two.\footnote{68. The plaintiffs made the same arguments at Step Two as at Step One. See Memorandum of Points and Authorities in Support of Plaintiffs’ Motion for Summary Judgment at 16 n.12, Loving v. IRS, 917 F. Supp. 2d 67 (D.D.C. 2013) (No. 12-0385), 2012 WL 8133439. Thus, they advanced no “independent” argument at Step Two, but they did not concede Step Two.} It is theoretically possible that those arguments are insufficient to persuade the court that the statute is clear (Step One) but do suffice to persuade the court that the regulation is unreasonable (Step Two). However, that margin of possibility is small. As a practical matter, even if not necessarily as a theoretical matter, the district court is correct that the plaintiffs win at Step One or they do not win at all.

For completeness, I add that although the *Loving* plaintiffs did not advance independent Step Two arguments, amici supporting the plaintiffs in the circuit court did so. They argued that the regulations fail Step Two—and for the same reasons are arbitrary and capricious—because Treasury failed to adequately explain the choices it made in the regulations and because they reflect a flawed cost-benefit analysis.\footnote{69. The APA empowers courts to set aside an agency action that is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. § 706(2)(A) (2012). Case law and commentary sometimes disagree as to whether *Chevron*’s Step Two and the arbitrary and capricious standard merge or are independent inquiries. The answer to this conundrum, I think, that arbitrary and capricious has both a procedural dimension and a substantive dimension. The procedural dimension includes such things as the agency’s duty to consider all relevant factors and to explain its choices. The substantive dimension is whether the agency’s balancing process was rational. *Chevron*’s Step Two subsumes, or is congruent with, the substantive dimension of arbitrary and capricious, but it does not subsume the procedural dimension of arbitrary and capricious. See Gen. Instrument Corp. v. FCC, 213 F.3d 724, 732 (D.C. Cir. 2000) (explaining that *Chevron*’s Step Two subsumes substantive dimension of arbitrary and capricious).} The amici also argued that the regulations violate the Regulatory Flexibility Act\footnote{70. Brief of Ronda Gordon, Dennis Tafelski, Jason Dinesen, Christine Engel, Russell Fox, Joe Kristan, Richard Schiveley, and the Tax Foundation as Amici Curiae in Support of Plaintiffs-Appellees at 11–13, Loving v. IRS, 742 F.3d 724, 732 (D.C. Cir. 2000) (explaining that *Chevron*’s Step Two subsumes substantive dimension of arbitrary and capricious).} and the APA notice-and-comment rules.\footnote{71. 5 U.S.C. §§ 601–602 (2012).} Arguments of this ilk are of
The spirit in which a court approaches the Step One analysis is important. A court wanting to uphold the agency’s decision often will find ambiguity, which will allow it to reach Step Two, where the agency usually (but not invariably) wins.74 A more rigorous approach to Step One will result in fewer agency wins.

Although examples of both approaches can be found in case law, an exacting Step One analysis is currently the dominant approach. In a recent *Chevron* case, for instance, the Supreme Court endorsed “taking seriously, and applying rigorously, in all cases, statutory limits on agencies’ authority.”75

This is consistent with a broad movement in recent years, across a variety of areas of administrative law, “exhibit[ing] a return to congressional primacy both in matters of interpretation and matters of policy . . . .”76 Three instances of this movement appear below.

First, of particular relevance to *Loving*, “the Court has moved away from deference to agency statutory interpretations toward a more traditional Court-centered approach with the focus on congressional intent.”77 This has resulted in “a significant expansion of the scope of Step One, so that many more interpretive questions are resolved based on clear congressional intent than might have been anticipated.”78

Second, a similar, less deferential approach is also gaining traction in application of Step Two. Although Step Two is typically agency-friendly, agencies have sometimes lost at Step Two.79 A more vigorous level of scrutiny has been apparent in a number of recent Step Two cases.80

73. See, e.g., Steve R. Johnson, Arbitrary and Capricious: Treasury’s Duty of Explanation as to Tax Regulations, 64 DUKE L. J. (forthcoming 2014); Mayo and the Future, supra note 4, at 1555–56; Preserving Fairness in Tax, supra note 4, at pt. VI.


77. Id. at 747.

78. Id. (adding that “it is now difficult to discern a difference between *Chevron* Step One and traditional, pre-*Chevron*, statutory interpretation”); see, e.g., Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5 (D.D.C. 2013).


Third, agencies traditionally have received a high degree of deference when interpreting their own regulations. However, in recent years, many prominent decisions have invalidated tax and non-tax regulations on the basis of interpretive exercises, concluding that the agency’s position was inconsistent with the clear text of the regulation.

Pendulums swing in legal doctrine no less than in hem-lines and 3-D movies. Thus there is no guarantee that exacting application of *Chevron’s* Step One will always be the norm. It is, however, the currently prevailing approach.

2. District Court’s Approach

The district court in *Loving* proceeded in the currently dominant spirit of exacting analysis. Having identified *Chevron* Step One as the *schwerpunkt* of the case, the district court stated the inquiry as to whether “using the traditional tools of the statutory construction,” it could fairly be said that the 1884 statute made clear Congress’s intent as to the Treasury’s ability to regulate return preparers. The court began “where all such inquiries must begin: with the language of the statute itself.”

Desiring to reach Step Two, where it feels itself in a strong position, the Government argued that the statute is ambiguous because it fails to define “representative” and “practice,” both of which can have broad meanings. The district court found this approach “simplistic” and rejected it because “[a]mbiguity is a creature not of definitional possibilities but of statutory context.” This is an eminently textual approach. Modern textualism takes a broader angle of vision than mere literalistic scru-

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82. See, e.g., Estate of Petter v. Comm’r, 653 F.3d 1012, 1021–23 (9th Cir. 2011); Estate of Christiansen v. Comm’r, 586 F.3d 1061, 1062 (8th Cir. 2009).


84. In German military theory, the *schwerpunkt* is the decisive point, the place where the battle will be won or lost.


tiny of one or a few statutory terms in isolation. As the foremost contemporary exponent of textualism as well as a co-author have observed:

Perhaps no interpretive fault is more common than the failure to follow the whole-text canon, which calls on the judicial interpreter to consider the entire text, in view of its structure and of the physical and logical relation of its many parts. . . . Context is a primary determinant of meaning.88

3. Nontextual Arguments

_ Loving’s_ textual orientation was confirmed later in the opinion. The district court noted that the Government had offered a number of “nontextual arguments,” but the court rejected their relevance, observing that “none of these can overcome the statute’s unambiguous text here. In the land of statutory interpretation, statutory text is king.”89

In fact, both parties offered nontextual arguments, a total of three of them: (1) the importance of the regulations, (2) legislative history, and (3) the inconsistency of the Treasury/IRS. These arguments, and their rejection by the district court, are described below.

a. Importance of the Regulations

Subpart IIB above described the practical stakes implicated by the 2011 regulatory initiative, and subpart IIC above demonstrated the importance that the Government attaches to it. The Government repeatedly impressed this importance upon the district court.

Nonetheless, the district court—properly in my estimation—rejected the pertinence of this consideration to the Step One analysis. The court stated that it did “not gainsay the importance of [the] regulation . . . indeed, it may very well have significant salutary effects . . . . At _Chevron_ Step One, however, such policy arguments have no relevance.”90

The district court’s approach is consistent with current doctrine. Policy arguments are admissible at Step Two.91 At Step One, however, “con-

89. _Loving_, 917 F. Supp. 2d at 79.
90. _Id.; see also Chevron_, 467 U.S. at 864 (stating that policy arguments advanced by parties “are more properly addressed to legislators or administrators, not to judges”); SEC v. Johnson, 650 F.3d 710, 715 (D.C. Cir. 2011) (“The Supreme Court has repeatedly made clear [that] [p]olicy considerations cannot overrule our interpretation of the text and structure of the [Act].” (second alternation in original) (internal quotation marks omitted)).
considerations of policy divorced from the statute’s text and purpose could not override its meaning.\footnote{92}

b. Legislative History

One might think that—the case having been decided nearly a third of a century ago—the interpretational questions raised by\textit{ Chevron} would by now have been resolved. Alas, this is not the case. There are probably more unsettled questions about \textit{Chevron} today than there were immediately after its decision.\footnote{93}

An enduring battleground has been whether legislative history is a proper source in the Step One inquiry. Even textualists acknowledge that intent is a relevant aspect of statutory interpretation—but an objectified intent that must be drawn from the enacted statute, not the subjective intent of legislators.\footnote{94} They even acknowledge that committee reports may legitimately be consulted for certain narrow purposes\footnote{95}—but not for the ascertainment of legislative intent, as purposivists do.

Thus, there is no consistent law on whether legislative history is properly consulted at Step One. The answer given by each case depends upon the accident of which judge pens the opinion.\footnote{96} \textit{Chevron} was authored by Justice Stevens, a purposivist, so \textit{Chevron} looked at committee reports at Step One.\footnote{97} When textualists write the opinions—as Justice Thomas did

\footnote{92. United States v. Tohono O’Odham Nation, 131 S. Ct. 1723, 1731 (2011); \textit{see also} Estate of Petter v. Comm’r, 653 F.3d 1012, 1025 (9th Cir. 2011) (noting when text is clear, “public policy cannot save the IRS”).

93. This is one reason that I and others have called for \textit{Chevron} to be relegated to the dust bin of failed doctrines. \textit{See, e.g.}, Jack M. Beerman, \textit{End the Failed \textit{Chevron} Experiment Now: How \textit{Chevron} Has Failed and Why It Can and Should Be Overruled}, 42 \textit{CONN. L. REV.} 779, 850–51 (2010); Bryan T. Camp, \textit{Interpreting Statutory Silence}, 128 \textit{TAX NOTES} 501, 507 (2010); \textit{Preserving Fairness in Tax}, supra note 4, at 281–84; Patrick J. Smith, \textit{Chevron’s Conflict with the Administrative Procedure Act}, 32 \textit{VA. TAX REV.} 813 (2013). However, that call is unlikely to be answered by the courts any time soon. In a recent case, a majority of the Justices made clear their desire to protect \textit{Chevron} from interpretations that would lead to its evisceration. \textit{See City of Arlington v. FCC}, 133 S. Ct. 1863, 1873 (2013).


95. \textit{See SCALIA & GARNER, supra note 88, at 388 (acknowledging utility of committee reports to establish linguistic usage at time statute was enacted and to refute attempted application of absurdity doctrine).}


in *Brand X*98 and Chief Justice Roberts did in *Mayo*99—this aspect of *Chevron* is conveniently ignored.

In *Loving*, both parties sought to enlist legislative history. The district court did not categorically rule such history out of Step One. Instead, the court found the history of section 330 to be equivocal, and it observed—consistent with the dominant contemporary view—that it is impermissible to use “ambiguous legislative history to muddy clear statutory language.”100

The court was more firm, however, with respect to one aspect of legislative history. On many occasions, bills have been introduced in Congress to provide explicit authority to Treasury to regulate return preparers not already covered. All failed.101 These failures could be spun by proponents of the regulations as evidence of their necessity, or by its opponents as evidence that the 1884 statute does not confer the needed authority. The district court chose to accord the failed proposals no weight, noting that “[f]ailed legislative proposals . . . are a particularly dangerous ground on which to rest an interpretation of a prior statute.”102

c. Agency Inconsistency

Treasury did not always take the view that the 1884 statute confers upon it the authority to promulgate rules like those contained in the 2011 regulations. Indeed, for many years, it took the contrary view, both publicly103 and privately.104 The 1966 version of Treasury regulations stated

104. For example, Professor Camp reports the view prevalent in the IRS during his time with the IRS was that “it would literally take an act of Congress to fix the very real problem of unregulated tax return preparers,” a view that he shared at the time but no longer does. *See* Bryan T. Camp, “*Loving*” Return Preparer Regulation, 140 TAX NOTES 457, 457 (2013) (noting, also, that “both the applicable regulations and the IRS had, for an equally long time, interpreted [the key language of
expressly: “Neither preparation of a tax return, nor the appearance of an individual as a witness for the taxpayer, nor the furnishing of information at the request of the [IRS] or any of its officers or employees is considered practice before the Service.” Should this matter?

The courts have weaved a tangled web as to the significance of agency inconsistency. In a 1939 case involving the validity of income tax regulations, the Supreme Court discounted the significance of Treasury’s change of position.

The principal alternative to *Chevron* is *Skidmore v. Swift & Co.*, decided in 1944. That case held that the weight a court should give an agency’s interpretation of a statute in a given case depends on a number of non-exclusive factors, including the “consistency [of the agency’s current position] with [its] earlier and later pronouncements . . . .”

The notion resurfaced in a 1979 tax case, *National Muffler Dealers Ass’n, Inc. v. United States*. Distilling pre-*Chevron* cases, the Court identified a number of factors bearing on the validity of tax regulations, including “the consistency of the Commissioner’s interpretation . . . .”

Taxpayers seized on this comment to argue in many later cases that alleged IRS inconsistency was a reason to deny deference. The better understanding of *National Muffler*, however, was that IRS consistency is a reason to accord extra deference, not that its absence is a reason to diminish deference. Indeed, the *National Muffler* Court added: “We would be reluctant to adopt the rigid view that an agency may not alter its interpretation in light of administrative experience.”

*Motor Vehicle Manufacturers Ass’n of the U.S. v. State Farm Mutual Automobile Insurance Co.*, is a leading case on when agency action is arbitrary and capricious. The *State Farm* Court stated that agencies “must be given ample latitude to adapt their rules and policies to the demands of changing circumstances.”

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106. See *Helvering v. Wilshire Oil Co.*, 308 U.S. 90, 101 (1939) (predicting negative impact on administrative effectiveness and efficiency if Treasury were unable to take flexible approach to regulatory interpretation).
108. *Id.* at 140.
110. *Id.* at 477; see also *Rowan Cos., Inc. v. United States*, 452 U.S. 247, 261 n.17 (1981).
111. See *Swallows I*, supra note 1, at 364–65 (outlining alternative deferential approaches to analyzing regulations and arguing that Supreme Court adopted additive deferential approach in *National Muffler*).
114. *Id.* at 42 (quoting *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968)) (internal quotation marks omitted).
Chevron itself involved an agency’s change of position, but the agency prevailed nonetheless. The Court remarked, “[a]n initial agency interpretation is not instantly carved in stone. On the contrary, the agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis.”

However, three years later, Justice Stevens wrote for the Court in INS v. Cardoza-Fonseca. This time, the author of Chevron said, “[a]n agency interpretation of a relevant provision which conflicts with the agency’s earlier interpretation is ‘entitled to considerably less deference’ than a consistently held agency view.”

In 2005, National Cable & Telecommunications Ass’n v. Brand X Internet Services offered a wrinkle. After confirming that agency inconsistency is not germane for Chevron purposes, the Court added, “[u]nexplained inconsistency is, at most, a reason for holding an interpretation to be an arbitrary and capricious change . . . under the Administrative Procedure Act.”

The most thorough exploration of agency inconsistency in the context of the arbitrary and capricious standard came in the Court’s 2009 FCC v. Fox Television Stations, Inc. decision. The FCC changed its position on indecent broadcasts. The circuit court found the agency’s action arbitrary and capricious, in part because the FCC allegedly failed to adequately explain the reasons for the change. A divided Supreme Court reversed the circuit court. Justice Scalia wrote for the Court, although only three other Justices joined his opinion in full. Justice Kennedy provided the fifth vote in his concurrence in part and concurrence in the judgment. Four Justices dissented.

The key paragraph in the Court’s opinion laid down four principles:

1. The requirement that an agency provide reasoned explanation . . . would ordinarily demand that it display awareness that it is changing position. . . .
2. And of course the agency must show that there are good reasons for the new policy.
3. But it need not demonstrate . . . that the reasons for the new policy are better than the reasons for the old one . . . .
4. The agency need not always provide a more detailed justification than what would suffice for a new policy created on a blank slate.

Sometimes it must—when, for example, its new policy rests upon factual findings that contradict those which underlay its prior policy; or
when its prior policy has engendered serious reliance . . . . 122

Mayo, in 2011, appeared—quite unnecessarily123—to abrogate National Muffler.124 Mayo also rejected the significance of agency inconsistency for Chevron purposes, saying that the Court has “repeatedly held that ‘[a]gency inconsistency is not a basis for declining to analyze the agency’s interpretation under the Chevron framework.’”125

Against this background, how did the Loving district court handle Treasury’s inconsistency as to the scope of its authority under section 330? The court invoked Brand X’s holding that an agency’s volte-face is irrelevant for Chevron purposes, as well as Brand X’s dictum that it may be a basis for holding the agency’s action to be arbitrary and capricious. The district court avoided that dictum by adding: “While the Court could find no explanation for the IRS’s flip-flop in the new Rule, Plaintiffs have not claimed here that the IRS was arbitrary and capricious.”126

C. Definition of “Practice”

Section 330(a)(1) authorized Treasury to “regulate the practice of representatives of persons before the Department . . . .”127 Central to the district court’s holding in Loving was its conclusion that the previously unregulated preparers are not engaged in “practice.”

The court began by sketching its conception of the process of IRS adjudication. The court saw three phases in the following order: assessment and collection, examination, and appeals.128 Phase one reflects the putative “self-assessment” nature of our tax system.129 Taxpayers file their returns; the IRS assesses the liabilities reported on those returns; and the

123. See Mayo and the Future, supra note 4, at 1553 (arguing that taxpayers in Mayo incorrectly applied National Muffler considerations and thus misused case).
125. Id. at 712 (quoting Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs., 545 U.S. 967, 981 (2005)) (citing United States v. Eurodif S.A., 129 S. Ct. 878, 887 (2009)).
126. Loving v. IRS, 917 F. Supp. 2d 67, 80 (D.D.C. 2013). As noted above, such a claim has been made in an amici brief to the D.C. Circuit. See supra notes 69–70 and accompanying text.
128. See Loving, 917 F. Supp. 2d at 69–70.
129. This characterization is widely used. See Brief of Former Comm’rs, supra note 35, at 7 (showing five former Commissioners of Internal Revenue use this characterization); Olson, supra note 18, at 771 (showing National Taxpayer Advocate characterizes tax system as one of self-assessment). But see Camp, supra note 104, at 462–66 (maintaining that our system involves self-reporting but not self-assessment). Professor Camp’s position is the more precise.
IRS deposits the accompanying payments or attempts to collect in the event of nonpayment.

In phase two, the IRS selects some returns for audit. During the audit, the “taxpayer may be represented . . . by an attorney, certified public accountant, or other representative.” The audit may conclude with an IRS “no change” letter, a taxpayer concession of additional liabilities, or disagreement between the taxpayer and the IRS agent.

Phase three resolves any such disagreement. The taxpayers may choose administrative appeal to the IRS Appeals Office, where they may “designate a qualified representative to act for them.” Absent agreement, the taxpayer may initiate litigation in the Tax Court, district court, bankruptcy court, or Court of Federal Claims, as appropriate.

The district court acknowledged that section 330(a)(1) does not define “practice of representatives,” but it looked to section 330(a)(2)(D) to illuminate the phrase’s meaning. That section provides that, before admitting “a representative to practice,” Treasury may require the representative to demonstrate “competency to advise and assist persons in presenting their cases.” On this basis, the district court concluded that those who merely advise taxpayers as to their returns are not engaged in “practice” within the contemplation of section 330. It said:

Filing a tax return would never, in normal usage, be described as “presenting a case.” At the time of filing, the taxpayer has no dispute with the IRS; there is no “case” to present. This definition makes sense only in connection with those who assist taxpayers in the examination and appeals stages of the process.

The court rejected two responses by the IRS. First, the Government argued: “It is nonsensical that Congress would authorize [Treasury] to ensure the competency of those who present ‘cases’ but not those who prepare returns, particularly where only a fraction of prepared returns are audited and thereafter become ‘cases’ upon appeal before the Service.”

The Government’s argument is an attempt to invoke the “absurd results” canon of construction, but it does not meet the high bar required by

130. Treas. Reg. § 601.105(b)(1) (1987); see also I.R.C. § 7521(b) (2012) (allowing taxpayer to suspend IRS interview in order to consult with “an attorney, certified public accountant, enrolled agent, enrolled actuary, or any other person permitted to represent the taxpayer before the [IRS] . . . ”).


133. Loving, 917 F. Supp. 2d at 74.


that canon. It is hardly absurd to think that Congress would want to regulate representatives more heavily than advisors.  

Second, the Government contended that section 330(a)(1) is a separate grant of authority from section 330(a)(2)(D), thus the latter does not limit the former. The court rejected this argument on the basis of the “same meaning” canon of construction. The court noted that the sections are proximate and use the same language. “It is a well established rule of statutory construction that a word is presumed to have the same meaning in all subsections of the same statute.”

“Well established,” yes, but invariant, no. No canon is absolute, and in actual practice, courts flout the same meaning canon about as often as they follow it. But adherence is more frequent when, as here, the provisions were enacted at the same time and were codified in the same place.

D. Wider Context

The terms of a statute “cannot be construed in a vacuum. It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.” This is part of the “classic judicial task of reconciling many laws enacted over time, and getting them to ‘make sense’ in combination, [which] necessarily assumes that the implications of a statute may be altered by the implications of a later statute.”

136. See Loving, 917 F. Supp. 2d at 75 (“Congress could well desire that those who represent taxpayers in examinations or appeals be more closely regulated than those who merely prepare returns.”).


138. Loving, 917 F. Supp. 2d at 75 (quoting Allen v. CSX Transp., Inc., 22 F.3d 1180, 1182 (D.C. Cir. 1994)); see also Ratzlaf v. United States, 510 U.S. 135, 143 (1994) (“A term appearing in several places in a statutory text is generally read the same way each time it appears.”).

139. See, e.g., Chickasaw Nation v. United States, 534 U.S. 84, 93 (2001) (rejecting plaintiffs’ arguments for application of statutory canons of construction because “canons are not mandatory rules”); see also Scalia & Garner, supra note 88, at 59 (addressing principle of interrelating canons).


The Loving district court proceeded in this vein in three respects: (1) return preparer-specific penalties that would control over general power to regulate preparers, (2) a disclosure provision that would be expected to reference the regulatory power, and (3) an injunction provision whose safeguards would be set at naught by the claimed regulatory power. In my view, these points have some force but are far from dispositive.

1. Preparer-Specific Penalties

The district court noted that “Congress ha[d] already enacted a relatively rigid penalty scheme to punish misdeeds by tax-return preparers,” a scheme consisting of at least ten penalties specific to preparers.144 The court found this significant for three reasons. First, the court feared that “if [section] 330 covers tax-return preparers, the IRS would have the discretion—with few restraints—to impose an array of penalties for this sort of conduct. . . . [This independence] would trample the specific and tightly controlled penalty scheme in [the Code].”145

Second and third, the court invoked the canons that specific statutes control over general ones and that highly detailed, comprehensive statutory schemes leave little space for courts to read in additional prescriptions.146 The court observed, “when statutes intersect, the specific statutes (in Title 26) trump the general ([section] 330). ‘That is particularly true where . . . Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.’”147

These rationales are not overwhelming. The first rationale—circumvention of procedures set out in the ten penalty sections—is undercut by the second rationale. Since the penalty sections are the more specific sections, the courts could easily hold that the IRS must comply with them, and not the general authority of section 330, when it seeks to discipline or penalize return preparers for conduct potentially covered by both section 330 and one or more of the ten penalty sections.

Moreover, it is doubtful that the ten penalty sections form so comprehensive a regulatory scheme as to squeeze out regulation under section 330. The ten sections are purely “back end” remedies, that is, sanctions after bad conduct has occurred. They do not exclude from practice those who are most likely (because of inadequate training or other incompetence) to commit bad conduct in the future, as the 2011 regulations would. It is entirely possible that Congress could want to address the prob-

144. Loving v. IRS, 917 F. Supp. 2d 67, 76 (D.D.C. 2013) (citing I.R.C. §§ 6694(a)–(b), 6695(a)–(d), (f)–(g), 6713, 7216).
145. Id.
147. Loving, 917 F. Supp. 2d at 77 (alteration in original) (quoting RedLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S. Ct. 2065, 2071 (2012)).
lem from both ends, thus that the purely ex post facto penalties do not rise to the level of a comprehensive scheme.

2. **Disclosure Provision**

Section 6103 of the Code establishes a broad principle of confidentiality of tax return information. It also provides many exceptions, situations in which the IRS may disclose some such information. One of the exceptions is in section 6103(k)(5), which permits the IRS to disclose, to state and local agencies that license and regulate tax return preparers, the identities of preparers against whom the sanctions under sections 6694, 6695, or 7216 have been imposed. The district court found it “curious” that penalties under section 330 were omitted from this list if, as claimed by the Government, section 330 already authorizes the IRS to penalize return preparers.\(^{148}\)

Well, maybe not so curious. First, in fact, omissions often do occur in statutes, which is why how to approach the *casus omissus* has been debated for centuries\(^ {149}\) and why the concept of implied delegation is central to *Chevron*.\(^ {150}\) Second, the oddity is not unique. One of the ten penalties identified by the district court is section 6713, yet that section is also omitted from the section 6103(k)(5) list. Third, the relevant Treasury regulations under section 330 were not promulgated until 2011, and so, of course, no penalties had been imposed. There would be little surprise, therefore, that section 330 would be under the radar when section 6103(k)(5) was drafted.

3. **Injunction Provision**

Under section 7407, upon the occurrence of specified conduct, the Government may bring an action to enjoin a tax return preparer from engaging in the conduct or even from acting as a preparer. The district court stated that, under the Government’s construction of section 330, Treasury could, by disbarring the preparer, “sidestep every protection [section] 7407 affords—judicial review, the demanding standards for the extraordinary remedy of an injunction, and the elevated hurdle for enjoining preparation of tax returns . . . .”\(^ {151}\)

\(^{148}\) See id.


\(^{150}\) *Chevron* held that Congress delegates authority to agencies both by express provisions and by implication from statutory silence. See *Chevron, U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 843–44 (1984). The Court identified several reasons why Congress may have been silent on a particular matter. Perhaps that body consciously desired the Administrator to strike the balance . . . perhaps it simply did not consider the question at this level; and perhaps Congress was unable to forge a coalition on either side of the question . . . . For judicial purposes, it matters not which of these things occurred.

\(^{151}\) *Loving*, 917 F. Supp. 2d at 78.
Technically speaking, the Government’s interpretation of section 330 would not render section 7407 surplusage\footnote{152}{For discussion of the “no surplusage” precept of construction, see Steve R. Johnson, The ‘No Surplusage’ Canon in State and Local Tax Cases, 65 State Tax Notes 793 (2012).} because the provisions offer different remedies: IRS disbarment versus judicial injunction. Nonetheless, the court believed that the easier disbarment route would render section 7407 “pointless” as a practical matter.\footnote{153}{See Loving, 917 F. Supp. 2d at 78 (“The Court will not lightly assume that Congress enacted such a pointless statute.”).}

This type of argument goes only so far. It is quite common for legislatures to enact duplicative measures.\footnote{154}{See Linda D. Jellum, Mastering Statutory Interpretation 104 (2008) (arguing that “the presumptions underlying the no surplusage canon simply do not match political reality”). But see Scalia & Garner, supra note 88, at 179 (criticizing Professor Jellum’s contention).} This is no less true in tax than in other areas. For instance, Congress has often provided the IRS with overlapping, redundant, but nonetheless independent options for collecting unpaid taxes,\footnote{155}{The general federal tax lien under section 6321, for example, typically “swallows” various special tax liens provided by the Code. See David M. Richardson, Jerome Borison & Steve Johnson, Civil Tax Procedure 352–55 (2d ed. 2008) (discussing general tax lien under section 6321 and supplemental special tax liens that vary from normal lien rules).} and the same conduct frequently could be prosecuted under two or more of the Code’s criminal offense sections.\footnote{156}{See Townsend et al., supra note 39, chs. 2A–2B.}

Indeed the district court itself acknowledged that section 7408 “might challenge the Court’s doubt that Congress enacts duplicative statutes” because the injunctive remedy provided by section 7408 largely swallows the comparable remedy under section 7407.\footnote{157}{Loving, 917 F. Supp. 2d at 78.} After “flagging” this point, however, the district court declined to pursue it further because the Government had not relied on, or even cited, section 7408.\footnote{158}{See id. at 79.} The Government does argue section 7408 in its circuit court briefs.\footnote{159}{Brief for the Appellants, supra note 31, at 18–19.}

The district court declined to decide whether any of its textual points would alone require invalidation of the 2011 regulations. Instead, the court found: “[T]ogether the statutory text and context unambiguously foreclose the IRS’s interpretation of [section] 330.”\footnote{160}{Loving, 917 F. Supp. 2d at 79.} Thus, the regulations failed scrutiny at Chevron’s Step One.\footnote{161}{See id.}

E. Remedy

Having concluded that the 2011 regulations do not pass muster at Chevron’s Step One, the district court granted a declaratory judgment that Treasury lacks the statutory authority to promulgate or enforce the new
regulatory scheme. After reviewing the four established conditions, the court also granted a permanent injunction against Treasury and the IRS enforcing the new scheme.\textsuperscript{162} The district court later clarified that the injunction applies to the regulation’s requirements that preparers (other than attorneys, certified public accountants, and enrolled agents and actuaries) pay fees unrelated to obtaining PTINs, pass a qualifying examination, and complete annual continuing education. The plaintiffs had not challenged the requirement that preparers obtain PTINs; thus the injunction does not apply to that requirement.\textsuperscript{163}

The Government asked the district court to stay the injunction pending appeal. The court evaluated this request under a four-factor test: (1) the likelihood of the Government prevailing on the merits of the appeal, (2) the likelihood that the Government would be irreparably harmed without a stay, (3) the prospect that others would be harmed by a stay, and (4) the public interest.\textsuperscript{164}

As to the first factor, the court stated: “Although the Court continues to believe its decision was correct, it is certainly cognizant that the issue is one of first impression and raises serious and difficult legal questions.”\textsuperscript{165} However, finding that the other three factors do not decisively tilt in the IRS’s favor, the court chose not to lift the injunction pending appeal.\textsuperscript{166}

\section*{IV. The “Practice” Rationale}

As seen in subpart IIIC above, a key part of the district court’s rationale was that previously unregulated preparers are not engaged in “practice” within the meaning of section 330. That rationale becomes even more important in light of the limitations identified in subpart IID above regarding the court’s other rationales.

Below, I develop the court’s “practice” rationale. Then, in light of a deeper understanding of what tax returns do, I critique that rationale.

\subsection*{A. District Court’s Conception of “Practice”}

The district court noted that section 330(a)(1) creates no special definition of “practice.”\textsuperscript{167} In such situations, courts typically “construe a stat-
utory term in accordance with its ordinary or natural meaning." But that does not take us very far in Loving. Legal dictionaries define "practice," in the sense most obviously pertinent here, as "engag[ing] in a profession" or "the pursuit of a profession," which leaves much room for interpretation.

Fortunately, in the view of the district court, Congress provided additional indication of its intended meaning. The court looked to section 330(a)(2)(D) to provide the definition omitted from section 330(a)(1). In the court's estimation, the phrase "advise and assist persons in presenting their cases," in section 330(a)(2)(D), provides the content of "practice" in section 330(a)(1).

What, then, does "case" mean? The district court saw "dispute" as being essential to "case." At the time a return is filed, the court reasoned, there is not yet any dispute in existence between the taxpayer and the IRS as to the taxpayer's liability for the year covered by the return. No dispute, no case, no practice subject to regulation.

The district court's approach could be challenged on any of several grounds: that "practice" is broader than "case," that dispute is not an essential element of "case," or that preparing returns is part of a dispute process. Before evaluating such possible challenges, however, it is important to understand just what tax returns do in our system of taxation.

### B. What Tax Returns Do

To understand the functions of tax returns, take as the paradigm individual income tax returns, which represent by far the largest category of returns filed with the IRS. All individual income tax returns have at least two elements, and most have a third element as well: (1) always, a number representing the calculation of the taxpayer's tax liability for the year, (2) often, a claim for a refund of the amount by which available refundable credits exceed that calculated tax liability, and (3) always, nu-

168. FDIC v. Meyer, 510 U.S. 471, 476 (1994). This has long been the rule. See 1 Joseph Story, Commentaries on the Constitution of the United States § 451 (Boston, Hilliard, Gray, & Co. 1833) ("[E]very word . . . is to be expounded in its plain, obvious, and common sense, unless the context furnishes some ground to control, qualify, or enlarge it.").


171. Loving, 917 F. Supp. 2d at 74.

172. Indeed, there usually is no dispute even later because the IRS accepts without change the great majority of returns as filed.

173. See Loving, 917 F. Supp. 2d at 74.

174. In fiscal year 2012, individual income tax returns represented over 60% of all returns filed with the IRS—about 146 million out of the total of about 237 million. The next largest category, employment tax returns, constituted about 13%, about 30 million returns. See IRS, Internal Revenue Service Data Book, 2012 4 (2012) [hereinafter IRS Data Book, 2012].
merous lines and schedules preceding the “bottom line” liability number (and any refund number), which provide the information from which the liability number (and any refund number) was calculated. A document filed with the IRS that lacks sufficient information from which tax liability can be computed does not constitute a valid return.175

The second of the above elements—refund claims—deserves amplification. Originally, individual income tax returns were part of a flow of money that had only one direction: from the taxpayer to the government. That changed as a result of three events: (1) the evolution of the income tax from a “class” tax affecting only a small percent of American citizens into a “mass” tax affecting most adult Americans,176 (2) the enactment of wage withholding, with excess withholding constituting a refundable credit claimed via income tax returns,177 and (3) the proliferation of other refundable credits.

The stories of the first and second of these events are well known.178 The third event and its relationship to Loving are explored in an article by Nina Olson, National Taxpayer Advocate,179 and an amici brief by former IRS Commissioners Mortimer Caplin, Sheldon Cohen, Lawrence Gibbs, Fred Goldberg, and Charles Rossotti,180 from which much of the following discussion is drawn.

In addition to excess withholding, major refundable credits include the earned income credit, child credit, medical insurance cost credit, first-time homebuyer credit, making-work-pay credit, and adoption expense credit.181 Many of these credits are not intrinsic to the measurement and taxation of income but rather are conceptually non-tax social welfare or incentive measures that Congress has chosen to administer through the income tax apparatus. Return preparers “find themselves on the front line of administering these programs.”182


176. Before the start of World War II, only 3% of Americans paid any federal income tax. That amount rose to 30% by the War’s end and continued to climb in succeeding decades. See Bruce Bartlett, The Sacrosanct Mortgage Interest Deduction, N.Y. Times (Aug. 6, 2013, 12:01 AM), http://economix.blogs.nytimes.com/2013/08/06/the-sacrosanct-mortgage-interest-deduction/.


179. See Olson, supra note 18.

180. See Brief of Former Comm’rs, supra note 35.

181. For a list of these provisions, see I.R.C. §§ 31, 32, 24(d)(1), 35, 36, 36A, and 23, respectively. Refundable credit claims represented over 36% of 2011 refund claims. See Olson, supra note 18, at 777 (citing IRS data).

182. Brief of Former Comm’rs, supra note 35, at 5.
In 2012, over 82% of filed individual income tax returns resulted in payment of a refund. Total refunds paid exceeded $322 billion, an average of nearly $2,700 per return claiming a refund.

Because many of the refundable credits—as well as other features of the Code, including many exclusions, deductions, and nonrefundable credits—are “hideously complex, return preparation is anything but straightforward” and is beyond the abilities of most taxpayers. As a result:

If you hold yourself out to the public as a tax return preparer, you are not a mere scrivener. You are in the business of advising and assisting your client, the taxpayer, on the treatment of her items of income and expense under the tax code, and on her eligibility for government benefits that are delivered through the tax code. It is your judgment and your knowledge that enable you to make that entry on the return on behalf of the taxpayer.

Thus, Taxpayer Advocate Olson maintains, “[u]nlike in 1884 . . . or 1982 (when the 1884 statute was 'stylistically' rewritten), return preparers today are the intermediaries between taxpayers and their government for most individual and business taxpayers,” and “[t]he definition of representative must keep up with the programs and policies Congress has chosen to administer through today’s tax code.”

I am somewhat uneasy with the above argument. There is an ongoing debate in statutory interpretation between dynamists who believe that courts should update old statutes in light of changed conditions and textualists who believe that “legal texts must be given the meaning they bore when adopted,” and “we do not allow courts to ‘update’ them.”

I am more in sympathy with the latter viewpoint. If the meaning of the statute can expand because Congress laces the Code with non-revenue provisions, it presumably would contract should Congress later move those


184. See IRS DATA BOOK, 2012, supra note 174, at 19. For a breakdown of the numbers and amounts of refunds claimed for 2011 for six of the largest refundable credits, see Olson, supra note 18, at 776 tbl.1 (giving statistics from IRS Compliance Data Warehouse).

185. Olson, supra note 18, at 767.

186. Id. at 770.

187. Id. at 771.

188. See, e.g., GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES (1982); LON L. FULLER, THE LAW IN QUEST OF ITSELF 9 (1940) (describing a statute as "not something that is, but something that becomes; it is not a hard chunk of reality, but a fluid process").

189. SCALIA & GARNER, supra note 88, at 403–04.
provisions out of the Code, transferring them to other agencies or repealing them entirely. Statutes should be imbued with greater stability.

Despite this uneasiness, there is some pedigree for the evolutionary approach. For instance, the Supreme Court’s iconic *Bob Jones University v. United States* decision was based on a static statute which was allowed to “evolve” to reflect changing public policy.191

C. Critique of District Court’s Conception

1. Is Dispute Necessary?

As seen in subpart IVA above, the district court defined “practice” in terms of presenting a “case” and saw an extant dispute as essential to the existence of a “case.” It is understandable for a federal judge to think so, steeped as such a magistrate is in the “case and controversy” limitation on his or her jurisdiction.192

But is dispute an indispensable ingredient of “case”? Dictionaries are not the be-all and end-all for legal definitions—the perils of dictionary shopping are well known193—but they are relevant to the exercise.

Legal dictionaries and related works often give dispute or controversy as an attribute of either “case” or its near relatives—often synonyms194—“cause,” “action,” and “suit.”195 But an approximately equal number define these terms without reference to dispute or controversy. The alternative definitions include “grounds,”196 “right to sue,”197 “all proceedings with respect to a . . . claim,”198 and “[t]he legal theory of the party.”199

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191. However, the *Bob Jones* Court cautioned that its approach should be used sparingly. See *id.* at 592.
192. See U.S. Const. art. III, §§ 1–2 (defining power of judiciary). This is the textual basis, for example, of the inability of federal judges to render advisory opinions. See *Flast v. Cohen*, 392 U.S. 83, 96–97 (1968).
195. See Ballentine’s *Legal Dictionary and Thesaurus* 142 (1995); Black’s *Law Dictionary* 243 (9th ed. 2009); Garner, supra note 194, at 142; Oran, supra note 169, at 79.
198. Clapp, supra note 170, at 71.
The reference above to “claim” is significant in light of the genesis of section 330. As shown in subpart IIA above, the provision originated in 1884, and the current (1982) revision was intended to effect only stylistic, not substantive, changes. The 1884 version referred to the representation of “claimants,” those who make claims. The dictionaries are virtually unanimous that “claim” means “an assertion that one is entitled to something,” or “[t]he aggregate of operative facts giving rise to a right enforceable by a court.” This also was the meaning understood around the time the original version of section 330 was enacted.

As described in subpart IVB above, tax returns assert the taxpayer’s calculated liability and, in most cases, their demand for a specified refund for which the taxpayer will be entitled to sue if not paid by the IRS. These sound like claims, rights to sue, and assertions of entitlement as used above. The filing of the returns could be viewed as a proceeding with respect to the claims.

Tax returns also contain numerous lines and schedules providing the information from which the liability and refund amounts were computed. These sound like the taxpayer’s grounds, legal theory, or the aggregate of operative facts giving rise to the taxpayer’s enforceable right.

2. Is Dispute Present?

Another possible avenue of attack would be to accept the district court’s premise that dispute is necessary but to maintain that dispute is present as to prepared returns, either potentially or actually. In taking this position, Taxpayer Advocate Olson offers three perspectives. First, “tax return filing has always been a somewhat adversarial act because the taxpayer holds all the information and gets to decide (at her own risk) how much she will tell the tax agency.”

Second, the sweep and complexity of the income “tax system almost guarantee that every return has an error in it—some inadvertent, some

200. CLAPP, supra note 170, at 84; see also BALLENTINE’S LEGAL DICTIONARY AND THESAURUS, supra note 195, at 101; GARNER, supra note 194, at 159; MELLINKOFF, supra note 194, at 81; ORAN, supra note 169, at 90.

201. BLACK’S LAW DICTIONARY, supra note 195, at 81–82; MELLINKOFF, supra note 194, at 81; ORAN, supra note 169, at 90.

202. See Hobbs v. McLean, 117 U.S. 567, 575 (1886) (“What is a claim against the United States is well understood. It is a right to demand money from the United States.”); see also Milliken v. Barrow, 65 F. 888 (C.C.E.D. La. 1895), aff’d, 74 F. 612 (5th Cir. 1896).

203. See BLACK’S LAW DICTIONARY, supra note 195, at 281.

204. See I.R.C. § 7422(a) (2012) (prohibiting suit for refund unless preceded by claim for refund).

205. It would be no answer to say that not all returns make refund claims. All preparers prepare some refund returns and some non-refund returns. As long as a preparer prepared some refund claims, the preparer would be engaged in “practice” under the above line of reasoning.

206. Olson, supra note 18, at 771.
intentional.” 207 Indeed, the “law has evolved so that competently advising a taxpayer and accurately preparing even the simplest return require an extraordinary exercise of judgment and knowledge by the return preparer.” 208

Third, the position taken on the return “constitutes the opening volley in making [the taxpayer’s] case,” part of the “annual conversation with the federal government.” 209 After the return has been submitted, but before it is accepted into the system, the IRS subjects the return to substantial error review and pre-screening, especially when the return claims a refund. These activities are not counted as audits. When these steps are taken into account, the audit rate rises from the officially announced rate of around 1% 210 to about 7.5%. 211 From this perspective, the bulk of the IRS’s compliance checks—arguably controversy “cases”—occur outside traditional examination and collection. 212 Based on modern IRS processing procedures, Professor Camp concludes: “Far from being automatically accepted as filed, all filed returns must make a prima facie case that they are correct . . . . Tax returns do, in a very real sense, present a case before the IRS as to what should be assessed.” 213

The perspectives above represent independent challenges to the district court’s “practice” rationale. Dispute might or might not be an essential component of “case” and thus “practice.” If it is, dispute might or might not be present in sufficient degree in the return preparation, filing, and processing system. Both of these propositions are debatable.

V. AN ALTERNATIVE RATIONALE—“REPRESENTATIVE”

A. “Representative”

The questionable nature of the rationales offered by the district court does not mean that Loving was wrongly decided. Appellate courts review the holdings, not the reasoning, of lower courts. 214 Accordingly, it has long been “the settled rule that, in reviewing the decision of a lower court, it must be affirmed if the result is correct although the lower court relied upon a wrong ground or gave a wrong reason.” 215

207. Id.
208. Id. at 771–72.
209. Id. at 772.
211. See Olson, supra note 18, at 773.
212. See id.
213. Camp, supra note 104, at 463, 465. Professor Camp’s painstaking historical elaboration makes his article, along with Taxpayer Advocate Olson’s, must-reads for those interested in Loving.
215. SEC v. Chenery Corp., 318 U.S. 80, 88 (1943) (internal quotation marks omitted). The courts are “reluctant to entertain novel propositions of law with broad implications . . . that were not advanced in earlier stages of the litigation . . . .” Comm’r v. Banks, 543 U.S. 426, 438 (2005). However, the “representa-
I believe there is an alternative rationale that provides a sounder basis for the district court’s holding. That rationale trenches on other language in section 330. Section 330(a)(1) authorizes regulation of “the practice of representatives of persons before the Department of the Treasury.”\textsuperscript{216} Thus, even if there is “practice,” it is not subject to regulation unless it is the practice of a “representative.” The centrality of “representative” to the statutory scheme is underlined by the fact that the term (or a form of it) appears in four other places in the statute\textsuperscript{217} and appeared in the original, 1884 version.\textsuperscript{218}

The sources are in virtually universal agreement that, in the sense relevant here, to represent is “to act for another, as an agent or attorney does; to stand in the place of another; to speak for another,”\textsuperscript{219} and that a representative is “[o]ne who stands for or acts on behalf of another.”\textsuperscript{220}

One who prepares the return of another, without more, is not acting, standing, or speaking for the taxpayer. Taxpayer Advocate Olson is surely correct in saying that taxpayers typically do not understand the tax law themselves and so rely on the expertise and advice of their preparers.\textsuperscript{221} But that does not alter the fact that the return is the taxpayer’s.\textsuperscript{222} A form signed by the taxpayer, but not the preparer, is a valid return; a form signed by the preparer, but not the taxpayer, is not a valid return.\textsuperscript{223} Thus, the preparer cannot act on behalf of the taxpayer in submitting a return.

The preparer-client situation in \textit{Loving} is distinguishable from the attorney-client relationship in \textit{Commissioner v. Banks}.\textsuperscript{224} In \textit{Banks}, the taxpayer’s “issue was raised by the plaintiffs from the start. \textit{See Complaint for Declaratory and Injunctive Relief at ¶¶ 55–58, Loving v. IRS, 917 F. Supp. 2d 67 (D.D.C. 2013) (No. 12-0385), 2012 WL 5356606.}


\textsuperscript{217} \textit{See id.} § 330(a)(2), (a)(2)(C), (b), (b)(4).

\textsuperscript{218} \textit{See Act of July 7, 1884, ch. 334, 28 Stat. 236, 258 (“representing of claimants”).}

\textsuperscript{219} \textit{Ballentine’s Legal Dictionary and Thesaurus, supra} note 195, at 575–76.

\textsuperscript{220} \textit{Black’s Law Dictionary, supra} note 195, at 1416; \textit{see also} Clapp, \textit{supra} note 170, at 372; Mellinkoff, \textit{supra} note 194, at 555; Oran, \textit{supra} note 169, at 418.

\textsuperscript{221} \textit{See Olson, supra} note 18, at 771–72 (observing complex evolution of tax law has resulted in reliance on expertise of tax preparers).

\textsuperscript{222} \textit{See Camp, supra} note 104, at 468 (arguing that return preparers are not agents or representatives of their clients). Professor Camp and I agree that “representative” is the best argument against the 2011 regulations. \textit{See id.} at 462–64 (providing support for assertion that representative is best argument). He, however, believes the argument ultimately fails, while I believe that it succeeds. \textit{See id.} at 466–69 (concluding that representative argument fails). For a discussion of his objections to the argument, see \textit{infra} notes 228–42.

\textsuperscript{223} \textit{See I.R.C. §§ 6061, 6064–65 (2012); Treas. Reg. § 1.6012–1(a) (5) (2012).}

ers, successful plaintiffs in tort actions, sought above-the-line deductions for contingent fees paid to their attorneys. On the basis of the assignment-of-income doctrine, the Supreme Court disagreed, relegating the taxpayers to less desirable below-the-line deductions. In rejecting an alternative argument for the taxpayers, the Court stated:

We further reject the suggestion to treat the attorney-client relationship as a sort of business partnership or joint venture for tax purposes. The relationship between client and attorney . . . is a quintessential principal-agent relationship. . . . The client may rely on the attorney's expertise and special skills to achieve a result the client could not achieve alone. That, however, is true of most principal-agent relationships, and it does not alter the fact that the client retains ultimate dominion and control over the underlying claim. . . . Even where the attorney exercises independent judgment without supervision by, or consultation with, the client, the attorney, as an agent, is obligated to act solely on behalf of, and for the exclusive benefit of, the client-principal, rather than for the benefit of the attorney or any other party.

In the context discussed by Banks, the attorney is authorized to act, and does act, on behalf of the plaintiff-client. In the Loving context, however, the preparer is not authorized to act, and does not act, on behalf of the taxpayer-client. The attorney is empowered to start the case and take other significant action via documents signed by him alone. The client makes the decisions, of course, but the lawyer has the power to execute them. In contrast, the preparer qua preparer lacks this power. It is the taxpayer’s execution, not the preparer’s, that makes the filed document legally operative as a tax return.

B. Counterarguments Considered

Presumably because it was not the focus of the district court’s opinion, the “representative” question received scant attention from the Government on appeal. The totality of the treatment of the question in its initial brief to the D.C. Circuit was the following half sentence in a footnote: “There can be no serious dispute that paid tax-return preparers are ‘representatives of persons’ . . . .”

Plainly, a more substantial rejoinder is needed. Commentators and officials have offered four: (1) preparers routinely communicate with the IRS after filing; (2) Treasury regulation has progressively and substantially

225. See Banks, 543 U.S. at 426 (providing facts).
226. Id. at 436.
227. See Olpin v. Comm’r, 270 F.3d 1297, 1300–01 (10th Cir. 2001), aff’d 78 T.C.M. (CCH) 1254 (1999) (holding that “return” signed by tax preparer but not taxpayers is invalid even if taxpayers intended document to be their return).
228. Brief for the Appellants, supra note 31, at 14 n.11.
expanded; (3) preparers have limited appearance rights; and (4) purposively, the current situation is comparable to the situation prompting the 1884 legislation. These arguments are considered below.

1. **Routine Communication**

The National Taxpayer Advocate points out that, after their clients’ returns are filed, “preparers call the IRS constantly inquiring about the status of these returns. In short, they have cases before the IRS and they are advocating on behalf of their clients’ claims.”

But inquiring when the IRS is likely to send out the refund is qualitatively different from urging the merits of the claim. The latter is substantive. The former is ministerial.

2. **History of Expansion**

Professor Camp carefully develops the history of regulation of practitioners under Treasury Circular 230, including modifications between 1884 and 1921, between 1921 and 1966, in 1984, in 1994, in 2004, and in 2007. He concludes: “What Treasury has done over time is expand the term ‘practice’ beyond simply the representational behavior of ‘representatives of persons.’ . . . The term ‘practice’ now includes nonrepresentational behavior—such as preparing returns and rendering written tax advice—as long as that behavior is engaged in by representatives of persons.”

As described in subpart IIB above, some of the policy concerns about the regulation are intrusion and regulatory overkill. The dramatic expansion of Treasury’s asserted authority under Circular 230—particularly in the last two decades—suggests that there may be substance to these concerns.

Moving beyond policy, there are three reasons why I believe the above history does not legitimize the 2011 regulations. First, usurpation is not its own justification. The fact that an agency expands its self-proclaimed power does not make such arrogations legitimate. This is especially so because the most aggressive assertions under Circular 230 came, not in the first 100 years after the 1884 legislation, but only comparatively recently, within the last twenty years.

Second, although courts sometimes consider post-enactment administrative behavior as one factor bearing on interpreting a statute, Part VI

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229. Olson, supra note 18, at 775.

230. Cf. S. REP. No. 94-354, at 37 (1975) (discussing when request for status report can constitute an *ex parte* communication prohibited by APA, 5 U.S.C. § 557(d)).

231. See Camp, supra note 104, at 457–62 (“I do not present the history of Circular 230 as a strictly legal or doctrinal argument favoring regulation . . . . My intention is to simply explain how the decision to regulate return preparers is more consistent than inconsistent with the past.”).

232. Id. at 462.
puts this and related factors together in the context of a Brown & Williamson analysis. As shown in Part VI, the totality of that analysis militates against the validity of the 2011 regulations, or at a minimum offsets the Circular 230 historical analysis.

Third, the most pertinent event in the Circular 230 history is the 1984 episode. In 1984, as part of the government’s ongoing war against tax shelters, Treasury amended sections 10.2(a) and 10.33 of Circular 230 to assert—for the first time—authority to control opinion writing by attorneys and certified public accountants.233

Professor Camp agrees that under a narrow reading of section 330(a), the 1984 change “was overreaching.”234 However, Congress sanctioned that change. It enacted section 330(d) to provide:

Nothing in [section 330] or in any other provision of law shall be construed to limit the authority of the [ ] Treasury to impose standards applicable to the rendering of written advice . . . of a type which the [Treasury] determines as having a potential for tax avoidance or evasion.235

The 1984 tax shelter opinion change was the only expansion of Circular 230 that Congress specifically ratified. Congress did not see fit to enact comparable provisions blessing other expansions of Circular 230. This episode points to the correct path in Loving. If Congress wishes, it can legitimate Treasury’s approach by enacting confirming legislation, as Congress did in 1984 regarding section 330(d). Absent such legitimation, the naked assertion of administrative power should not be sustained.

3. Limited Appearance Rights

Section 10.7 of Circular 230 created limited practice rights for return preparers. With respect to returns they have prepared, they are allowed to “appear without enrollment as the taxpayer’s representative . . . before revenue agents and examining officers” of the IRS Examination Division.236

The Government does not emphasize this provision in Loving. Properly so. One could understand Treasury, based on section 330, regulating preparers who actually do represent clients during audits under section 10.7. But most return preparers do not exercise this privilege. The section should not be used as a cat’s paw to sweep into the regulatory net the numerous return preparers who never act as representatives.

234. Camp, supra note 104, at 460.
236. Camp, supra note 104, at 459 (alteration in original) (internal quotation marks omitted).
4. **Comparable Purposes**

As shown in subpart IIA above, Congress enacted the original version of section 330 because of misconduct by unscrupulous attorneys and claims agents.\(^{237}\) Likening current incompetence and dishonesty to that earlier misconduct, the National Taxpayer Advocate maintains: “Today’s tax system, with its industry of preparers, closely resembles the circumstances in 1884 when Congress sought to impose order on the process of filing claims before Treasury.”\(^{238}\)

If the analogy holds, this argument could be persuasive to judges who accept purpose as a legitimate part of the *Chevron* Step One inquiry. I think, though, that the situations are distinguishable in three respects. First, the 1880s claims agents actually appeared before Treasury officials;\(^{239}\) mere return preparers do not. Second, claimants in the 1880s often conveyed their claims to the representatives;\(^{240}\) taxpayers do not convey their tax refund claims to their return preparers—indeed they are legally prohibited from doing so by the Anti-Assignment Act.\(^{241}\) Third, in the 1880s, rival agents and attorneys often made conflicting claims on Treasury;\(^{242}\) there is no indication that something of the same nature is a problem now. The proffered analogy does not fit with much precision.

**VI. BROWN & WILLIAMSON**

The Supreme Court’s 2000 *Brown & Williamson* decision is an important case for *Chevron*, general administrative law, and statutory interpretation.\(^{243}\) The district court’s *Loving* opinion cited *Brown & Williamson* twice.\(^{244}\) In my view, however, that case should play a larger role in the current controversy.

There are differences between *Brown & Williamson* and *Loving* to be sure, but there are meaningful similarities as well. Below, I describe *Brown & Williamson*, then note its application to *Loving*.

\(^{237}\) For a further discussion of the reasons Congress enacted the original version of section 330, see *supra* notes 16–23 and accompanying text.

\(^{238}\) Olson, *supra* note 18, at 775.

\(^{239}\) *See* George Maurice Morris, *Growth and Regulation of the Treasury Bar*, 8 A.B.A. J. 742, 742 (1922) (observing that claims agents appeared before Treasury officials).

\(^{240}\) *See id.* (“As the result of the conveyance by claimants of their claims to their representatives questions began to arise between such claimants and their agents . . . .”).

\(^{241}\) *See Anti-Assignment Act, 31 U.S.C. § 3727(b) (2012)* (restricting who can receive assignment).

\(^{242}\) *See Morris, supra* note 239, at 742.


\(^{244}\) *See Loving v. IRS, 917 F. Supp. 2d 67, 75, 77 (D.D.C. 2013)* (standing for proposition that ambiguous words can be clarified by context and idea that meaning of one statute may be clarified by other statutes, especially ones subsequently enacted and more specific).
The Food, Drug, and Cosmetic Act (the “Act”) grants the Food and Drug Administration authority to regulate, inter alia, “drugs” and “devices.”\footnote{245. See 21 U.S.C. §§ 321(g)–(h), 395 (2012).} In 1996, after having long disclaimed having authority to do so, the FDA asserted jurisdiction under the Act to regulate tobacco products, and it promulgated regulations to do so. By a five to four vote, the Supreme Court invalidated the regulations under Chevron’s Step One. The majority stated that, at Step One, “a reviewing court should not confine itself to examining a particular statutory provision in isolation.”\footnote{246. Brown & Williamson, 529 U.S. at 132.} It should consider, as well, other related statutes, “particularly where Congress has spoken subsequently and more specifically to the topic at hand.”\footnote{247. Id. at 133. The Court has not been consistent as to nuance. In contrast to Brown & Williamson’s “especially” language, the Court in the same year said that courts should “interpret the text of one statute in the light of text of surrounding statutes, even those subsequently enacted.” Vt. Agency of Natural Res. v. United States ex rel. Stevens, 529 U.S. 765, 786 n.17 (2000) (emphasis added) (calling this principle “well established”); see also United States v. Estate of Romani, 523 U.S. 517, 530–31 (1998) (“[A] specific policy embodied in a later federal statute should control our construction of the [earlier] statute, even though it ha[s] not been expressly amended.”).} In addition, the court “must be guided to a degree by common sense as to the manner in which Congress is likely to delegate a policy decision of such economic and political magnitude to an administrative agency.”\footnote{248. Brown & Williamson, 529 U.S. at 133.} The Court reached its Step One conclusion on the basis of several considerations. One was the Act taken as a whole.\footnote{249. See id. at 142.} By itself, however, this likely would have been insufficient, especially because, as noted by the dissent, the statutory language—read literally—seemed to countenance the regulations.\footnote{250. See id. at 162 (Breyer, J., dissenting).} Thus, looming large to the outcome were the four reinforcing rationales discussed below: (1) the pattern of subsequent legislation, (2) the FDA’s repeated disavowal of the authority it eventually asserted in 1996, (3) Congress’s rejection of bills that would have clearly conferred the authority, and (4) the expectation that Congress will make particularly important decisions itself rather than delegate them to an agency.

1. Pattern of Subsequent Legislation

The Brown & Williamson majority noted that, over a thirty-five year period after passage of the Act, Congress had enacted six separate pieces of legislation addressing tobacco use and human health, the “collective premise” of which was that tobacco products would continue to be sold in
the United States. Although the text of the Act could, at the time of its enactment, have been plausibly interpreted to allow regulation or even prohibition of tobacco products, the subsequent legislation had narrowed the range of plausibility, excluding that possibility.

I have never been entirely sure why this should be so. As seen earlier, textualists—and the five Justices in the majority in *Brown & Williamson* were usually considered textualists—typically insist that the meaning of language at the time the statute is enacted should control. And the reenactment and inaction canons are usually (and properly) considered weak, in part because the views of subsequent legislatures should not be attributed to the enacting legislature. Also, when a later statute does not purport to amend or abrogate a prior statute, there is a strong presumption against repeal by implication.

Why then should later statutes influence the construction of earlier statutes? One reason seems to be courtesy to a coordinate branch of government. Courts presume that legislatures pass laws “with deliberation, and with full knowledge of existing ones on the same subject . . . .” Of course, “[t]he legislative omniscience assumed by this explanation is fanciful,” but Anglo-American law would be unrecognizable without fictions. It is polite to assume that Congress’s actions, even over time, are cohesive.

Additionally, courts believe that it is part of their function to provide stability and assist the governed to understand the commands of the sovereign. Thus:

251. See id. at 139, 143 (majority opinion).

252. See id. at 143 (“Over time, however, subsequent acts can shape or focus those meanings.”).

253. See Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 650 (1990) (“It is a particularly dangerous ground on which to rest an interpretation of a prior statute when it concerns, as it does here, a proposal that does not become law.”); Sullivan v. Finkelstein, 496 U.S. 617, 632 (1990) (Scalia, J., concurring) (“Arguments based on subsequent legislative history . . . should not be taken seriously, not even in a footnote.”); United States v. Sw. Cable Co., 392 U.S. 157, 170 (1966) (stating that views of subsequent legislators have “very little, if any, significance”); Haynes v. United States, 390 U.S. 85, 87 n.4 (1968) (“The view of a subsequent Congress of course [can] provide no controlling basis from which to infer the purposes of an earlier Congress.”).


255. See Bob Jones Univ. v. United States, 461 U.S. 574, 600–02 (1983) (stating that these canons are usually disfavored but finding special reasons to apply them in case at hand).


258. Scalia & Garner, supra note 88, at 328.
Where a statutory term . . . is ambiguous, we construe it to contain that permissible meaning which fits most logically and comfortably into the body of both previously and subsequently enacted law. We do so not because that precise accommodative meaning is what the lawmakers must have had in mind (how could an earlier Congress know what a later Congress would enact?), but because it is our role to make sense rather than nonsense out of the corpus juris.259

2. Agency’s Prior Disavowal of Authority

In a brief filed in a 1980 case, the FDA stated: “In the 73 years since the enactment of the original [Act] . . . the FDA has repeatedly informed Congress that cigarettes are beyond the scope of the statute . . . .”260 In light of the importance and visibility of the issue, the Court thought it inconceivable that Congress was unaware of these prior agency statements.261

In light of the Court’s frequent previous statements discounting the significance of agency inconsistency,262 the Brown & Williamson majority did not say that the FDA’s former statements were themselves controlling. Instead, “[t]he consistency of the FDA’s prior position is significant . . . for a different reason: It provides important context to Congress’s enactment of its tobacco-specific legislation . . . [which] has effectively ratified the FDA’s previous position that it lacks the jurisdiction to regulate tobacco.”263

3. Rejected Bills

The Brown & Williamson majority noted that Congress had considered and rejected bills that would have granted the FDA the authority it asserted for its invalidated regulations.264 As the Loving district court noted, the Court in other cases has downplayed the significance of such behavior as a guide to statutory interpretation.265

261. See id. at 156 (concluding that in light of circumstances, it was “hardly conceivable that Congress . . . was not abundantly aware of what was going on”). This is similar to what the Court observed about Congress’s knowledge of the IRS’s position on tax exemption of racially discriminatory schools. See Bob Jones Univ. v. United States, 461 U.S. 574, 600–02 (1983).
262. See supra notes 103–26.
264. See id. at 144 (explaining Congress’s considerations).
265. See supra notes 99–100 and accompanying text.
What made the Brown & Williamson context different? In United States v. Rodgers, an important tax collection case, the Court discounted the significance of Congress’s failure to enact a bill, concluding that the reason for non-enactment was more likely that Congress viewed the bill as unnecessary (because the IRS already possessed the power in question) than as undesirable (because the IRS should not have that power). That could not have been the reason for the failure of the tobacco regulation bills. With the FDA consistently stating that it lacked the regulatory authority, Congress could not have concluded that the bills were superfluous, making more probable the inference that Congress, in rejecting the bills, wished to keep the authority out of the FDA’s hands.

4. Major Question

There is a debate about whether there is and should be a “major question” exception to judicial deference to agencies. There is some judicial support for a strong form of the rule: major policy choices should be made by Congress, not by agencies. There is substantial judicial support for a weaker form of the rule: it is presumed that Congress intends to address major questions itself and that only unambiguous statutory language will persuade a court that Congress intended to delegate resolution of such questions to an agency.

Commentators continue to discuss both the scope and the wisdom of “major question” rules. However, many Justices embraced the weak form in a fairly recent tax decision and the Court adopted an important rationale behind the rules in an even more recent non-tax case.

267. See id. at 702 n.31.
268. See Abigail R. Moncrieff, Reincarnating the “Major Questions” Exceptions to Chevron Deference as a Doctrine of Noninterference (or Why Massachusetts v. EPA Got It Wrong), 60 ADMIN. L. REV. 593 (2008).
269. See Indus. Union Dep’t, AFL-CIO v. Am. Petroleum Inst., 448 U.S. 607, 687 (1980) (Rehnquist, J., concurring) (“It is the hard choices, and not the filling in of the blanks, which must be made by the elected representatives of the people. When fundamental policy decisions underlying important legislation about to be enacted are to be made, the buck stops with Congress and the President insofar as he exercises his constitutional role in the legislative process.”).
272. See United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836, 1842 (2011); see also Johnson, supra note 5.
273. See City of Arlington v. FCC, 133 S. Ct. 1863, 1872 (2013) (“[C]oncerns about agency self-aggrandizement are at their apogee . . . in cases where an
The Brown & Williamson majority linked the “major questions” doctrine to Chevron’s notion that a statutory gap may be an implicit delegation of authority to the agency. It stated: “In extraordinary cases, [ ] there may be reason to hesitate before concluding that Congress has intended such an implicit delegation.”274 And it offered the following—the weak form of the doctrine—apparently as an example: “A court may also ask whether the legal question is an important one. Congress is more likely to have focused upon, and answered, major questions, while leaving interstitial matters to answer themselves in the course of the statute’s daily administration.”275 Applying this to tobacco regulation, the Court stated: “Congress could not have intended to delegate a decision of such economic and political significance to an agency in so cryptic a fashion.”276

There is an epilogue. By the time Brown & Williamson had worked its way through the courts, “Congress had enacted limited versions of most of FDA’s major initiatives” regulating tobacco.277 Then, in 2009, Congress enacted the Family Smoking Prevention and Control Act, conferring upon the FDA broad authority to regulate tobacco products.278

B. Application to Loving

As seen in subpart IIIB, the Loving district court conducted the Step One inquiry in an exacting fashion, not stopping at the fact that section 330(a)(1) had not defined “practice of representatives.”279 Instead, it enlisted other portions of the statute, as well as other statutes, to reach its conclusion that Congress had unambiguously withheld the authority asserted by Treasury and the IRS.

Brown & Williamson reflects the same kind of approach. The literal language of the statute at issue supported the agency, but the majority did not stop there. The majority found the literal language to be overridden by a combination of contextual clues.

Giving greater attention to Brown & Williamson bolsters the Loving plaintiffs’ cause in four ways: (1) providing a stronger framework for the district court’s context and “wider context” points, (2) creating some purchase for potential arguments the district court discounted, (3) laying agency’s expansive construction of the extent of its own power would have wrought a fundamental change in the regulatory scheme.”).

275. Id. (quoting Stephen Breyer, Judicial Review of Questions of Law and Policy, 38 ADMIN. L. REV. 363, 370 (1986)).
277. Moncrieff, supra note 268, at 627 (identifying different versions).
a foundation for a strong-form major-question argument, and (4) suggesting a favorable tie-breaker via a weak-form major-question argument. Below, I discuss the first and second of these possibilities together, then the third and fourth together.

1. **Wider Context and Discounted Arguments**

   The *Brown & Williamson* majority did not treat any one indicator as dispositive. Instead, it wove several threads together to form the contextual tapestry it found decisive: the statute as a whole, other statutes enacted subsequent to the statute at issue, the FDA’s prior and contrary position—surely known to Congress—that it lacked the authority in question, and Congress’s rejection of bills that would have conferred the authority the FDA said it lacked under existing legislation.

   Each of these elements arguably exists in *Loving* as well: the statute as a whole (the district court reading section 330(a)(1) in light of section 330(a)(2)(D)), other subsequent statutes (the ten preparer penalties, the disclosure statute, and the injunction statute), the agency’s denial of authority (including in testimony given by the IRS to Congress), and Congress’s rejection of bills that would have conferred on the Treasury/IRS the authority it originally said it lacked under section 330.

   Deploying these arguments in a *Brown & Williamson* analysis would strengthen the arguments—context of the statute and wider context—that the district court did employ. Part III noted that these points have some cut when based solely on various canons of construction but that their cut is limited by certain weaknesses. These points would have greater force when grounded on both traditional canons and *Brown & Williamson*.

   In addition, the district court chose not to enlist Treasury/IRS’s inconsistency and Congress’s rejection of potentially empowering bills. That rejection is understandable based on precedents as to such things taken in isolation. But adopting a *Brown & Williamson* framework could allow these rejected points to be considered as part of a meta-contextual analysis.

   I do not maintain that the *Loving* circumstances map with perfect congruence onto the *Brown & Williamson* circumstances. For instance, the six subsequent tobacco-specific statutes strike me as closer in subject matter to the Food and Drug Act than the preparer penalty, disclosure, and injunction sections are to section 330. Further, the FDA’s disavowals of jurisdiction were more frequent and visible than the IRS’s disavowals of jurisdiction. Thus, the meta-context in *Brown & Williamson* is stronger than the meta-context in *Loving*.284

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280. See supra notes 127–41 and accompanying text.
281. See supra notes 142–61 and accompanying text.
282. See supra notes 103–26 and accompanying text.
283. See supra notes 93–102 and accompanying text.
284. And even the *Brown & Williamson* meta-context persuaded only five of the nine Justices.
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But if Loving is “Brown & Williamson lite,” it is more “Brown & Williamson” than “lite.” That is, although there is some difference in degree or intensity, the similarities between the two cases remain striking. Serious development of Brown & Williamson and its comparability to Loving would, I believe, bolster the Loving result.

2. “Major Question” Arguments

The Loving district court stated that the importance of the initiative is irrelevant at Step One of Chevron. Brown & Williamson takes the same tack. The dissent in that case offered that “the statute’s basic purpose—the protection of public health—supports the inclusion of cigarettes within its scope.” The majority rejoined that, “[i]n our anxiety to effectuate the congressional purpose of protecting the public, we must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop.”

But this attains yet more strength when put in a Brown & Williamson major-question context. By a rhetorical ju-jitsu, the more significant the return preparer regulation project—the more preparers involved, the more clients affected, and the more the dollar stakes—the more the plaintiffs can argue, first, that the matter is so significant that Congress, not Treasury, should create the regulatory scheme (strong form) or, second, that the courts should find that Congress delegated that authority to Treasury only upon the clearest textual evidence (weak form).

Of the two, the weak-form version stands the better chance of winning judicial acceptance. One of the problems with the major-question approach is the absence of readily manageable judicial standards: at what point does a question become important enough to trigger the doctrine? That is a bigger concern when applying the strong form. The weak form is a species of the well-known and often invoked “plain statement” principle of statutory interpretation, and line-drawing difficulties

285. See supra notes 90–92 and accompanying text.

286. FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 162 (2000) (Breyer, J., dissenting) (pointing out FDA’s findings that unregulated tobacco use causes over 400,000 deaths annually and that tobacco products kill more people than AIDS, car accidents, alcohol, homicides, illegal drugs, suicides, and fires combined).

287. Id. at 161 (majority opinion) (quoting United States v. Article of Drug, Bacto-Unidisk, 394 U.S. 784, 800 (1969)).


289. When a particular interpretation of a statute would compromise important substantive principles (here, that the legislature should make the big calls), courts typically accept the interpretation only if the statute contains a plain, unambiguous statement that the legislature intended to do so. See, e.g., Nixon v. Mo.
do not seem to have deterred courts very often from invoking that principle.

The district court properly acknowledged that *Loving* presents “serious and difficult legal questions.” A tie-breaking principle such as *Brown & Williamson’s* weak-form, major-question approach might present a tempting way to resolve the case in favor of the plaintiffs.

### VII. CONCLUSION

There always are two questions in law: desirability and legitimacy. The desirability question is whether the outcome sought by a party would be a wise result as measured by fairness, efficiency, administrability, or whatever set of criteria the law makes controlling in the situation at hand. But, in our legal system, no agency or tribunal is a knight-errant. None possesses a roving commission to do Good and fight Evil wherever found. The authority of all agencies—including Treasury and the IRS—is limited, and these limits cannot legitimately be exceeded. Thus, the second question in law is always whether the official or body whose intervention the party seeks is duly empowered to decree the desirable outcome.

The second question—legitimacy—is at the core of *Loving*. At the level of desirability, the Government may well be right that increased regulation of tax return preparers would serve the public interest. But that conviction remains idle unless and until Congress cloaks the Treasury with authority to effect such regulation. In my view, although the question is close, section 330 does not confer the requisite authority, and the challenged regulations are illegitimate.

The district and circuit courts’ invalidation of the assumedly desirable but illegitimate regulations need not frustrate the Good for long. Congress always has the power to reverse the decision by amending section 330. In our democratic society, Congress is the ultimate arbiter of desirability.

Beyond its practical significance, *Loving* matters in the ongoing doctrinal disputes about Step One of the *Chevron* analysis. The decision of the *Loving* district court takes a textual and exacting approach to Step One. This is consistent with the contemporary, dominant—though certainly not universal—approach. The ultimate outcome in *Loving* will influence future Step One jurisprudence.

It will be interesting as well to see what role *Brown & Williamson* plays in future cases. The invocation of that precedent in more than passing


291. As the Supreme Court recently underscored: “No matter how it is framed, the question a court faces when confronted with an agency’s interpretation of a statute it administers is always, simply, whether the agency has stayed within the bounds of its statutory authority.” *City of Arlington*, 133 S. Ct. at 1868.
fashion could help entrench the hyper-textual mode of interpretation and the major question exception to administrative deference.

VIII. EPILOGUE

As this Article was in the editing process, the D.C. Circuit issued its decision in Loving. As predicted by this Article, the panel unanimously affirmed the district court’s decision. The panel invoked rationales strikingly similar to the arguments advanced in this Article.

The panel held: “Put in Chevron parlance, the IRS’s interpretation [of section 330] fails at Chevron [S]tep 1 because it is foreclosed by the statute. In any event, the IRS’s interpretation would also fail at Chevron [S]tep 2 because it is unreasonable in light of the statute’s text, history, structure, and context.”

The panel offered six reasons for its conclusion. First, the panel looked to the statutory term “representatives,” which Part V of this Article identified as a rationale superior to that stressed by the district court. The panel acknowledged that a “tax-return preparer certainly assists the taxpayer, but the tax-return preparer does not represent the taxpayer.” A preparer “cannot legally bind the taxpayer by acting on the taxpayer’s behalf” and so is not a “representative” within the contemplation of section 330.

The panel’s remaining five rationales involved the statutory phrase “practice . . . before the Department of the Treasury,” the history of section 330, the broader statutory framework of provisions governing return preparation, the importance of the issue, and the fact that, for generations before promulgation of the 2011 regulations, the IRS had interpreted section 330 as insufficient authority by which to regulate preparers.

Although the circuit court’s discussion of these considerations resembled the district court’s discussion at many points, the Supreme Court’s Brown & Williamson decision (discussed in Part VI of this Article) occupied a more prominent place in the former than in the latter. First, although acknowledging that post-enactment history can sometimes be a hazardous guide, the circuit panel saw post-1884 events as forming the sort of pattern that Brown & Williamson took as the basis of its statutory construction. Second, the panel invoked Brown & Williamson’s “major question” exception to Chevron deference, noting that “courts should not lightly presume

292. See Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2014).
293. Id. at 1022.
294. Id. at 1017.
295. Id.
296. Id. at 1016–22 (internal quotation marks omitted) (citing 31 U.S.C. § 330(a)(1)).
297. See id. at 1020–21; see also supra notes 245–78, 280–84 and accompanying text.
congressional intent to implicitly delegate decisions of major economic or political significance to agencies. 298

Although the Government did not seek Supreme Court review of Loving, amending section 330 to reverse the effect of Loving remains a possibility. However, Congress has been in near gridlock for several years, and the IRS's credibility with Congress remains damaged as a result of well publicized junket excesses by the IRS and the IRS's questionable handling of applications for tax exemption by conservative political organizations. 299 Thus, timing may not be propitious for such a legislative initiative.

Administrative action in a different form is another possibility. One approach might be voluntary, rather than compulsory. That is, the IRS could create a specially recognized class of preparer/representatives for those who choose to meet criteria like those in the 2011 regulations. Some preparers may find this attractive, whether for perceived competitive benefits in the marketplace or because of privileges or benefits the IRS might confer. To some extent, a carrot might work even if Loving prohibits the stick. 300

Sometimes regulation—like nature—abhors a vacuum. If, for reasons political and doctrinal, efforts prove unavailing to achieve greater federal regulation of tax return preparers, efforts may intensify at the state level. Only a few states currently substantially regulate preparers. 301 It is too early to say with confidence what effect Loving will have on this picture. 302

In short, it appears probable that the 2011 regulations will not provide a firm foundation for stricter federal regulation of tax return preparers. However, it would be unwise to assume that the campaign for tighter regulation—in one form or another—is over. 303

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298. Id. at 1021; see also supra notes 285–90 and accompanying text.


300. See Vincent R. Barrella & Walter Antognini, Loving: A Case for Overreach- ing, 91 TAXES 33, 44 (2013); Hoffman, supra note 10, at 172–73 (both discussing this alternative).

301. See supra note 28.


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SENTENCING IN TAX CASES AFTER BOOKER: STRIKING THE RIGHT BALANCE BETWEEN UNIFORMITY AND DISCRETION

SCOTT A. SCHUMACHER

I. INTRODUCTION

It has been nearly ten years since the Supreme Court’s seminal decision in United States v. Booker, in which the Court invalidated the mandatory application of the United States Sentencing Guidelines. In the cases that followed, the Court addressed subsidiary issues regarding the application of the Guidelines and the scope of appellate review. However, despite—or perhaps because of—these opinions, there is little consensus regarding the status and extent of appellate review, as well as the discretion afforded to sentencing courts. More troubling, what consensus there is seems to permit judges to impose any sentence they wish, as long as the appropriate sentencing procedures are followed. As a result, we are in danger of returning to “the ‘shameful’ lack of parity, which the Guidelines sought to remedy.”

The Sentencing Reform Act and the Sentencing Guidelines were designed to reduce disparity in sentencing and to reign in what one commentator described as a “lawless system.” However, the Guidelines, as ultimately conceived, drastically limited the sentencing judge’s ability to impose a sentence that was appropriate for the conduct and culpability of

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2. Id. at 233.
4. See, e.g., United States v. Feemster, 572 F.3d 455 (8th Cir. 2009) (en banc); United States v. Tomko, 562 F.3d 558 (3d Cir. 2009) (en banc); United States v. Cavera, 550 F.3d 180 (2d Cir. 2008) (en banc).
5. See, e.g., Tomko, 562 F.3d at 568 (“[I]f the district court’s sentence is procedurally sound, we will affirm it unless no reasonable sentencing court would have imposed the same sentence on that particular defendant for the reasons the district court provided.”).
7. See MARVIN FRANKEL, CRIMINAL SENTENCES: LAW WITHOUT ORDER 8 (1973) (describing judges’ sentencing power as “effectively subject to no law at all”).

(563)
the defendant, creating a different kind of sentencing disparity. The current, post-Booker system provides more guidance than the pre-Guidelines system, but permits sentencing judges to disregard the Guidelines and develop their own sentencing policies. As a result, rather than having a system that allows for sentences to be tailored to individual defendants, the current system allows sentences to be imposed based on the penal philosophy of individual judges. This will inevitably lead to unwarranted sentencing disparity. This Article traces the recent history of criminal sentencing and argues for a better system that allows for both guidance to sentencing judges and appropriately individualized sentences. John Rawls and H. L. A. Hart, in their seminal works on punishment, posited that there are two questions that must be asked, each at different stages of the sentencing proceeding. The first question is why do we punish offenders? To that question, Rawls and Hart answer that we punish to deter others from committing crimes and to protect other members of society. The second question is why do we punish this particular person? The answer to that question is because that person did something wrong and deserves to be punished. They advocate that the first question is relevant to the legislative function, while the second is relevant to the judicial function at the time of sentencing an offender. I advocate a sentencing regime where the Sentencing Guidelines provide the starting point for each sentence and are based on the deterrent policies that are the answer to Rawls and Hart’s first question. In tax cases, that means that the baseline Guidelines sentence should continue to focus on tax loss and general deterrence. However, when it comes to sentencing the particular offender, judges should be instructed to sentence the offender based upon the offender’s culpability and personal circumstances. Appellate review of these sentences should require that judges follow the initial Guidelines but allow variance from the Guidelines range if it is properly based on the individual characteristics of the defendant. In this way, sentences will be uniform where it is relevant and will have disparity that is warranted.

Part II of this Article will detail the sentencing procedures prior to the Sentencing Guidelines and the problems with that regime. In Part III, this

9. See United States v. Higdon, 531 F.3d 561, 562 (7th Cir. 2008).
10. See id.
11. See infra notes 197–206 and accompanying text.
15. See Rawls, supra note 12, at 38–39; see also Hart, supra note 12, at 19–20.
Article will describe the Sentencing Reform Act, the Guidelines, and the issues that arose as a result of the Guidelines. Part IV will discuss Booker and its progeny, and it will describe the semi-chaotic current state of sentencing law. Finally, in Part V, I will outline what I view is a better system that preserves sentencing discretion without rendering the system standardless and lawless. My recommendation, although equally applicable to any federal sentence, will be examined through the lens of tax sentencing.

II. Sentencing Prior to the Guidelines

Prior to the Sentencing Reform Act and the Sentencing Guidelines, federal judges had nearly unfettered discretion in imposing criminal sentences. As long as the sentence was within the statutory range, and not based upon a constitutionally impermissible basis, the sentence would not be disturbed. Moreover, appeals of sentences were almost non-existent. Thus, a convicted defendant’s sentence was based, at least initially, on the predilections, whims, and philosophy of the sentencing judge. This was not always the case.

A. A Very Brief History of Pre-Guidelines Sentencing

Prior to the middle of the nineteenth century, judges had very little discretion in sentencing matters. In the early development of the common law, sentences were imposed to keep what was at times a very fragile peace, and sentences took the place of the individual’s “quest for vengeance.” Thus, retribution was the prevailing theory of punishment, and justice being a “substitute for vengeance, was brutal.” Indeed, most sentences for felonies in the early common law carried the death penalty. In addition, all felonies carried with them the penalties of “forfeiture of goods and attainder,” meaning that the felon’s heirs could not...

17. See Frankel, supra note 7, at 5.
18. See id. at 5–6 (describing range of permissible judicial discretion in sentencing).
20. Under the sentencing rules prior to the Sentencing Reform Act of 1984, defendants received indeterminate sentences. Prior to the Act, the amount of time actually served would depend upon the decision of the Parole Board. For a discussion of the sentencing rules prior to the Sentencing Reform Act of 1984 and the use of the Parole Board’s discretion, see infra notes 33–39 and accompanying text.
21. See Frankel, supra note 7, at 8.
23. Id. at 92.
24. See generally 2 William Blackstone, Commentaries. Even when the death penalty was relaxed, the sentences were nevertheless shocking. For misdemeanors, the usual penalty was pillory and flogging; for petty larceny, ears were cut off; and for other crimes, branding was imposed. See Pound, supra note 22, at 103.
succeed to his property or title.\textsuperscript{25} When those draconian penalties were lessened, crimes nevertheless carried a fixed penalty.\textsuperscript{26} The judge would supervise the trial or guilty plea, and once guilt was determined, the sentence would follow automatically.\textsuperscript{27}

In the middle of the nineteenth century, penal theories other than retribution began to influence policy makers.\textsuperscript{28} As a result, uniform sentences began to change, and judges were given the discretion to determine the sentence to be imposed.\textsuperscript{29} This discretion reached its zenith, at least at the federal level, beginning in the 1910s, when rehabilitation became the predominate theory of punishment, and Congress established indeterminate sentencing.\textsuperscript{30} It was believed that the propensity to commit a criminal act was a “sickness,” akin to mental illness, that could be “cured” through proper rehabilitation.\textsuperscript{31} As a result, a sentence imposed on a person convicted of a crime should have been no longer than was necessary to cure or rehabilitate the person.\textsuperscript{32} It was, of course, impossible to know at the time of sentencing exactly how long it would take for the convict to be cured and ready to re-enter society. Thus, parole boards were established to make this post-hoc diagnosis.\textsuperscript{33} Under this system, judges could impose any sentence within the statutory range, with the sentence based upon the level of culpability or sickness of the defendant. Whether the defendant served all or even a major portion of that sentence was determined after the fact by the parole board. As a result, defendants would not know, and indeed could not know, the length of time they would spend in prison at the time of their sentencing.

The unfettered discretion of sentencing judges was blessed by the Supreme Court in \textit{Williams v. New York}.\textsuperscript{34} In \textit{Williams}, the defendant was convicted of murder, and the jury recommended a punishment of life imprisonment. However, relying, in part, on evidence and facts that were not submitted to the jury at trial, the judge found that the defendant had committed other serious crimes and was a “menace to society.”\textsuperscript{35} The

\begin{itemize}
\item \textsuperscript{25} POUND, supra note 22, at 103.
\item \textsuperscript{26} See Note, Procedural Due Process at Judicial Sentencing for Felony, 81 HARV. L. REV. 821, 821–22 (1968).
\item \textsuperscript{27} See id. at 822.
\item \textsuperscript{28} See Michele Pifferi, Individualization of Punishment and the Rule of Law: Reshaping Legality in the United States and Europe Between the 19th and the 20th Century, 52 AM. J. LEGAL HIST. 325, 333–34 (2012).
\item \textsuperscript{29} See Procedural Due Process at Judicial Sentencing for Felony, supra note 26, at 822.
\item \textsuperscript{32} See Vitiello, supra note 31, at 1016.
\item \textsuperscript{33} See FRANKEL, supra note 7, at 89.
\item \textsuperscript{34} 337 U.S. 241 (1949).
\item \textsuperscript{35} Id. at 244.
\end{itemize}
judge sentenced the defendant to death. The defendant appealed, arguing that his due process rights were violated when the judge sentenced him by relying on facts that were not presented in court and were provided by persons the defendant was not permitted to cross-examine or confront. The Supreme Court rejected this challenge and held that there are different evidentiary standards for trial and for sentencing.\(^{36}\) Under the then-prevailing indeterminate sentencing system, discretion was essential to making the appropriately individualized sentence, both at the time of sentencing and in later proceedings before parole boards.\(^{37}\) Moreover, the Court asserted that the new, “modern” indeterminate sentencing regime usually resulted in a lesser sentence than under the prior system where judges simply imposed the full sentence for that crime. Judicial discretion and fact-finding served to benefit offenders and “[i]n general, these modern changes have not resulted in making the lot of offenders harder.”\(^{38}\) Thus, sentencing judges were not limited to in-court evidence subject to the normal trial rules. Such a system “would hinder if not preclude all courts—state and federal—from making progressive efforts to improve the administration of criminal justice.”\(^{39}\)

B. Too Much Discretion: A Lawless System

The system of unfettered judicial discretion and indeterminate sentencing came under focused attack in the 1960s and 1970s.\(^{40}\) Following the work of the American Law Institute’s Model Penal Code and the National Commission on Reform of Federal Criminal Laws (Brown Commission), Congress began to reform the federal criminal laws into a more rational and fair classification of crimes.\(^{41}\) While neither the Model Penal Code nor the Brown Commission specifically addressed sentencing, those efforts nevertheless paved the way for comprehensive sentencing reform.\(^{42}\)

\(^{36}\) See id. at 248–49.

\(^{37}\) See id. at 249.

\(^{38}\) Id. Of course, the discretion that the sentencing judge exercised certainly made the lot of Mr. Williams a lot harder. Given that Williams was sentenced to death, the callousness of the Court’s statement is breathtaking.

\(^{39}\) Id. at 251.


\(^{42}\) See id.
The source of the most important, and influential, attack came from an unlikely source—a United States District Court judge. In *Criminal Sentences: Law Without Order*, Judge Marvin E. Frankel set forth, in stark and vivid detail, the problems with the then-existing sentencing regime. First, judges could impose any sentence within the statutory limit. Given the often cavernous range of federal sentences, sentencing judges were essentially not subject to any law at all. Frankel noted the maxim that the United States is a nation of laws, not men. Yet, in the realm of sentencing, the vast discretion afforded judges created a "regime of such arbitrary fiat [that] would be intolerable in a supposedly free society, to say nothing of being invalid under our due-process clause."

Frankel also noted that in the effort to individualize sentences, the system is contrary to fundamental concepts of "equality, objectivity, and consistency in the law." Frankel acknowledged that individualized sentences were a good thing, but asserted that these sentences should be made to turn on objective criteria and "not left for [the] determination in the wide-open, uncharted, standardless discretion of the judge . . . ." Thus, the most significant failure of the system was not just the unbridled discretion given to judges. Rather, it was that this discretion was conferred without any guidance or standards, save maximum penalties. Some judges believed that certain crimes called for the maximum penalty by default, unless the defendant’s case warranted mercy, while another judge—perhaps in the same courthouse—believed that the same crimes should receive no jail time, unless they were more serious than normal.


44. I say unlikely because the ultimate indictment of the system by Judge Frankel is that he and his fellow judges have too much discretion and power. It is unlikely that the powerful will relinquish power.

45. For example, mail fraud has a statutory maximum penalty of twenty years. See 18 U.S.C. § 1341 (2012). Thus, if convicted, a defendant could face anywhere from probation to twenty years in prison.
Accordingly, “individualized sentencing” came to mean not that the sentence was based on the unique aspects of the defendant’s crime and personal history. Instead, it meant the individual predilections and prejudices of the judge.  

Another issue was the failure of indeterminate sentencing and the use of rehabilitation as a justification for sentencing. Critics argued that the authority of parole boards to release convicts when they were sufficiently rehabilitated was too arbitrary and too shielded from public view, providing yet another avenue for unjust and unreviewable disparity.  

The sentencing procedures themselves added to the arbitrariness and lawlessness. “Individualized” sentences were based on information obtained quickly and from over-worked probation officers. Sentencing hearings were often short and pro forma, and the judge would usually impose the sentence immediately. Noting that judges generally ruminate at length before rendering an opinion in comparatively trivial legal matters, Judge Frankel lamented the common practice that, when imposing a criminal sentence that will subject a person to years of incarceration, judges imposed their judgment instantly, and from the bench, without so much as an explanation for the sentence imposed. “The court renders no ‘opinion’ because it has not followed the rational steps required to create one.”

This failure to articulate reasons behind the sentence imposed further underscored the arbitrariness and lawlessness of the sentencing system. Without articulating these reasons, the judge appears to act without rules or the need to abide by them. The failure to articulate the bases for a sentence also prevented any meaningful review of the sentence on appeal. This failure was not necessarily a problem, since sentences could not be reviewed on appeal. But the lack of appellate review merely com-

51. See id. ("[S]weeping penalty statutes allow sentences to be ‘individualized’ not so much in terms of defendants but mainly in terms of the wide spectrums of character, bias, neurosis, and daily vary encountered among occupants of the trial bench.").


54. See FRANKEL, supra note 7, at 27.

55. See id. at 37.

56. Id. at 38. This system also violated the maxim of Justice Frankfurter that “justice must satisfy the appearance of justice.” Offutt v. United States, 348 U.S. 11, 14 (1954).

57. See FRANKEL, supra note 7, at 39 (“The existence of a rationale may not make the hurt pleasant or even just. But the absence, or refusal, of reasons is a hallmark of injustice. So it requires no learning in law or political philosophy to apprehend that the swift ukase, without explanation, is the tyrant’s way. The despott is not bound by rules. He need not justify or account for what he does.”).
pleted the tragedy: federal judges with life tenure could impose any sentence within a statutory range, which commonly ranged from zero to twenty years.\footnote{58. See, e.g., 18 U.S.C. § 1341 (2012).} The sentence was imposed with no common embarkation point, no common route, and very little process, either due or otherwise. These judges would then impose their sentence articulating no justification or reasoning, all without concern of appellate review. It is little wonder that Frankel deemed this regime to be “arbitrary, cruel, and lawless.”\footnote{59. Frankel, supra note 7, at x.}

III. THE RISE OF SENTENCING GUIDELINES

A. The Sentencing Reform Act and Congressional Intent

In response to the consensus that the current system of indeterminate sentencing was not working, as well as the criticisms leveled by Judge Frankel, the ABA,\footnote{60. See Standards Relating to Appellate Review of Sentences, supra note 19. The committee that drafted this recommendation included several federal judges from district courts and the courts of appeals, as well as academics like Professor Herbert Wechsler. See id. at vii–ix.} and others,\footnote{61. See supra note 43.} Congress set about to revise the system. After several failed attempts,\footnote{62. See, e.g., S. 2699, 94th Cong. (1975) (exhibiting Congress’s first attempt to enact sentencing guidelines legislation).} Congress finally passed the Sentencing Reform Act of 1984 (the SRA).\footnote{63. Pub. L. No. 98–473, 98 Stat. 1976.}

The SRA had three main objectives. First, the principal goal of the SRA was to alleviate the problem of sentencing disparity.\footnote{64. See Feinberg, supra note 41, at 295. For example, a study showed that, in the Second Circuit, punishments for identical cases could range from three to twenty years of imprisonment. See S. Rep. No. 98-225, at 41 (1974) (citing Anthony Partridge & William Eldridge, The Second Circuit Sentencing Study: A Report to the Judges I–3 (1974)), reprinted in 1984 U.S.C.C.A.N. 3182, 3224.} The primary vehicle for accomplishing this objective was the establishment of the Sentencing Commission, which would be tasked with adopting sentencing guidelines.\footnote{65. See Feinberg, supra note 41, at 295–96. There were three primary reasons for having a commission, rather than Congress, draft the sentencing guidelines. See id. at 297. “First . . . Congress had neither the necessary time nor expertise” to develop something as complex as sentencing guidelines. Id. Second, there was a concern that Congress, subject to the pressures of politics, would substantially increase criminal sentences. See id. Finally, there was a real question as to whether congressionally-drafted guidelines could ever gain the full support of the Senate and House of Representatives. See id.} The sentencing guidelines would be used as a basis for all sentences imposed in the federal courts.\footnote{66. See 28 U.S.C. § 994 (2012).}

Second, the SRA abolished parole and indeterminate sentencing.\footnote{67. See Feinberg, supra note 41, at 296.} Convicted defendants would be sentenced to a definite term of imprisonment.
ment or other punishment, and they would serve the entire sentence imposed by the judge.68 This effort would restore “truth in sentencing,” or so the saying went.69 Related to this goal was the removal of rehabilitation as a rationale for imposing a sentence.70 Relying on Frankel’s book, as well as articles by Norval Morris and others,71 Congress concluded that the well-intentioned, but ultimately misguided theory of rehabilitation as a goal of imprisonment could no longer be justified.72

Finally, the SRA provided appeal rights to both defendants and the government.73 “Appellate review of criminal sentences would provide the mechanism for assuring that a sentence deemed too harsh or too lenient would be remedied by an appellate court . . . .”74 In so doing, Congress established that sentencing is a legal question, subject to review.75

The SRA is divided into two sets of provisions. The first, in title 28, sections 991 through 998 of the United States Code, sets forth the make-up, powers, and duties of the Sentencing Commission.76 The most significant provisions are in section 994, which requires the Commission to “promulgate and distribute to all courts of the United States” guidelines “for use of a sentencing court in determining the sentence to be imposed in a criminal case.”77 The second set, in title 18, sections 3551 through 3559 of

68. See id. Offenders would, however, be eligible for a limited amount of good-time credit, which was also drastically reduced over prior practice. See 18 U.S.C. § 3624(b) (Supp. IV 1986).
70. See Feinberg, supra note 41, at 297–98.
72. See Feinberg, supra note 41, at 297–98.
73. See id. at 296–97.
74. Id.
75. See id.
77. Id. § 994. The Commission was instructed to consider, inter alia:
(1) the grade of the offense;
(2) the circumstances under which the offense was committed which mitigate or aggravate the seriousness of the offense;
(3) the nature and degree of the harm caused by the offense, including whether it involved property, irreplaceable property, a person, a number of persons, or a breach of public trust;
(4) the community view of the gravity of the offense;
(5) the public concern generated by the offense;
(6) the deterrent effect a particular sentence may have on the commission of the offense by others; and
(7) the current incidence of the offense in the community and in the Nation as a whole.

Id.
the United States Code, sets forth the matters the judge should consider when imposing a sentence. Most significantly, section 3553(a) requires a sentencing court to consider factors such as the nature and circumstances of the offense and the history and characteristics of the defendant.78 Section 3553(a) also sets forth the penal philosophies that a court should consider, while notably not choosing between the varying, and often conflicting, philosophies.79 Judges are to consider:

[T]he need for the sentence imposed—to reflect the seriousness of the offense, to promote respect for the law, and to provide just punishment for the offense; to afford adequate deterrence to criminal conduct; to protect the public from further crimes of the defendant; and to provide the defendant with needed . . . medical care, or other correctional treatment.80

The Sentencing Commission then undertook the herculean task of writing comprehensive guidelines applicable to every criminal sentence. Working from the time of its appointment on October 29, 1985, until April 13, 1987, the Commission studied the sentences imposed in 10,000 actual cases.81 In developing the Guidelines, it attempted to follow what was “typical past practice,” and imposed sentences that were the average of

78. See 18 U.S.C. § 3553(a) (2012). The factors courts were required to consider include:
   (1) the nature and circumstances of the offense and the history and characteristics of the defendant;
   (2) the need for the sentence imposed—
      (A) to reflect the seriousness of the offense, to promote respect for the law, and to provide just punishment for the offense;
      (B) to afford adequate deterrence to criminal conduct;
      (C) to protect the public from further crimes of the defendant; and
      (D) to provide the defendant with needed educational or vocational training, medical care, or other correctional treatment in the most effective manner;
   (3) the kinds of sentences available;
   (4) the kinds of sentence and the sentencing range established for—
      (A) the applicable category of offense committed by the applicable category of defendant as set forth in the guidelines
         * * *
   (5) any pertinent policy statement
   (6) the need to avoid unwarranted sentence disparities among defendants with similar records who have been found guilty of similar conduct; and
   (7) the need to provide restitution to any victims of the offense.

Id.

79. See id. § 3553(a)(2).

80. Id.

these prior sentences. However, the Commission did not even attempt
to fully differentiate between all offenders and offenses: “Punishment, as
the Commission came to see, is more of a blunderbuss than a laser beam.
An effort to make fine distinctions among criminal behaviors is like a sta-
tistician running out crude statistics to ten decimal places, giving an im-
pression of precision that is false.”

Using a detailed set of rules, tables, and adjustments that look at the
entire conduct of a convicted defendant, the Guidelines produce a numer-
ic score, or offense level, that translates into a range of months of impris-
onment. For tax cases, most defendants are sentenced under section
2T1.1, and the sentence is based primarily on the amount of the tax
evaded, or “tax loss,” with adjustments for more sophisticated tax crimes
and for crimes that involve illegally-derived income.

B. Problems with the Guidelines

Problems with the Guidelines were raised almost immediately after
their adoption. The criticisms leveled at the Guidelines were the result
of problems in both design and implementation. First, the system that
Congress created shifted to prosecutors the power that was formally in the
hands of sentencing judges. Since the Guidelines were mandatory and
statistics and presentence reports, omitting consideration of the judgment and
thinking processes of the judges who produced those sentences.” Id. at 1744.

82. See Breyer, supra note 81, at 7. Breyer noted, however, that in certain
cases, like white collar crime cases, the Commission increased the severity of
sentences imposed over prior practice. See id. at 7 n.49. Indeed, under pre-Guide-
lines practice, roughly half of all tax defendants were sentenced to probation with-
out imprisonment. This Guideline drastically curtailed the number of pure
probationary sentences.

83. Id. at 14.

84. See U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1) (2012) (defining,
for many tax related penalties, tax loss as loss that would have resulted had offense
been successfully completed).

85. See JOHN A. TOWNSEND, LARRY A. CAMPAGNA, STEVE JOHNSON & SCOTT A.
SCHUMACHER, TAX CRIMES 301–08 (2008) (discussing application of Guidelines in
tax cases).

86. See, e.g., Dissenting View of Commissioner Paul H. Robinson on the Pro-
mulgation of Sentencing Guidelines by the U.S. Sentencing Comm’n, reprinted in
adopted by Commission subverted its “ultimate goal” of drafting “a rational sen-
tencing system”); Paul H. Robinson, A Sentencing System for the 21st Century?, 66 TEX.
“unlikely to bring rationality and uniformity to federal criminal sentencing”).
See generally, A. VON HIRSCH, PAST OR FUTURE CRIMES: DESERVEDNESS AND DANGER-

87. See Robinson, supra note 86, at 4. There were other problems with the
Guidelines that were attributable neither to the SRA nor the work of the Commiss-
ion. Most notable were the continuing meddling of Congress in sentencing and
the repeated imposition of mandatory minimum sentences. See, e.g., Albert W. Al-
schuler, The Failure of Sentencing Guidelines: A Plea for Less Aggregation, 58 U. CHI. L.
fact-driven, and since prosecutors are largely in control of sentencing
facts, prosecutors were often able to dictate the sentence that was im-
posed. More fundamentally, the Commission and the Guidelines are
"an expression of confidence in the administrative state: the idea that 'ex-
erts' insulated from politics are well suited (and sometimes best suited)
to make important public choices." This belief in the omniscience or
omnicompetence of the Commission influenced the Commission's work,
as well as sentencing judges' reactions to the Guidelines.

The belief in the primacy of administrative experts manifested itself
most fully when the Commission grabbed more power for itself and the
Guidelines, contrary to the statutory mandate set forth by Congress. The
primary vehicle for preventing unjust results from a too-rigid applica-
tion of the Guidelines was the ability of the sentencing judge to depart
from the Guidelines. Under the SRA, the sentencing judge would first
consider the factors set forth in section 3553(a), including the nature and
circumstances of the offense, the history and characteristics of the defen-
dant, and the purposes of sentencing. The judge was then required, un-
der section 3553(b), to determine the Guideline range and to decide
whether a sentence within the Guideline range was appropriate, or
whether a sentence outside the range was more appropriate because the
Guidelines failed to adequately reflect the section 3553(a) factors. Con-
gress never intended to eliminate judges' "thoughtful imposition of indi-
vidualized sentences." However, "the departure power never operated
as intended." The Commission substantially curtailed the ability of sen-
tencing judges to depart, "except as explicitly authorized by the Commis-
sion itself." The Commission then sought to identify nearly every fact
that could be relevant to the imposition of a criminal sentence and to
make a rule about whether the sentencing judge should consider it, and if

88. See Freed, supra note 81, at 1697–98 ("Guidelines are administrative hand-
cuffs that are applied to judges and no one else. When an AUSA negotiates a
disposition by setting or reducing charges and identifying relevant facts, she effec-
tively restricts the judge's sentencing range and, consequently, the ambit within
which upward and downward adjustments can make a difference. . . . The judge's
sentencing range is now tethered to the prosecutor's choice of charges and facts,
unless the probation officer's independent inquiry brings some facts into
question.").

89. Frank O. Bowman, III, Mr. Madison Meets a Time Machine: The Political Sci-

90. See Freed, supra note 81, at 1699–1700.

91. Other problems include failing to provide for sentences of probation for

92. See Amy Baron-Evans & Kate Stith, Booker Rules, 160 U. PA. L. REV. 1631,
1641 (2012).


94. See id. § 3553(b).


96. Baron-Evans & Stith, supra note 92, at 1641.

97. Id. at 1646.
so, how.\textsuperscript{98} In the Commission’s view, it took into account all of the section 3553(a) factors in the Guidelines themselves, and thus would “prevent a court from using it as grounds for departure.”\textsuperscript{99}

Finally, as a result of the complexity of the Guidelines, and the limited ability to depart from them, the Guidelines system created its own disparities.\textsuperscript{100} Some of the disparities resulted from the policy choices made by the Commission.\textsuperscript{101} For example, the Guidelines have had a disproportionate impact on black offenders.\textsuperscript{102} Moreover, offenders who differed significantly in their culpability, danger to the public, and risk of recidivism were treated the same.\textsuperscript{103} Thus, the Sentencing Commission did not create guidelines so much as it created judicial straightjackets. Sentencing courts were not given guidance but were required to march in lockstep to a mandated result, regardless of the wishes of the judge.\textsuperscript{104}

C. Booker and the Demise of Mandatory Guidelines

The Guidelines were challenged on constitutional grounds almost immediately after their adoption, and the Supreme Court appeared to settle the constitutionality of the Guidelines in \textit{Mistretta v. United States}.\textsuperscript{105} However, more constitutional challenges were to come. Challenges to the federal Sentencing Guidelines were preceded by decisions involving state

\textsuperscript{98} See id. at 1648.

\textsuperscript{99} 52 Fed. Reg. 18,046, 18,050 (May 13, 1987).


\textsuperscript{101} See Mark Osler, \textit{Indirect Harms and Proportionality: The Upside-Down World of Federal Sentencing}, 74 MISS. L.J. 1, 1–6 (2004). Osler discusses examples of the “up-side-down” world of the Guidelines. Examples of these disparities include: (1) “in child pornography cases, the sentence for an individual who sends a computer image of ‘virtual’ child pornography, made without the use of actual children, would face a sentence twice as harsh as that allowed under the Guidelines for a defendant who actually rapes a child;” (2) a person who manufactures a counterfeit identity document is punished more harshly than the person who then uses that same document to sneak into the country; and (3) “the punishment for possessing the weapon, which constitutes a threat, is often more severe than that for actually using a gun in a violent crime.” Id. at 4 (footnote omitted).


\textsuperscript{103} Schulhofer, \textit{supra} note 8, at 851–70.

\textsuperscript{104} Sentencing judges retained, as mentioned, a limited ability to depart. Some judges were more skilled than others at avoiding what they believed to be the harsh results of certain Guidelines sentences. See Jack B. Weinstein, \textit{A Trial Judge’s Reflections on Departures from the Federal Sentencing Guidelines}, 5 FED. SENT’G REP. 1 (1992).

\textsuperscript{105} 488 U.S. 361 (1989) (rejecting delegation doctrine and separation of powers challenges to Sentencing Guidelines).
sentencing guidelines.\textsuperscript{106} In \textit{Apprendi v. New Jersey},\textsuperscript{107} the defendant pled guilty to various firearm offenses, which carried a maximum sentence of ten years. However, at sentencing, the judge found that the offense was “motivated by racial bias,” and held that the hate crime enhancement applied, which authorized a twenty year sentence.\textsuperscript{108} The Supreme Court reversed on Sixth Amendment grounds, holding that “[o]ther than the fact of a prior conviction, any fact that increases the penalty for a crime beyond the prescribed statutory maximum must be submitted to a jury, and proved beyond a reasonable doubt.”\textsuperscript{109} In \textit{Ring v. Arizona},\textsuperscript{110} the Supreme Court applied \textit{Apprendi} to an Arizona law that authorized the death penalty if the judge found certain aggravating factors. As in \textit{Apprendi}, the Court concluded that the defendant’s constitutional rights had been violated because the judge had imposed a sentence greater than the maximum that could have been imposed under state law without the challenged factual finding.

In \textit{Blakely v. Washington},\textsuperscript{111} the Supreme Court extended the holdings of \textit{Apprendi} and \textit{Ring} to Washington state’s sentencing guidelines regime. The defendant in \textit{Blakely} pled guilty to second-degree kidnaping, which carried a maximum sentence of ten years.\textsuperscript{112} Under Washington’s sentencing guidelines, the standard range for this crime was forty-nine to fifty-three months.\textsuperscript{113} However, after hearing the victim’s description of the kidnaping, the judge found that the defendant had acted with “deliberate cruelty,” which was one of the statutorily enumerated grounds for departure in domestic-violence cases, and sentenced the defendant to ninety months.\textsuperscript{114} Treating the standard guideline range as the “statutory maximum,” the Court held that the judge’s finding of “deliberate cruelty” violated the Sixth Amendment, as enumerated in \textit{Apprendi}.\textsuperscript{115} The Court came to this conclusion despite the fact that Blakely’s sentence of ninety months was less than the ten year statutory maximum for the crime to which he pled.\textsuperscript{116}

\begin{flushleft}
\textsuperscript{107} 530 U.S. 466 (2000).
\textsuperscript{108} See id. at 471.
\textsuperscript{109} Id. at 490 (emphasis added).
\textsuperscript{110} 536 U.S. 584, 592–93 (2002).
\textsuperscript{111} 542 U.S. 296 (2004).
\textsuperscript{112} See id. at 299.
\textsuperscript{113} See id.
\textsuperscript{114} See id. at 300.
\textsuperscript{115} See id. at 303–05.
\textsuperscript{116} See id. at 303.
\end{flushleft}
Regardless of the merits of the decision,\footnote{Blakely has come under heavy criticism. See, e.g., Bowman, supra note 53, at 418 (referring to Blakely decision as “silly” and “nearly incomprehensible”). Indeed, neither Apprendi nor the Sixth Amendment required the invalidation of the Washington guidelines in Blakely or the federal Guidelines in Booker. Neither the Washington guidelines nor the federal Guidelines permitted the sentencing judge to impose a sentence above the statutory range for the crimes for which the defendant was found guilty by a jury.} Blakely meant that an attack on the federal Guidelines was inevitable.\footnote{Indeed, the second question asked during the Blakely oral argument was: “Well, I assume that if your position were adopted it would invalidate the Federal sentencing scheme that we have.” Transcript of Oral Argument at 4, Blakely v. Washington, 542 U.S. 296 (2004) (No. 02-1632), available at 2004 WL 728362.} Indeed, within six months, the Supreme Court decided United States v. Booker, \footnote{543 U.S. 220 (2005).} a multi-part decision with two majority opinions and four dissents that struck down the federal Sentencing Guidelines. The first part of the majority’s decision dealt with the question of whether the Guidelines provisions allowing the sentencing judge to base a sentence on conduct that was not found by a jury violates the Sixth Amendment right to a jury trial.\footnote{See id. at 245.} The Court held that the mandatory application of the Sentencing Guidelines violated the Sixth Amendment.\footnote{See id. at 226–27.} Extending the curious logic in Blakely, the Court held that the Sixth Amendment right to a jury trial “is implicated whenever a judge seeks to impose a sentence that is not solely based on ‘facts reflected in the jury verdict or admitted by the defendant,’”\footnote{Id. at 232.} and then two paragraphs later stated, “when a trial judge exercises his discretion to select a specific sentence within a defined range, the defendant has no right to a jury determination of the facts that the judge deems relevant.”\footnote{Id. at 233.} Thus, the Court held that it is a violation of a defendant’s right to a jury trial for the sentencing judge to base the sentence on facts not found by the jury, unless the sentencing judge found those facts in the exercise of his discretion.\footnote{See id. The Court does not explain, other than a citation to Williams, how fact-finding as part of the exercise of discretion cures what it so clearly found to be a Sixth Amendment violation. I can see no logical or constitutional basis for this distinction, and Williams is a very shaky foundation indeed on which to base a revised sentencing regime.} The Court believed, and stated “everyone agrees,” that if the Guidelines were merely advisory, the Sixth Amendment issue—and apparently the logical flaw as well—would be cured.\footnote{See id.}

In fashioning the appropriate remedy for the constitutional violation, the so-called “remedial majority” held that the sentencing court should still find the facts and must consider the Guidelines, but that the Guidelines were “effectively advisory” and permitted sentencing courts to tailor
the appropriate punishment to each offender.126 The Court also excised the portion of the SRA that called for de novo review and held that appellate courts were to review sentences for “unreasonableness.”127 However, as others have noted, making the Guidelines merely advisory does not change the “fundamental requirements of rational decisionmaking.”128

After Booker, just as under the mandatory Guidelines regime, judges find facts that determine the sentence, many of which were never found by a jury. A sentencing judge is given a range of sentencing choices, and “a sentence at the upper end of such a range cannot be rationally justified unless the judge finds some fact in addition to the elements of the crime.”129 In tax cases, juries do not make findings with respect to tax loss, nor in drug cases do they make findings regarding the amount of cocaine sold. Indeed, the Guidelines still permit uncharged and acquitted conduct to be considered by the judge at sentencing. Thus, the remedy articulated in Booker, just like the constitutional portion of the opinion, is incompatible with the Sixth Amendment.130

Booker left many unanswered questions with which the lower courts have had to wrestle,131 the thorniest being the nature and extent of appellate review. Simply stated, if the Guidelines are not binding, and are only advisory, can a sentence that is within statutory limits ever be a reversible error?

Ultimately, the Supreme Court itself has had to jump back into the fray, issuing no fewer than five opinions to clarify what it redundantly claims to have made “pellucidly clear” in Booker.132 First, in Rita v. United States,133 the Court held that when a district court sentences within the range that the Sentencing Commission deems appropriate, the court of appeals may presume that the sentence is reasonable. Thus, following Rita, the courts of appeals may apply a “presumption of reasonableness” to a sentence that reflects a proper application of the Sentencing Guidelines.134 It did not require appellate courts to apply a presumption of reasonableness, however, which will invariably lead to inconsistent appellate review of sentences.135

126. See id. at 245.
127. See id. at 259–61.
129. Id.
130. See id. at 440–41.
131. In his dissent in Booker, Justice Scalia warned that the opinion would “wreak havoc on federal district and appellate courts quite needlessly, and for the indefinite future.” Booker, 543 U.S. at 313 (Scalia, J., dissenting). Given the tens of thousands of cases that have cited Booker in the past four years, he appears to be correct.
134. See id. at 347.
135. For a more extensive discussion of this issue, see infra notes 264–65 and accompanying text.
Then in December 2007, the Court issued its decisions in *Gall v. United States*[^136] and *Kimbrough v. United States*[^137] which attempted to further resolve the extent of appellate review of sentences imposed. In *Gall*, the defendant had been a member of a drug conspiracy while he was in college.[^138] Several months after joining the conspiracy, Gall advised his co-conspirators that he was withdrawing from the conspiracy, and thereafter he did not sell illegal drugs of any kind.[^139] He then graduated from college, obtained gainful employment, and put his prior life of crime behind him. Several years later, he was indicted for his role in the drug conspiracy and pleaded guilty.[^140] Under the Guidelines, Gall’s sentencing range was thirty to thirty-seven months of imprisonment. However, the district court, noting both Gall’s brief participation in the conspiracy and his rehabilitation, sentenced Gall to probation for a term of thirty-six months.[^141] The court of appeals reversed, holding that “a sentence outside of the Guidelines range must be supported by a justification that is proportional to the extent of the difference between the advisory range and the sentence imposed.”[^142] The Supreme Court reversed and rejected the idea that a sentence outside the Guidelines range must be justified by “extraordinary” circumstances.[^143]

The Supreme Court then set up the procedure by which sentencing courts should determine and impose sentences. The sentencing court should begin by calculating the applicable Guidelines range, noting that, in an effort to maintain nationwide consistency, the Guidelines should be the starting point.[^144] Then, “after giving both parties an opportunity to argue for whatever sentence they deem appropriate, the district judge should then consider all of the section 3553(a) factors to determine whether they support the sentence requested by a party.”[^145] In so doing, the court “must make an individualized assessment based on the facts presented.”[^146] If the sentence is outside the Guidelines range, the court must “ensure that the justification is sufficiently compelling to support the degree of the variance.”[^147] Finally, the judge “must adequately explain the chosen sentence to allow for meaningful appellate review and to promote the perception of fair sentencing.”[^148]

[^138]: See *Gall*, 552 U.S. at 41.
[^139]: See id.
[^140]: See id. at 42.
[^141]: See id. at 43.
[^142]: Id. at 45 (internal quotation marks omitted).
[^143]: See id. at 47.
[^144]: See id. at 49.
[^145]: Id. at 49–50.
[^146]: Id. at 50.
[^147]: Id.
[^148]: Id.
The Court then turned to the nature of appellate review and held that courts of appeals must review the sentence under an abuse-of-discretion standard. First, the reviewing court must ensure that the district court committed no significant procedural error, such as failing to calculate the Guidelines range or failing to consider the section 3553(a) factors. The appellate court must also “consider the substantive reasonableness of the sentence imposed under an abuse-of-discretion standard.”

When conducting this review, the court . . . will take into account the totality of the circumstances, including the extent of any variance from the Guidelines range. If the sentence is within the Guidelines range, the appellate court may, but is not required to, apply a presumption of reasonableness. But if the sentence is outside the Guidelines range, the court may not apply a presumption of unreasonableness. It may consider the extent of the deviation, but must give due deference to the district court’s decision that the § 3553(a) factors, on a whole, justify the extent of the variance.

In Kimbrough, decided the same day as Gall, the Supreme Court addressed the situation in which it was the Guidelines themselves, rather than the exceptional conduct of the defendant, that were the basis of a sentence below the Guidelines range. Kimbrough had pleaded guilty to various drug-related charges, including possession with intent to distribute crack cocaine. Under the Guidelines, Kimbrough’s sentencing range was 228 to 270 months. The district court determined that a sentence in this range “would have been greater than necessary to accomplish the purposes of sentencing set forth in [section] 3553(a).” The court also commented that the case “exemplified the disproportionate and unjust effect that crack cocaine guidelines have in sentencing.” The court sentenced Kimbrough to 180 months in prison. The Fourth Circuit vacated the sentence, holding that a sentence imposed “outside the guidelines range is per se unreasonable when it is based on a disagreement with the sentencing disparity for crack and powder cocaine offenses.” The Supreme Court reversed the Fourth Circuit and held that as long as the sentencing judge follows the requirements of Gall (i.e.,

149. See id. at 51.
150. Id.
151. Id. (citation omitted).
153. See id. at 92.
154. Id. at 92–93 (internal quotation marks omitted).
155. Id. at 93 (internal quotation marks omitted). Kimbrough would have received a Guidelines range of 97 to 106 months had he been sentenced for an equivalent amount of powder cocaine. See id.
156. See id.
there was no procedural error and the sentence was substantively reasonable) a sentence outside the Guidelines range, even if based on a disagreement with the Guidelines themselves, is not reversible error.\textsuperscript{158}

Finally, in \textit{Spears v. United States},\textsuperscript{159} the sentencing judge disagreed with the powder-to-crack cocaine ratio of 100:1 set forth in the Guidelines and sentenced the defendant using his own 20:1 ratio.\textsuperscript{160} The court of appeals reversed, holding that while sentencing judges may disagree with the Guidelines as applied, they cannot adopt their own categorical crack-powder ratios in place of the Guidelines’ ratio.\textsuperscript{161} The Supreme Court summarily reversed the decision of the Eighth Circuit and held that sentencing courts are “entitled to reject and vary categorically from the crack-cocaine Guidelines based on a policy disagreement with those Guidelines.”\textsuperscript{162}

D. \textit{The Application of the Guidelines Since Booker}

Despite the Supreme Court’s efforts, or perhaps because of them, the courts of appeals are still unclear as to the nature of the review of sentencing decisions.\textsuperscript{163} Part of this ambiguity is the lack of clarity in standards like “abuse-of-discretion” and “substantively reasonable.” However, this uncertainty also stems from the confusion and lack of clarity at the Supreme Court level.\textsuperscript{164} This section will discuss some of the appellate cases that illustrate this confusion.

In \textit{United States v. Tomko},\textsuperscript{165} the Third Circuit struggled to apply the principles set out by the Supreme Court in determining whether the sentencing judge abused his discretion in imposing a sentence with no term of imprisonment in a tax evasion case.\textsuperscript{166} The stipulated tax deficiency in \textit{Tomko} was $228,557, which would have resulted in a Guidelines range of twelve to eighteen months of incarceration.\textsuperscript{167} However, the district court did not impose a term of imprisonment but instead sentenced Tomko to 250 hours of community service and three years of probation.\textsuperscript{168} The

\textsuperscript{158} See Kimbrough, 552 U.S. at 110–11.
\textsuperscript{159} 555 U.S. 261 (2009).
\textsuperscript{160} See id. at 262.
\textsuperscript{161} See id. at 262–63.
\textsuperscript{162} Id. at 265–66.
\textsuperscript{163} See, e.g., United States v. Feemster, 572 F.3d 455 (8th Cir. 2009) (en banc); United States v. Tomko, 562 F.3d 558 (3d Cir. 2009) (en banc); United States v. Cavera, 550 F.3d 180 (2d Cir. 2008) (en banc).
\textsuperscript{164} See infra notes 260–68 and accompanying text.
\textsuperscript{165} 562 F.3d 558 (3d Cir. 2009) (en banc).
\textsuperscript{166} The original panel decision in \textit{Tomko} was issued on August 20, 2007. See United States v. Tomko, 498 F.3d 157 (3d Cir. 2007), rev’d en banc, 562 F.3d 558 (3d Cir. 2009). The en banc decision was not issued until April 17, 2009. The court of appeals, in a thirty-four page opinion, split eight to five on whether the sentence should be upheld. See \textit{Tomko}, 562 F.3d at 574–75.
\textsuperscript{167} See \textit{Tomko}, 562 F.3d at 561.
\textsuperscript{168} See id. at 563.
court imposed the lighter sentence because (1) Tomko had only a “negligible criminal history;” (2) his company employed more than 300 people, and Tomko’s incarceration would jeopardize their employment; and (3) Tomko’s record of charitable works.169

On appeal, a divided en banc court agreed on the general standard to be imposed. Quoting extensively from Gall, both the majority and dissent agreed that their review of the sentence should be in two stages. First, the court of appeals must ensure that the sentencing court committed no significant procedural error, such as improperly calculating the Guidelines range, treating the Guidelines as mandatory, failing to consider the section 3553(a) factors, or failing to adequately explain the chosen sentence.170 Assuming there was no procedural error, the court of appeals must then consider the substantive reasonableness of the sentence, which requires the court to look at the “totality of the circumstances” surrounding the sentence.171 Finally, the court of appeals should review both the procedural and substantive reasonableness of the sentence imposed for an abuse of discretion.

However, the majority and dissent disagreed as to the degree of deference to be given. The majority held that “if the district court’s sentence is procedurally sound, we will affirm it unless no reasonable sentencing court would have imposed the same sentence on that particular defendant for the reasons the district court provided.”172 While the majority was quick to point out that it did not necessarily agree with the sentence imposed, it was unwilling to disturb what it considered to be fact-bound inquiries that are better suited for a sentencing judge to make.173 The majority thus confined its review to whether the sentencing judge considered the section 3553(a) factors, holding that “[t]he touchstone of ‘reasonableness’ is whether the record as a whole reflects rational and meaningful consideration of the factors enumerated in 18 U.S.C. § 3553(a).”174

In so doing, the majority seemed to reserve little for itself in the way of substantive review. Indeed, the majority’s “touchstone of reasonableness”—and therefore its view of the substantive reasonableness of the sentence—only examines the procedural soundness of the sentence: whether

169. See id. at 562–64.
170. Id. at 567 (quoting Gall v. United States, 552 U.S. 38, 50 (2007)).
171. See id.
172. Id. at 568.
173. See id. at 560. The majority noted “'‘[t]he sentencing judge is in a superior position to find facts and judge their import under § 3553(a) in the individual case.'” Id. at 561 (alteration in original) (quoting Gall, 552 U.S. at 51). The majority also noted that, “'district courts have an institutional advantage over appellate courts in making these sorts of determinations, especially as they see so many more Guidelines sentences than appellate courts do.'” Id. at 566 (quoting Gall, 552 U.S. at 52).
174. Id. at 575 (alteration in original) (quoting United States v. Grier, 475 F.3d 556, 571 (3d Cir. 2007)).
the record “reflects rational and meaningful *consideration*” of the section 3553(a) factors.\(^{175}\) Under the majority’s deferential approach to appellate review, it is unclear under what circumstances the court would find a procedurally sound sentence substantively unreasonable.

The dissent undertook a more substantive review of the sentence imposed and the reasons given for the sentence. Purporting to use the same abuse-of-discretion standard of review as the majority, the dissent examined the reasons articulated by the sentencing judge for imposing a sentence well below the Guidelines range. The dissent also found support in the opinions of other courts of appeals and argued that even though it will give due deference to the district court’s decision that the section 3553(a) factors justify the extent of the variance, a reviewing court may nevertheless “find that a district court has abused its considerable discretion if it has weighed the factors in a manner that demonstrably yields an unreasonable sentence.”\(^{176}\)

In analyzing the factors the sentencing court relied on in imposing the sentence, the dissent opined that a negligible criminal history did not support the variance “because Tomko’s status as a ‘first-time offender’ [did] not differentiate him from many, if not most, tax evaders.”\(^{177}\) Likewise, the dissent found that Tomko’s employment record failed to distinguish him from other tax evaders. Many white-collar criminals run successful businesses, hence the desire to evade taxes. The dissent believed that the prospect of the business failing should not be considered as a mitigating factor, particularly “when the business itself was the vehicle through which the defendant perpetrated the crime.”\(^{178}\) Finally, while the dissent acknowledged that Tomko’s charitable works, however well-timed, might justify some downward variance, they were not sufficient to support the degree of variance in this case. Thus, according to the dissent, only one out of the three reasons offered by the sentencing judge for the extraordinary variance justified a downward variance.\(^{179}\)

In addition, the dissent noted that the “mitigating” circumstances relied upon by the sentencing court only addressed one of the section 3553(a) factors, and the judge failed to emphasize other factors, including the nature, circumstances, and seriousness of the offense.\(^{180}\) The dissent noted that Tomko did much more than just fail to report income. Rather, he developed a sophisticated plan to evade taxes that spanned several

\(^{175}\) Id. (quoting *Grier*, 475 F.3d at 571).

\(^{176}\) Id. at 578–79 (Fisher, J., dissenting) (quoting United States v. Pugh, 515 F.3d 1179, 1191 (11th Cir. 2008)); see also United States v. Cavera, 550 F.3d 180, 191 (2d Cir. 2008) (en banc); United States v. Taylor, 532 F.3d 68, 69–70 (1st Cir. 2008); United States v. Abu Ali, 528 F.3d 210, 265 (4th Cir. 2008).

\(^{177}\) *Tomko*, 562 F.3d at 583 (Fisher, J., dissenting) (citing United States v. Goff, 501 F.3d 250, 261 (3d Cir. 2007)).

\(^{178}\) Id. at 584 (citing United States v. Reilly, 33 F.3d 1396, 1424 (3d Cir. 1994); United States v. Sharapan, 13 F.3d 781, 785 (3d Cir. 1994)).

\(^{179}\) See id. at 585.

\(^{180}\) See id. at 585–86.
years and required planning, coordination, and coercion of numerous subcontractors. The dissent thus determined that not only did the sentencing judge’s justifications for imposing Tomko’s sentence fail to differentiate him from other tax evaders, but also “the severity of his offense and the extent of his culpability, as evidenced by the willful and brazen nature of his conduct, remove Tomko’s tax evasion from the garden variety type.”

Finally, the dissent noted the “perverse irony” of sentencing Tomko to “home confinement in the very mansion that was built through the fraudulent tax evasion scheme at issue . . . [a] house on approximately eight acres, with a home theater, an outdoor pool and sauna, a full bar, $1,843,500 in household furnishings, and $81,000 in fine art.”

In United States v. Cavera, the defendant pled guilty to a firearms trafficking offense. The district court sentenced him to a longer sentence than was called for by the Guidelines, “simply because [it thought] the sentencing guidelines may understate the seriousness of this offense because of the consequences for the community of bringing or transporting . . . firearms into New York City.” A divided en banc Second Circuit wrestled with the question of whether the district court’s use of information that did not pertain to the individual defendant, but only to perceived geographical and sociological differences, was reasonable. The majority noted that, after Kimbrough, a sentencing judge “may vary from the Guidelines range based solely on a policy disagreement with the Guidelines . . . .” The majority held that it would not substitute its own judgment for the district court’s on the question of what is sufficient to meet the section 3553(a) factors and that it will “set aside a district court’s substantive determination only in exceptional cases where the trial court’s decision ‘cannot be located within the range of permissible decisions.’”

One of the dissents argued that “[w]here a district court’s sociological and statistical findings, as to which it enjoys no special comparative advantage vis-à-vis the Sentencing Commission, do not reasonably follow from the evidence it cites, the court exceeds its allowable discretion and the sentence is unreasonable.” Judge, now Justice, Sotomayor, in her own dissenting opinion, decried the:

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181. Id. at 586.
182. Id. at 587.
183. 550 F.3d 180 (2d Cir. 2008) (en banc).
184. Id. at 185 (second alteration in original).
185. Cavera contained a majority opinion, two concurring opinions, two opinions that concurred in part and dissented in part, and one dissenting opinion. See id.
186. Id. at 191.
187. Id. at 189 (quoting United States v. Rigas, 490 F.3d 208, 238 (2d Cir. 2007)).
188. Id. at 212 (Straub, J., concurring in part and dissenting in part) (citation omitted).
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[M]ajority’s excessive deference to the district court’s decision, which risks a regression of the sentencing process to the “greatest deficiencies of the pre-Guidelines regime,” namely “its failure to provide for review of the decisions of sentencing judges and its failure to ensure that the sentencing judge’s exercise of discretion was informed by authoritative criteria and principles.”189

She warned that “[a]ppellate courts must not abdicate their responsibility to ensure that sentences are based on sound judgment, lest we return to the ‘shameful’ lack of parity, which the Guidelines sought to remedy.”190

In United States v. Feemster,191 a divided en banc Eighth Circuit addressed the scope of its appellate review.192 After remanding the sentence twice, the court reviewed a drug sentence for a third time. The sole issue was whether the district court had adequately explained the basis for a reduction from a 360 month Guidelines sentence to 120 months. The majority held that the judge’s explanations were sufficient.193 The dissent disagreed, and asserted that the majority’s review was essentially:

[A] standard of no appellate review at all. We adopt a posture today that is so deferential that, so long as the district court gives lip service and a bit of discussion to the relevant 18 U.S.C. § 3553(a) factors, a sentence will almost never be reversed, procedurally or otherwise.194

There are other cases that struggle with the standard of review after Gall.195 What is significant about these cases is that, despite numerous attempts, the Supreme Court has failed to articulate a workable standard of review. If panels of courts of appeals cannot even agree on what the standard of review is, or how it is to be applied, sentencing judges will be further at-sea in discerning the amount of discretion they have in imposing sentences. Also, the majority of courts appear to be granting almost unlimited discretion to sentencing judges, which is contrary to the intent of Congress in the SRA and ignores the problems of the past.

With more discretion came more variance from the Guidelines:

191. 572 F.3d 455 (8th Cir. 2009) (en banc).
192. Feemster contains a majority opinion, two concurring opinions, and one dissenting opinion. See id.
193. See id. at 463–64.
194. Id. at 471 (Beam, J., dissenting).
195. See, e.g., United States v. Carty, 520 F.3d 984 (9th Cir. 2008); United States v. Smart, 518 F.3d 800 (10th Cir. 2008); United States v. Pugh, 515 F.3d 1179 (11th Cir. 2008).
PERCENTAGE OF CASES SENTENCED WITHIN GUIDELINES

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Tax</th>
<th>Fraud</th>
<th>Drugs</th>
<th>Year</th>
<th>Total</th>
<th>Tax</th>
<th>Fraud</th>
<th>Drugs</th>
</tr>
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<tbody>
<tr>
<td>1998</td>
<td>66.3</td>
<td>75.4</td>
<td>75.5</td>
<td>95.9</td>
<td>2006</td>
<td>61.7</td>
<td>54.7</td>
<td>64.4</td>
<td>93.2</td>
</tr>
<tr>
<td>1999</td>
<td>64.9</td>
<td>74.1</td>
<td>72.3</td>
<td>93.8</td>
<td>2007</td>
<td>60.8</td>
<td>47.5</td>
<td>64.6</td>
<td>90.9</td>
</tr>
<tr>
<td>2000</td>
<td>64.5</td>
<td>71.2</td>
<td>68.6</td>
<td>93.0</td>
<td>2008</td>
<td>59.4</td>
<td>44.1</td>
<td>61.9</td>
<td>89.6</td>
</tr>
<tr>
<td>2001</td>
<td>64.1</td>
<td>66.2</td>
<td>70.7</td>
<td>92.9</td>
<td>2009</td>
<td>56.8</td>
<td>37.7</td>
<td>58.5</td>
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</tr>
<tr>
<td>2002</td>
<td>65.0</td>
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<td>71.2</td>
<td>95.2</td>
<td>2010</td>
<td>55.0</td>
<td>35.5</td>
<td>55.5</td>
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<tr>
<td>2003</td>
<td>69.4</td>
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<td>74.8</td>
<td>88.8</td>
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<td>54.5</td>
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<td>2004</td>
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</table>

As this chart shows, while the overall sentences within the applicable Guidelines range declined, the tax sentences within the Guidelines declined much more dramatically. The fact that more than sixty percent of post-Booker sentences in tax cases now fall outside the Guidelines range demonstrates that there is substantially more disparity in tax cases post-Booker. The question then becomes whether this disparity is warranted, which Congress presumably would support, or unwarranted, which the SRA was enacted to prevent.

Whether disparity in sentences is warranted cannot be answered in the absolute. Whether a difference in treatment of two offenders is warranted will depend upon the individual facts of each case. Indeed, it is the failure to recognize this fundamental premise that caused the Guidelines, in their obsessively rigid constraint of judges, to be unworkable. If a judge does not impose a Guidelines sentence, it does not mean that the sentence is more just or more appropriate. It only means that the judge imposed an individualized sentence. While an individualized sentence might, in the abstract, be better than a cookie-cutter one, this would not be the case if sentences were based on inappropriate criteria or the judge incorrectly applied appropriate criteria.

IV. Ensuring a More Just Sentence

In the past 100 years, the sentencing pendulum has swung from unfettered discretion and indeterminate sentencing, to detailed and mandatory guidelines, and now to guidelines-with-discretion. The new, more balanced approach to sentencing appears to be an improvement,

197. The “Drugs” columns refer to drugs-simple possession. See id.
198. Of course, the possibility remains that all tax sentences have been uniformly reduced and there is no disparity. While data is not available to disprove this possibility, it seems unlikely.
199. See Feinberg, supra note 41, at 295.
200. See, e.g., Baron-Evans & Stith, supra note 92, at 1633–34 (“The advisory guidelines system has broad support: the vast majority of federal judges believe that advisory guidelines achieve the purposes of sentencing better than any kind of mandatory guidelines system or no guidelines at all, the Criminal Law Committee of the Judicial Conference of the United States supports the advisory guidelines system, prosecutors prefer advisory guidelines to other available options, and the organized public and private defense bars support the advisory guidelines system.” (footnotes omitted)).

201. See H. L. A. Hart, The Concept of Law 141–47 (Penelope A. Bulloch & Joseph Raz eds., 2d ed. 1994). Hart analogizes the law and judges’ role in the law to a game of cricket or baseball played first without, and then with, an official scorer. See id. The players can predict what the scorer’s ruling will be because they know and have used the rules, and because the scorer will, in the vast majority of the cases, follow the rules. See id. at 143–44. Applying this analogy to law, judges have considerably more discretion than official scorers in a game, but they nevertheless are bound by laws, constitutions, and rules. See id. at 145. Hart warns that these “standards could not indeed continue to exist unless most of the judges of the time adhered to them, for their existence at any given time consists simply in the acceptance and use of them as standards of correct adjudication.” Id.; see also Scott A. Schumacher, MacNiven v. Westmoreland and Tax Advice: Using “Purposive Textualism” to Deal with Tax Shelters and Promote Legitimate Tax Advice, 92 MARQ. L. REV. 33, 72–73 (2008).

202. See supra note 196 and accompanying table.


204. See United States v. Feenster, 572 F.3d 455, 471 n.15 (8th Cir. 2009) (Bean, J., dissenting) (“I firmly believe, based upon almost five years of experience as a federal trial judge and the sentencing pre-Guidelines, of at least 500 federal felons, that the ‘disparity principle,’ advanced by advocates as the foundation and bedrock underlying federal guideline sentencing, is an illusion, by at least half. Virtually every individual presents a different picture to a careful and conscientious sentencing judge. As a result, alleged uniformity is often disparity, viewed through a different prism.”).
potential for abuse cannot be ignored. As Professor Bowman noted, “[s]hould the Booker system survive, the exercise of the added judicial discretion might secure better outcomes for some defendants, but it would also inevitably create more interjudge and interdistrict disparity.”

In order to form a more perfect sentencing system, the sentencing regime should be modified to include three elements. First, just like the current system, there must be a set of guidelines that are the starting point for every sentence. Second, similar to the current system, judges should be required to impose a sentence that is adapted to the individual offender. However, this individualized determination should not be left to the unfettered and unguided discretion of the sentencing judge with only the vague standards listed in section 3553. Rather, each guidelines section should contain matters that are relevant and pertinent to individualizing a particular offender’s sentence. Finally, in order to ensure that the sentencing judge imposes the sentence correctly, the system must allow for real, substantive appellate review. Discretion assumes power, and power presupposes abuse of that power, or at least the ability to do so. Thus, while guidelines and a common starting point, as well as the ability to deviate from those guidelines, are essential to a just system, real appellate review is necessary to quell the inevitable abuse of discretion. I will take each of these three proposals in turn.

A. The Sentence Must Reflect the Culpability of the Offender

Both the problems with the sentencing regime and the problems with the appellate standard of review stem from a lack of coherent philosophy underlying sentencing. The philosophical bases upon which society punishes wrongdoers have bedeviled philosophers, scholars, and judges for centuries. While a full exploration of this subject is beyond the scope of this Article, there are essentially five traditional theories for which punishment may be imposed: deterrence, retribution, just deserts, rehabilit-

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205. Bowman, supra note 89, at 257.
206. See, e.g., Christine Mai-Due, Judge in Rape Case Criticized for Light Sentence, Remarks About Victim, L.A. TIMES (Aug. 28, 2013), http://articles.latimes.com/2013/aug//nation/la-na-montana-judge-20130829 (imposing thirty-day sentence on former high school teacher for raping fourteen year-old student who later committed suicide). The judge stated that the victim was “older than her chronological age,” and that she was “as much in control of the situation” as her teacher. Id.
207. These two sets of problems are, of course, interrelated. It is because there is no coherent and consistent view of sentencing that appellate courts struggle with the nature and extent of appellate review. Likewise, since there is no consistent or coherent view of appellate review, sentencing courts struggle with the amount of authority they have in sentencing.
1. Two Theories of Punishment, One Sentencing System

The five theories of punishment noted above can be divided into two overarching theories: the utilitarian theory and the retributivist theory. Utilitarians maintain that punishment is only justified if the benefits to society outweigh the harm caused to the person punished. Utilitarians therefore rely on deterrence, rehabilitation, and incapacitation to justify punishment. Retributivists focus on the conduct of the offender in justifying punishment. It is because that person did something wrong and violated the law that the person is being punished. Thus, the theories advanced by the retributivist are retribution and just deserts.

For many legal theorists, these two theories of punishment were irreconcilable. However, more recently, John Rawls and H. L. A. Hart each reconciled the utilitarian and retributivist theories into one coherent sentencing structure. In his influential work, Two Concepts of Rules, Rawls argued that in justifying punishment there are two questions: why do we punish at all, and why do we punish this particular person? The utilitarian theory answers the first question, while the retributivist theory answers the second. Rawls then asserts that each of these questions, as well as their answers, is relevant at different times in the sentencing proceeding:

The answer, then, to the confusion engendered by the two views of punishment is quite simple: one distinguishes two offices, that

210. This problem is not new to the SRA. As Judge Frankel stated regarding the pre-Guidelines state of the law, “Congress and state legislatures have failed even to study and resolve the most basic of the questions affecting criminal penalties, the questions of justification and purpose.” FRANKEL, supra note 7, at 7.
212. I realize that with politics being what it is, it is perhaps naïve to think that Congress and its multitude of members and viewpoints could ever articulate one coherent view on anything, let alone on sentencing. Indeed, as Frankel noted, Congress is not a philosopher’s grove. FRANKEL, supra note 7, at 62.
213. BAIRD & ROSENBAUM, supra note 209, at 8.
214. Id.
215. Id.
216. Id.
218. Id.
of the judge and that of the legislator, and one distinguishes their different stations with respect to the system of rules which make up the law; and then one notes that the different sorts of considerations which would usually be offered as reasons for what is done under the cover of these offices can be paired off with the competing justifications of punishment. One reconciles the two views by the time-honored device of making them apply to different situations.219

Hart espoused a similar theory.220 The Rawls and Hart model is the ideal framework for the application of the Guidelines after Booker. The general focus of the Guidelines should be utilitarian, with deterrence, incapacitation, and, to a certain extent, rehabilitation as the justifying principles. Thus, in tax cases, the initial Guidelines determination should be based, as is currently the case, on deterring others. In this regard, the introductory commentary to section 2T1.1 provides:

The criminal tax laws are designed to protect the public interest in preserving the integrity of the nation’s tax system. Criminal tax prosecutions serve to punish the violator and promote respect for the tax laws. Because of the limited number of criminal tax prosecutions relative to the estimated incidence of such violations, deterring others from violating the tax laws is a primary consideration underlying these guidelines. Recognition that the sentence for a criminal tax case will be commensurate with the gravity of the offense should act as a deterrent to would-be violators.221

In its legislative capacity, the Sentencing Commission rightly focused on deterrence as the primary justification for tax prosecutions. Indeed, the introductory commentary is a perfect answer to the question of why we prosecute tax evaders.

But “tax loss calculations,” “preserving the integrity of the tax system,” and “deterrence” do not fully justify why we punish a particular tax evader, nor should a sentencing judge be bound by the rough-and-ready tax loss calculation.222 The answer to why we punish a particular defendant requires the judge to focus on the retributivist justifications. This is particu-

219. Id. at 39–40.
222. See Rawls, supra note 12, at 38–39; see also United States v. Cavera, 550 F.3d 180, 192 (2d Cir. 2008) (en banc) (noting that many Guidelines sentences, including tax offenses, drastically vary based only on amount of money involved). However, “a district court may find that even after giving weight to the large or small financial impact, there is a wide variety of culpability amongst defendants and, as a result, impose different sentences based on the factors identified in § 3553(a).” Id.
larly appropriate in tax cases, where often the sole difference between legal tax avoidance and illegal tax evasion is the mental state (i.e., the culpability) of the defendant.223

An example of this application is the case of Mary Estelle Curran.224 Curran was prosecuted for failing to disclose Swiss bank accounts that she had inherited from her husband, which held as much as $43 million.225 Curran had hired a lawyer to disclose the accounts, but the lawyer did not file the proper paperwork until after the government already had her name from the bank.226 Under the section 2T1.1 calculation, Curran faced a sentence of thirty to thirty-seven months. However, the defense presented evidence that Curran was a seventy-nine year-old widow, she was financially unsophisticated, and that she relied on her attorneys and her deceased husband regarding the tax treatment of this account.227 Deeming the prosecution a “tragic situation,” the district court judge sentenced Curran to one year of probation, but then immediately revoked it, effectively sentencing her to probation for less than a minute.228 Thus, the judge relied on both Curran’s lack of culpability and her age in dramatically lowering her sentence below the suggested Guidelines range.

By the same token, some tax evaders may be more culpable than their tax loss score would indicate and should therefore receive a harsher sentence. A noteworthy example of this situation is United States v. Ciccolini.229 Ciccolini embezzled $1,038,680 from a charitable organization of which he was the director.230 Not only did he embezzle funds from a charity, he structured the deposits of the embezzled funds by making 139 separate deposits of less than $10,000 each.231 He also filed false tax returns for multiple years and underreported his tax liabilities by $292,136.232 Thus, this is a case in which the individual was more culpable than the garden-variety tax evader. The judge appeared to recognize this understanding.

The Presentence Report recommended a total offense level of fifteen, with a range of eighteen to twenty-four months. However, the district

225. See id.
226. See id.
228. See Nesmith & Voreacos, supra note 224.
229. 491 F. App’x 529 (6th Cir. 2012).
230. See id. at 530–31.
231. See id. at 531. Ciccolini made deposits in this manner to avoid certain currency reporting requirements. See id.
232. See id.
court found that Ciccolini had testified falsely during his plea colloquy, and the court found that the source of funds for both the structuring and tax counts were the proceeds of illegal activity. As a result, the judge determined a total offense level of twenty-six, with a range of sixty-three to seventy-eight months. Notably, while the judge appeared to correctly determine the defendant’s Guidelines score, he did not vary above the Guidelines range based upon the defendant’s abhorrent behavior, perhaps believing that the Guidelines sentence was appropriate. But in fashioning the individualized sentence, the judge did not determine the sentence based upon Ciccolini’s culpability. Rather, the judge relied on the writings of a “Nobel-winning economist,” who argued that in financial crimes, “incarceration is less important than providing a disincentive to others and that the disincentive can sometimes be obtained through financial penalties.” The judge imposed a sentence of one day of incarceration, followed by three years of supervised release, and he ordered restitution of $3,500,000.

On appeal, the Sixth Circuit determined that the judge had no authority to order restitution and reversed the entire sentence, because sentences are “a package of sanctions” and the restitution portion of the sentence was the means by which the judge sanctioned the seriousness of the defendant’s conduct. Significantly, the court of appeals did not reprove the sentencing judge for employing a penal philosophy so at odds with the Guidelines.

2. Institutionalizing Individuality

Following Booker, sentencing courts, after they calculate the Guidelines range, are required to consider the section 3553(a) factors and “make an individualized assessment based on the facts presented.” As indicated, the section 3553(a) factors include “the nature and circumstances of the offense,” the need for the sentence imposed to “reflect the seriousness of the offense,” the need “to afford adequate deterrence,” and the need “to protect the public from further crimes of the defendant.” Of course, many of these factors were already considered by the Sentencing Commission in fashioning the Guidelines range. More significantly, some of these factors have nothing whatsoever to do with the

233. See id.
234. See id.
235. See id. at 531–32.
236. Id. at 531.
237. See id. at 532.
238. Id. at 534 (quoting Pepper v. United States, 131 S. Ct. 1229, 1251 (2011)).
individual facts of a given case. Thus, it is relevant to the individual sentence that Gall abandoned the drug conspiracy and turned his life around well prior to his conviction. However, it is irrelevant for purposes of imposing an individualized sentence that the judge in *Kimbrough* believed the crack-powder cocaine ratio was unjust. That judge would presumably reach the same sentence in *every* crack cocaine prosecution and not just in the case of Kimbrough. Likewise, it is relevant for purposes of imposing an individualized sentence that Curran was elderly and unsophisticated. However, it is irrelevant for imposing an individualized sentence that the judge in *Ciccolini* believes deterrence in white collar crime cases is best served by imposing a large fine in lieu of imprisonment. Yet, the current system allows judges to make these so-called individualized determinations that are not based on factors unique to the individual case at all.

In order for a sentence to be properly individualized, section 3553 should be amended to limit the factors that judges may consider in varying or departing from the Guidelines. Those factors should include the particular facts of the defendant’s personal, family, and business situation and, significantly, should focus on the relative culpability of the defendant. The impact of the personal circumstances of the defendant, including family situation; physical condition or impairment, and age; charitable, public, or military service; diminished capacity, and mental or emotional conditions; and post-offense rehabilitation, should be left to the discretion of the sentencing judge. Likewise, sentencing judges should also be permitted to vary from the Guidelines by relying on circumstances that are unique to the defendant’s case but are not necessarily personal to the individual, including whether the Guidelines sentence will have adverse effects on employees or other innocent third-parties. These factors are routinely and appropriately used by courts in varying from the Guidelines.


243. Indeed, the Supreme Court appears to have accepted as a fact that the sentencing court would have come to the same result in every case. The Court accepted this categorical rejection of the Guidelines because, in the Court’s view, the crack-powder Guidelines were not the result of the considered judgment of the Commission, but were the result of the requirements of the Anti-Drug Abuse Act of 1986.


245. See id. But see United States v. Tomko, 562 F.3d 558 (3d Cir. 2009) (en banc) (sentencing defendant well below Guidelines range). The sentencing decision was made on grounds that the dissent, and I, believe are dubious; the sentence was nevertheless affirmed. Alas, no system will be perfect.

246. See SENTENCING COMM’N REPORT, supra note 244.
However, the Guidelines should also be amended to provide more structure for judges to base sentences more explicitly on the relative culpability of the individual defendant. Section 3553 provides that the sentence should "reflect the seriousness of the offense," and section 994 instructs the Sentencing Commission to fashion Guidelines that, inter alia, reflect the "circumstances under which the offense was committed which mitigate or aggravate the seriousness of the offense." Yet, many of the Guidelines provisions focus primarily on the harm caused by the crime, but largely ignore, or minimize, the defendant’s relative culpability.

The tax Guidelines are a perfect example of this shortcoming. The Guidelines sentence under 2T1.1 is driven primarily by tax loss. There is a twelve-point difference between a tax loss of $2,000 and a loss of $200,000. Yet, the Guidelines provide only a two-point increase for a sophisticated means adjustment, the only specific offense characteristics adjustment that is applicable in legal-source tax prosecutions. Moreover, this two-point increase can be canceled out by an acceptance of responsibility adjustment, making the defendant’s culpability and the manner in which the tax loss was generated virtually irrelevant. Similarly, the Guidelines for antitrust violations are driven almost exclusively by the volume of commerce affected by the offense. Thus, these Guidelines focus almost exclusively on the harm caused and largely ignore, or minimize, the relative culpability of the individual defendant.

The Guidelines should allow for a finer-grained analysis of the defendant’s culpability. In this regard, the Department of Justice has proposed an amendment to section 2T1.1 that would permit an upward departure where "the offense level determined under this guideline substantially understates the seriousness of the offense." As an example, the recommendation cites a defendant who fails to disclose an offshore bank account that has unreported income from the account that is relatively small in comparison with the value of the assets hidden. Because of this situation, the tax loss computation might underestimate the defendant’s true culpability.

249. The Guidelines do allow for adjustments for the defendant’s "role in the offense," which increases the defendant’s sentence if the defendant was a manager or leader. See U.S. SENTENCING GUIDELINES MANUAL § 3B1.1 (2012).
250. See id. § 2T1.1(b). There is an additional two-point increase if the income that was underreported is derived from criminal activity, like narcotics sales. See id.
251. See id. § 2R1.1.
253. See id.
254. See id.
While there is a good deal of merit to this proposal, assessing the relative culpability of the defendant should not be relegated to a departure from the Guidelines, as if considering the defendant’s culpability is an extraordinary matter. Rather, judges should be mandated to consider that culpability in every case. The fraud Guidelines, in section 2B1.1, might provide a useful template for individualizing the Guidelines sentence based on individual conduct and culpability of the defendant and not just the monetary harm caused to the victim. Courts could be instructed to consider factors like whether the tax crime occurred over multiple years, whether the conduct was more sophisticated than the limited two-point enhancement would provide,255 whether the defendant was advised by a professional,256 and whether the defendant was part of an illegal protest movement. Whatever is agreed upon as relevant for these purposes, the focus should be on the culpability of the defendant that makes the defendant’s conduct more serious or less serious than the Guidelines starting point.

How is the system that I propose different from the post-Booker system we currently enjoy? Are sentencing judges not required to start with the Guidelines and then consider things like “the seriousness of the offense,” “just punishment,” and the defendant’s need for rehabilitation in imposing their sentences?257 In a way, yes. But judges are required to consider all of the section 3553 factors, which include not only these retributivist factors, but also deterrence, protecting the public, and promoting respect for the law.258 Moreover, judges are given no guidance on which of these factors they should choose from, and they are left to apply their own penal philosophy in imposing their sentences. Thus, a judge could rely solely on deterrent theories in imposing the sentence, ignoring the retributivist factors.259 The system must ensure that the culpability of the individual offender forms the basis of the individualized sentence, not the penal philosophy of the individual judge.

255. Section 2T1.1 currently only allows for a two-point increase for sophisticated means. See U.S. Sentencing Guidelines Manual § 2T1.1(b) (2012). Sophisticated means is defined to include the use of an offshore account. See id. But there are many gradations of sophistication from the simple ownership of an offshore account that the defendant inherited, to the use of multiple layers of entities to hide the defendant’s ownership of an offshore account.

256. Ordinarily, a defendant’s reliance on the advice of a professional is a defense to the willfulness element of tax crimes. See Townsend et al., supra note 85, at 175. However, juries nevertheless find defendants guilty of tax crimes even though they were advised that the conduct was acceptable. See, e.g., United States v. Snipes, 611 F.3d 855, 859–60 (11th Cir. 2010).


258. See id.

259. See, e.g., United States v. Ciccolini, 491 F. App’x 529 (6th Cir. 2012).
B. Sentences Should Be Subjected to Real and Substantive Appellate Review

In order to ensure that sentencing judges correctly apply the Guidelines and correctly impose the ultimate sentence on appropriately individualized factors, sentencing decisions must be subject to robust appellate review. Unfortunately, the Supreme Court’s jurisprudence has left lower courts with a confusing and inconsistent mandate. The standard of review that the Court has articulated is “reasonableness” review. However, the Court, in explaining what the reasonable review entails, equates reasonableness with abuse-of-discretion. But those two standards “are not equivalent.” In addition, the Court allows, but does not require, courts of appeals to employ a presumption of reasonableness when the sentence is within the Guidelines range, but does not afford that same presumption to sentences outside of the range. Such a presumption is contrary to the abuse-of-discretion standard the Court purports to use. Permitting but not requiring courts to use this presumption also creates inter-circuit, and perhaps inter-panel, inconsistencies by allowing courts of appeals to decide whether they will review a Guidelines sentence more deferentially than one outside of the Guidelines. Thus, abuse-of-discretion review could mean different things in different cases, not a usual feature of appellate review.

Moreover, under traditional abuse-of-discretion review, courts review factual findings for clear error, while questions of law are reviewed de novo. However, after Kimbrough, sentencing judges can disregard the policies of the Guidelines and can develop their own sentencing regime—their own law. As Judge Posner stated, “[i]t is apparent from Kimbrough v. United States, that the regime created by the Booker case, which demoted the guidelines from mandatory to advisory status, permits a sentencing judge to have his own penal philosophy at variance with that of the Sentencing Commission.” But, developing an original penal philosophy at variance with the Guidelines is a legal question, which ordinarily would be subject to de novo review. Thus, courts of appeals are to engage in “reasonableness” review, which is really abuse-of-discretion (although they are

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261. Id. at 9–10.
263. Hessick & Hessick, supra note 260, at 15.
264. Id. at 19.
265. See id. at 22.
266. Id. at 14, n.66.
267. United States v. Higdon, 531 F.3d 561, 562 (7th Cir. 2008) (citation omitted).
268. See Hessick & Hessick, supra note 260, at 25.
in fact two different standards), and the kind of abuse-of-discretion review courts are to use bears little resemblance to traditional abuse-of-discretion review. The following section offers a better alternative.

1. **Sentencing Decisions Should Be Subject to Traditional Abuse-of-Discretion Review**

   Determining a sentence and entering a judgment and commitment order involve the application of law to facts. There is nothing about these determinations that make them incapable of substantive appellate review. In determining a sentence, judges make hard choices in reviewing evidence and must make determinations regarding credibility. But judges make similar factual and credibility determinations in nearly every case. Those decisions are not absolved from thorough appellate review.\(^{269}\)

   The Rawlsian system, combining utilitarian principles at the legislative (or Commission) level with retributivist principles left to the trial judge, is well-suited for traditional abuse-of-discretion review. Under this system, appellate courts would be tasked with reviewing whether the sentencing judge correctly applied the objective, legal matters. This would entail reviewing whether the sentencing judge correctly calculated the Guidelines range and based the sentence on a correct application of the individualized, retributivist factors. Despite the holding in *Kimbrough*, sentencing judges should not be permitted, as Judge Posner explained, to develop their “own penal philosophy at variance with that of the Sentencing Commission.”\(^{270}\) The Guidelines, to the extent they employ utilitarian principles, must be the starting point. To permit otherwise is simply to instill a lawless system.

   In order to prevent the abuses of the past, there should be a uniform starting point, and then an individualized sentence, to take into account the facts of the individual defendant’s case, not the sentencing philosophy of the individual sentencing judge. Appellate courts would then review for clear error whether the facts on which the judge based the individualized sentence support the sentence imposed. Using traditional abuse-of-discretion review, where questions of law are reviewed *de novo* and findings of fact are reviewed for clear error, would allow for the required uniformity and individualization.

**V. Conclusion**

Imposing a criminal sentence on an offender is, or at least should be, one of the most momentous tasks a judge undertakes. Being sentenced to a term in prison is undoubtedly the most momentous legal judgment an individual will endure. Subjecting these sentences to clear and identifiable legal rules and procedures that allow for both uniformity and individ-

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\(^{269}\) See Standards Relating to Appellate Review of Sentences, *supra* note 19, at 5.

\(^{270}\) *Higdon*, 531 F.3d at 562.
ualization, where appropriate, is essential to a just system. We have centuries of experience on which to draw in crafting a sentencing regime. More recently, the SRA was enacted in response to real problems and real abuses in a system of unfettered discretion. Less-fettered discretion is only less bad if used appropriately, particularly when it is paired with a seemingly unworkable standard of review. Policymakers should revisit the SRA and craft revisions so that there is a consistent sentencing law that is applicable to every case. Judges should not be allowed to devise and deploy their own penal system, which is in effect creating their own law. Judges should be allowed to make appropriately individualized determinations in each case, but only if the facts of the individual case make that case different from the mine-run case contemplated by the Commission and the Guidelines. In this way, criminal defendants will be subject to the same law as every other defendant, and criminal defendants will receive the sentences they deserve.

271. See, e.g., United States v. Engle, 592 F.3d 495, 497–99 (4th Cir. 2010) (sentencing defendant to eighteen months’ home detention with work release and international travel privileges, despite having committed tax evasion over sixteen years and having paid only $480 of $2 million in taxes owed during four year interval between his guilty plea and sentencing).

272. I use the word “unworkable” because of the confusion the current standard of review appears to have engendered. See, e.g., United States v. Feemster, 572 F.3d 455 (8th Cir. 2009) (en banc); United States v. Tomko, 562 F.3d 558 (3d Cir. 2009) (en banc); United States v. Cavera, 550 F.3d 180 (2d Cir. 2008) (en banc).
TAX EVaded IN THE FEDERAl TAX CRIMES SENTENCING PROCESS AND BEYOND

JOHN A. TOWNSEND*

I. INTRODUCTION

A. Scope—Taxes in the Criminal Tax Enforcement System

This Article discusses the role of taxes in the federal criminal tax enforcement system. The centerpiece of the federal criminal tax enforcement system is the tax evaded. Even when a criminal charge does not have an element of tax evaded, the Government’s incentive to bring criminal tax charges is very low when there is no material amount of tax evaded.1 The role of the amount of tax evaded results in some degree of proportionality and implements the commonly stated concern that the punishment fit the crime; as the reader might suspect, proportionality in the tax crimes universe means that the more tax evaded, the more punishment.2

In this Article, I address the various guises in which tax evaded appears in federal tax crimes sentencing. Tax evaded must appear in the guilt determination phase for the crime of tax evasion under 26 U.S.C. § 7201. Tax evaded is an element of the crime. The remaining tax crimes

* Partner, Townsend & Jones, L.L.P. Significant parts of this outline have been drawn—often verbatim—from the author’s current working draft of the next edition of his self-published text titled Federal Tax Crimes. The 2013 first edition of this text is available on SSRN. See John A. Townsend, Federal Tax Crimes (Working Paper, 2013), available at http://ssrn.com/abstract=2212771 or http://dx.doi.org/10.2139/ssrn.2212771. All such materials are used without further attribution by express permission of the author, being me. I have benefitted greatly in this presentation from Peter Hardy’s comprehensive publication: PETER D. HARDY, CRIMINAL TAX, MONEY LAUNDERING AND BANK SECRECY ACT LITIGATION (2010).

1. See 26 U.S.C. § 7201 (2012). An oft-theorized issue is whether the tax evaded element of the crime of tax evasion, under section 7201, can be met with an insubstantial or immaterial amount of tax evaded. If the statute were read literally, a taxpayer evading $1.00 of tax could be convicted. Perhaps reflecting the concern that the law does not deal with trifles or, at least that juries will not convict for trifles, some courts require that the tax evaded be substantial and some pattern jury instructions to direct the jury. See, e.g., United States v. Helmsley, 941 F.2d 71, 83–84 (2d Cir. 1991) (“We have also required a showing that the deficiency was substantial.”). Some courts, however, read the statute literally and can find no substantiality requirement for tax due and owing. See, e.g., United States v. Daniels, 387 F.3d 636, 639–41 (7th Cir. 2004) (invoking, however, substantial tax evaded).

2. It is perhaps an overstatement to say no tax, no crime. Or perhaps no tax, no prosecution; or even no tax, no punishment. And, to insert proportionality, little tax, little punishment; or much tax, much punishment. In a nutshell, that is how the Sentencing Guidelines work. United States v. Booker, 543 U.S. 220 (2005), changes the rigidity in the Guidelines’ sentencing by the numbers approach, but because the Guidelines are the starting point (and often the ending point) for sentencing, understanding proportionality based on the tax evaded is important.
do not have tax evaded as an element;\textsuperscript{3} hence tax evaded may or may not surface as a key issue in the guilt determination phase in prosecutions for those crimes. But, for all tax crimes, tax evaded is a critical and necessary component of sentencing.

For purposes of this Article, I make two key assumptions at the outset. First, I assume that the taxpayer is the actor in the tax evaded; the taxpayer is the defendant in this Article. Enablers such as return preparers and promoters can also be charged with tax crimes where the tax evaded is tax owed by others.\textsuperscript{4} I do not discuss enablers, but the concepts discussed in this Article with respect to the taxes involved would apply equally in that setting as well.

Second, I assume that the tax evaded was in the context of underreporting and underpayment with respect to the taxpayer’s return filing obligation. This generally would be underreporting and underpayment with respect to a filed tax return, although it could occur with respect to a failure to file with an underpayment. Tax evasion can occur with respect to assessed taxes, but I do not deal here with that type of evasion—called evasion of payment. The most common form of evasion encountered by most practitioners relates to evasion of assessment accomplished by underreporting and underpayment, the intended consequence of the underreporting.

\textbf{B. The Criminal Justice System}

Our criminal justice system is multi-faceted. At its most basic level, it punishes conduct that violates norms imposed by society through criminal laws. But, the criminal justice system has significant goals other than punishment. In the federal system, these various goals are summarized as “deterrence, incapacitation, just punishment, and rehabilitation.”\textsuperscript{5} The latter three aspects deal with the individual before the court. The first deals

\textsuperscript{3} The Internal Revenue Code has a number of tax crimes, but the principal crimes encountered in practice are 26 U.S.C. §§ 7206(1) (often referred to as tax perjury), 7206(2) (aiding and assisting), 7203 (failure to file), and 7212(a) (tax obstruction). These crimes do not have a textual requirement of evaded tax.

\textsuperscript{4} For example, in the prominent tax shelter prosecutions in the last ten years, tax shelter enablers with major law and accounting firms were convicted for evading the taxes of their clients. \textit{See}, e.g., United States v. Coplan, 703 F.3d 46 (2d Cir. 2012), \textit{cert. denied}, 134 S. Ct. 71 (2013); United States v. Pfaff, 407 F. App’x. 506 (2d Cir. 2010); United States v. Daugerdas, No. S3 09 CR 581, 2012 WL 92293 (S.D.N.Y. Jan. 11, 2012).

\textsuperscript{5} U.S. \textsc{sentencing guidelines manual} ch. 1, pt. A (2013). This highly summarizes the factors set forth in the governing statute. \textit{See} 18 U.S.C. § 3553(a) (2012). All references hereafter to the U.S. Sentencing Guidelines Manual are cited to the manual for 2013 (effective November 1, 2013), which was the most current version at the time this Article was prepared. Hence, for example, the key tax Guideline will be cited as U.S. \textsc{sentencing guidelines manual} § 2T1.1. Notably absent from the sentencing factors is the “quality of mercy.” \textit{See} William Shakespeare, \textsc{the merchant of venice} act 4, sc. 1.
with deterrence of others. Deterrence is a critical part of the criminal tax enforcement system.

C. The Criminal Tax Enforcement System

The criminal tax enforcement system must be understood in the context of the role it plays in the tax system. The tax system raises revenue for the Government. The Government could not function if it could not raise revenue. Our tax system creates a number of incentives for taxpayers to participate in the tax system and to pay their tax liabilities as, to paraphrase Justice Holmes, the cost they pay for a civilized society. I deal here principally with the criminal enforcement incentives.

The role of the criminal tax enforcement system is summarized as follows:

The Government helps to preserve the integrity of this Nation’s self-assessment tax system through vigorous and uniform criminal enforcement of the internal revenue laws. Criminal prosecutions punish tax law violators and deter other persons who would violate those laws. To achieve maximum deterrence, the Government must pursue broad, balanced, and uniform criminal tax enforcement. Uniformity in tax cases is necessary because tax enforcement potentially affects more individuals than any other area of criminal enforcement. Broad and balanced enforcement is essential to effectively deter persons of varying economic and vocational status, violators in different geographic areas, and different types of tax law violations.


7. Okay, these are commonly called penalties rather than incentives, but they serve that function.

8. See Compania General de Tabacos de Filipinas v. Collector, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting). Taxes even have important religious aspects. Jesus famously said that we should “give back to Caesar what is Caesar’s, and to God what is God’s.” Matthew 22:21 (New International Version). Perhaps inspired by Jesus, in 2007, Pope Benedict was reported to be preparing a doctrinal pronouncement in his second encyclical—the encyclical being the most authoritative statement the Pope makes—asserting that evading taxes is “socially unjust.” Benedict’s 2nd Encyclical Said to Condemn Tax Evasion by Wealthy as ‘Socially Unjust’, CATHOLIC ONLINE (Aug. 13, 2007), http://www.catholic.org/international/international_story.php?id=25018. Indeed, even before this, the Catholic Church ascribed tax evasion as a violation of the Seventh Commandment. See CATECHISM OF THE CATHOLIC CHURCH, pt. 3, sec. 2, Exodus 20 2-17, available at http://www.vatican.va/archive/ccc_css/archive/catechism/command.htm (“You shall not steal.”). So, there are religious, social, and moral imperatives to paying taxes. Alas, however, I deal in the text only with the legal aspects of paying taxes and obligations—such as reporting taxes—related thereto.

Similarly, and more succinctly, the Internal Revenue Service (IRS) division responsible for investigating tax crimes, Criminal Investigation (CI)—often referred to as the Criminal Investigation Division (CID)\(^\text{10}\)—explains its role as follows: “Criminal Investigation serves the American public by investigating potential criminal violations of the Internal Revenue Code (IRC) and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law.”\(^\text{11}\)

**D. The Tax System in the Sentencing Process**

The Introductory Comment to the key starting point for the Sentencing Guidelines calculations for tax crimes states:

The criminal tax laws are designed to protect the public interest in preserving the integrity of the nation’s tax system. Criminal tax prosecutions serve to punish the violator and promote respect for the tax laws. Because of the limited number of criminal tax prosecutions relative to the estimated incidence of such violations, deterring others from violating the tax laws is a primary consideration underlying these guidelines. Recognition that the sentence for a criminal tax case will be commensurate with the gravity of the offense should act as a deterrent to would-be violators.\(^\text{12}\)

The tax evaded—in sentencing jargon, the object of the criminal tax offense—serves to ensure that “the sentence for a criminal tax case will be commensurate with the gravity of the offense” and “act as a deterrent to would-be violators.”\(^\text{13}\)

**E. Tax Liability Concepts in the Criminal Tax Universe**

I stated earlier that tax evaded is the centerpiece of the sentencing in criminal tax cases and, hence, is at the forefront from the earliest steps in the criminal investigation and enforcement process, where practitioners must anticipate and, if possible, shape what will happen at sentencing. I will first state generally the varying concepts of tax liability as they play out in the criminal tax context and specifically at sentencing. The key deter-

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\(^{10}\) This criminal investigative branch of the IRS was formerly named Criminal Investigation Division, but the name was shortened to Criminal Investigation. Nevertheless, it is still often referred to as CID.


\(^{13}\) Id.
ominant in the advisory Sentencing Guideline calculations for financial
crimes is the financial loss to the victim.\textsuperscript{14} For taxes, the victim is the IRS;
the financial loss to the IRS is the tax loss which is, as will be discussed, the
principal determinant of Guidelines calculations for tax sentencing.

1. \textit{Civil Tax Liability and Tax Deficiency}

A taxpayer may think of tax liability as what a taxpayer offers to the
IRS. In the case of a filed return, the return is the taxpayer’s offer. In the
case of an unfiled return, the taxpayer’s offer is nothing (except to the
extent of prepayments such as withholding or estimated taxes). In either
case, the IRS may disagree and think the taxpayer owes more than the
taxpayer has offered. That is the context for IRS investigations into liabil-
ity that may include both audits and criminal investigations.

The taxpayer will have a civil tax liability which is imposed on the
original due date of the return.\textsuperscript{15} That liability is determined before ap-
lication of payments. To the extent that the liability exceeds the pay-
ments made or deemed made as of the due date of the return, the
taxpayer has an unpaid civil tax liability, often referred to in a civil context
as a deficiency.\textsuperscript{16} Taxpayers who fully pay their civil tax liability will usu-
ally not be at risk of criminal prosecution because of the phenomenon
noted above that punishment is determined by evasion of the unpaid
tax.\textsuperscript{17} At least \textit{usually}, in the tax crimes universe, if there is no tax un-
derpaid, there is no crime—or at least no crime that the Government will
have the incentive to prosecute.\textsuperscript{18}

\textsuperscript{14} See United States v. Babul, 476 F.3d 498, 502 (7th Cir. 2007) (discussing
Guidelines for fraud and theft offenses).
\textsuperscript{15} See 26 U.S.C. § 6151(a) (2012).
\textsuperscript{16} See id. § 6211(a) (providing definition of “deficiency”). All references
hereinafter to sections are to the Internal Revenue Code of 1986 unless otherwise
noted.
\textsuperscript{17} This is a bit too broad of a statement. Taxpayers who fully report their
liability but do not fully pay because, often, they are unable to do so, have no risk
of prosecution from the mere fact that they do not pay. If they take action to avoid
paying the unpaid but reported taxes, then they may be criminally prosecuted ei-
ther for evasion of payment or one of the tax obstructive crimes—such as 26 U.S.C.
§ 7212(a) or its conspiracy counterpart, the \textit{Klein} defraud conspiracy, 18 U.S.C.
§ 371. Then, taxpayers will have nonpayment of the taxes as an object of their
criminal offense and the punishment can be made to fit the crime. The \textit{Klein}
conspiracy, named for the leading case, is the defraud conspiracy described in
section 371, appearing in a tax setting. See United States v. Klein, 247 F.2d 908 (2d
Cir. 1957); see also 18 U.S.C. § 371 (2012). It is a term of art for the conspiracy to
impair or impede the lawful functions of the IRS.
\textsuperscript{18} At the risk of too much brevity to support this statement, given the rela-
tionship of the amount of tax evaded to the sentence, the Government is unlikely
to prosecute a taxpayer with no tax evaded even if his conduct meets the technical
definition of a crime that has no element of tax evaded. For example, tax perjury
under section 7206(1) does not require tax to have been evaded. The reason is
that the Guidelines—even with 18 U.S.C. § 3553(a)/\textit{Booker} discretion—generally
would require no incarceration, and, without incarceration, the message from the
conviction and sentence would be weak. See generally United States v. Booker, 543
The actual unpaid tax liability—the deficiency as the Code defines it—is not directly the key concept in tax crimes and sentencing. The term deficiency does not describe the tax, if any, a taxpayer intended to evade. It is simply the unpaid tax. The taxpayer may have intended to evade some or all of the deficiency. Unfortunately, the term deficiency is used by many cases to describe the portion of the deficiency that the taxpayer intended to evade—what I call the tax evaded. In order to keep the statutory term of art distinct, I use the term deficiency as used in the statute to mean the unpaid civil tax liability and will use a different term for the portion of the deficiency the taxpayer intended to evade for the reasons I now discuss.

2. The Tax the Taxpayer Intended to Evade—The Criminal Tax Numbers or Figures

I think it helpful to illustrate the concepts in an example. Assume that, for civil tax purposes, the taxpayer had $100,000 of income that the taxpayer failed to report and pay. Assume that the tax liability on that omitted income is $35,000; that liability is the deficiency. The $100,000 omitted income consists of two items—$50,000 of embezzlement income which the taxpayer knew was taxable and chose not to report and $50,000 of personal injury income that the taxpayer thought or could have reasonably thought was excludable under section 104 but which, for technical reasons, is not properly excludable under that section. In calculating the tax evaded as an element of tax evasion, the Government will compute the tax only on the $50,000 of embezzlement income and will not include the $50,000 of personal injury income. So, let’s say the tax on $50,000 of embezzlement income is $17,500. The criminal tax number for establishing the evaded tax element in a tax evasion case is $17,500 (even though the deficiency is $35,000). The Government must prove the evaded tax beyond a reasonable doubt.

I need to explain now my use of the term evaded tax. Section 7201 describes the crime of tax evasion as a willful attempt “to evade or defeat any tax imposed by” title 26. It does not refer to the tax deficiency.
which, as noted above, has a defined meaning in the Code that is not the same as evaded tax. To be sure, courts—including the Supreme Court—often refer to the evaded tax element as tax deficiency.22 Because of the different Code meaning of the term tax deficiency, I think use of deficiency for the evaded tax element is confusing. The evaded tax element is sometimes described as the tax “due and owing”—sometimes shortened to just “tax due.”23 I find this formulation less descriptive of the evaded tax, because just based on the words used it might be interpreted the same as tax deficiency. In this Article, I will use the term evaded tax because I think it is more descriptive of the evasion element and because it permits better development of the other concepts I discuss in this Article.24

Evaded tax is not the tax deficiency which is the civil tax number; it is instead the part of the tax deficiency the taxpayer intended to evade. In the example, the deficiency would include the $50,000 personal injury income, which, let’s say, doubles the tax deficiency to $35,000. The deficiency is never less than the criminal tax number (referred to here as the evaded tax) and is often more because of the phenomenon I just mentioned—i.e., some components entering the deficiency may not be items resulting in evaded tax.

Finally, as I develop in the example, the evaded tax is the portion that would be the element of the crime of tax evasion, which is the issue decided in the guilt determination phase before sentencing. This Article does not discuss the guilt determination phase, but I think the foregoing

22. See Boulware, 552 U.S. at 432 n.9. For a discussion of courts’ references to the evaded tax element as tax deficiency, see supra note 20 and accompanying text.


24. My dislike of the use of the term deficiency to mean the tax the taxpayer intended to evade could be semantics if the term deficiency is considered in the context of a criminal prosecution. Because each element of a crime must be proved beyond a reasonable doubt, necessarily the tax evasion component of the prosecution must exclude the portion of the deficiency that the taxpayer did not intend to evade. Stated otherwise, when the element is stated as just the deficiency, it necessarily, because of the burden of proof, means only the portion of the civil tax deficiency that the taxpayer intended to evade. I just prefer to avoid this type of semantic uncertainty and use terms that are more descriptive of their functions in the similar but not exactly parallel civil and criminal universes. I will admit that my term “tax evaded” does conflate the willfulness element with the tax that the taxpayer intended to evade. I do not think that possible conflation is critical to this Article, because the crime of tax evasion is not the focus.
example illustrates the concept of tax evaded for that purpose. The tax evaded concept does carry forward into the sentencing phase via two key concepts—the sentencing tax loss, which is the principal driver of the sentence, and restitution.

3. Sentencing Tax Loss

The Sentencing Guidelines use “tax loss” as the principal component in the advisory guideline sentencing range for a defendant convicted of one or more tax or tax related crimes. The Sentencing Guidelines define tax loss as “the total amount of loss that was the object of the offense . . . .” It is the same as the tax the taxpayer intended to evade—“tax evaded” as I use the term. There are some key nuances in the tax loss concept in the Guidelines that may cause the tax loss to exceed the tax evaded number used in the guilt determination phase. First, because sentencing findings (including tax loss) are determined by a preponderance of the evidence rather than beyond a reasonable doubt, the evaded tax for Sentencing Guidelines purposes may include more components than tax evaded for guilt of the crime of tax evasion. Second, the tax loss can include tax loss for “relevant conduct”—other related crimes for which
the defendant was not convicted.\textsuperscript{28} The relevant conduct concept is described as the cornerstone of the Guidelines (although consistent with pre-Guidelines sentencing practice) and plays a major role in tax cases where multiple years or events may be involved.\textsuperscript{29}

Consider this example: The indictment alleges that the taxpayer evaded $100,000. That means that the prosecutors believe they can prove beyond a reasonable doubt that the taxpayer evaded $100,000. The taxpayer is convicted on that basis. Suppose, however, that, for sentencing purposes, the Government can prove by a preponderance of the evidence that the taxpayer really evaded $200,000, but did not allege the additional $100,000 in the indictment because it did not believe that it could prove that additional amount beyond a reasonable doubt. Further, suppose that the taxpayer’s real unpaid civil tax liability for the year is $300,000, with the additional $100,000 representing items for which the Government cannot prove the taxpayer intended to evade under any standard of proof. There are three concepts related to the overall unpaid civil tax liability. In the order presented, they are: (i) the evaded tax—the “criminal number”—of $100,000 used for purposes of charging and convicting for evasion; (ii) the evaded tax for sentencing purposes—the tax loss—of $200,000, consisting of the evaded tax of $100,000, proved beyond a reasonable doubt, and the evaded tax of $100,000 proved by a preponderance of the evidence; and (iii) the residual tax of $100,000 not related to tax evasion for any criminal purpose (i.e., it solely affects civil tax liability).\textsuperscript{30} The three components in the aggregate represent the civil tax lia-

\textsuperscript{28} U.S. SENTENCING GUIDELINES MANUAL § 1B1.3 (2013). The Guidelines define relevant conduct as all acts or omissions (broadly defined to include conspiracies, aiding and abetting, etc.) “that were part of the same course of conduct or common scheme or plan as the offense of conviction . . . .” Id. § 1B1.3(a)(2). Application Note 2 of section 2T1.1 states: “In determining the total tax loss attributable to the offense, all conduct violating the tax laws should be considered as part of the same course of conduct or common scheme or plan unless the evidence demonstrates that the conduct is clearly unrelated.” Id. § 2T1.1 cmt. n.2 (internal citation omitted).

\textsuperscript{29} See, e.g., William W. Wilkins, Jr. & John R. Steer, Relevant Conduct: The Cornerstone of the Federal Sentencing Guidelines, 41 S.C. L. REV. 495, 499 (1990). This article was written by authors intimately involved in conceptualizing and drafting the original Guidelines, which incorporated as a centerpiece the concept of relevant conduct. See id. at 495 nn.a–aa (discussing authors’ credentials). I should note that prior to the introduction of the specific terminology in the Guidelines, the courts could consider what is now called relevant conduct in determining sentences. See DOJ CTM, supra note 9, § 43.04. Hence, the general concept was not new, but the Guidelines’ adoption of the concept under the rubric of “relevant conduct” regularized its consideration in the sentencing process by addressing scope issues for relevant conduct and requiring that relevant conduct be considered in sentencing.

\textsuperscript{30} Conceivably, some portion or all of the third amount might be subject to the civil fraud penalty under the burden shifting rules in section 6663 if the trier of fact is in a state of equipoise as to whether this final unpaid portion is or is not attributable to fraud. See 26 U.S.C. § 6663 (2012). Resolutions of such cases by
bility (or deficiency), whereas only the first two are evaded taxes relevant to the criminal process.

This is a simplified example. As I will note later, there are other concepts that can cause the sentencing tax loss to vary from the tax evaded used in the guilt determination phase. The principal concept is the relevant conduct Guidelines concept that requires, or at least permits, the sentencing court to include in the base offense calculations criminal conduct for unconvicted crimes. In a criminal tax setting involving income taxes, the relevant conduct is the tax loss from similar evasive conduct in years other than the year(s) in the count(s) of conviction. I used a single year in the example above, but assume that the taxpayer had similar evasive conduct in three other years and tax loss in the same amount—$200,000—for each of the years (the one convicted year and the three unconvicted years). The tax loss for those unconvicted years can be included in the tax loss computation regardless of whether (i) the defendant was acquitted of criminal conduct for the unconvicted years;31 (ii) criminal conduct was charged for the unconvicted years but dismissed pursuant to the plea agreement; or (iii) criminal conduct was never charged for the unconvicted years for whatever reason, including expiration of the statute of limitations.32 Hence, if the three other years involved the same type of conduct, the defendant’s tax loss number would be $800,000 rather than $200,000. That makes for a significantly higher sentencing range under the Guidelines.33 Relevant conduct tax losses to drive up sentencing are frequently encountered in tax cases.

1 burden of proof equipoise are rare, so in most of the cases of the type described, the final $100,000 will not be treated as tax evaded for criminal or civil purposes.

31. See United States v. Watts, 519 U.S. 148, 154 (1997) (holding there to be no violation of Double Jeopardy Clause). The Court in Watts based its holding on the notion that such sentencing enhancements “do not punish a defendant for crimes of which he was not convicted, but rather increase his sentence because of the manner in which he committed the crime of conviction” and the lower standard of proof. Id. at 154–56. Note that in this regard, there is a similar civil tax analog which permits the Government to assert civil fraud even if the defendant has been acquitted of criminal evasion for the same period(s), a result justified by the lower standard of proof (generally as to fraud in a civil case, requiring clear and convincing evidence). See Helvering v. Mitchell, 303 U.S. 391, 397–98 (1938).

32. See DOJ CTM, supra note 9, § 43.04 (citing cases involving conduct beyond statute of limitations and other uncharged conduct).

33. The range thus calculated is limited by the maximum terms in the aggregate for the count(s) of conviction. For example, if the range calculated for the aggregate tax loss with all relevant conduct included were—when combined with other sentencing factors—to indicate a sentence exceeding the maximum terms for the counts of conviction, the sentence would be limited to the maximum for the count(s) of conviction. That maximum could then be subject to section 3553(a)/Booker downward variances, but not upward variances. See 18 U.S.C. § 3553(a) (2012); United States v. Booker, 543 U.S. 220, 222 (2005).
4. Restitution

a. The Concept—Reimbursing the Victim for Financial Loss

Restitution is reimbursement to the victim for the financial loss related to the crime(s) the defendant committed.^{34} For federal tax crimes, the victim is the public via the IRS.^{35} Accordingly, restitution, when ordered in criminal tax cases, is made to the IRS. Unlike tax loss, which is the amount that was the object of the crime, restitution is reduced by payments up to the point that restitution is quantified in the restitution order, so that it is the remaining unpaid tax evaded at the time restitution is imposed.^{36} In this regard, where it is possible for the defendant to pay all of the evaded tax prior to sentencing, it is to the defendant’s benefit to do so because, in addition to reducing or eliminating restitution, it sets the right tone for the judge to give the defendant discretionary benefits in the sentencing process.

b. Statutory Mandatory and Permissive Restitution

Restitution may be imposed by the court pursuant to two overlapping provisions: 18 U.S.C. § 3663, the general restitution provision, and 18 U.S.C. § 3663A, the Mandatory Victim Restitution Act (MVRA).^{37} These statutes require or permit restitution for tax related title 18 crimes (including federal tax crimes).^{34} See United States v. Innarelli, 524 F.3d 286, 293–94 (1st Cir. 2008) (“This is necessarily a backward-looking inquiry that takes into account what actually happened, including whether the victim managed to recover some or all of the value it originally lost.”). In sentencing, the court is required to consider “the need to provide restitution to any victims of the offense.” 18 U.S.C. § 3553(a)(7). “If the court does not order restitution, or orders only partial restitution, the court shall include in the statement the reason therefor.” Id. § 3553(c) (flush language). Finally, restitution is decided by the judge alone, because it is not punishment subject to the requirement that the jury determine the amount of restitution. See United States v. Milkiewicz, 470 F.3d 390, 403–04 (1st Cir. 2006); United States v. Leachy, 438 F.3d 928 (3d Cir. 2006); United States v. May, 413 F.3d 841, 849 (8th Cir. 2005).

35. See DOJ CTM, supra note 9, ¶ 44.02[1] (citing cases).

36. There is a nuance. Even where the defendant has paid the victim of the crime (here the IRS), the court may order restitution and note that it has already been paid, meaning that, to the extent paid, there is no restitution remaining due as of the sentencing. I intend the concept here to mean the unpaid portion of the restitution ordered at sentencing.

37. See 18 U.S.C. § 3556 (referencing sections 3663A and 3663); see also United States v. Amato, 540 F.3d 153, 159 (2d Cir. 2008). Restitution, although intended to compensate the victim, does not make the victim a party to the sentencing proceeding in which restitution is imposed. The sentencing court may hear from the victim and will certainly consider the victim’s claims. But, a victim not satisfied with the restitution order has no standing to appeal. See United States v. Stoerr, 695 F.3d 271, 276 (3d Cir. 2012).
ing the ubiquitous *Klein* defraud conspiracy).\(^{38}\) Restitution, where authorized, takes priority over fines.\(^{39}\)

Mandatory restitution is only permitted for losses from the count(s) of conviction and not for any conduct that may be considered as relevant conduct—criminal conduct outside the count(s) of conviction—in determining the tax loss which is the principal driver for the Guidelines sentencing range.\(^{40}\) For example, assume that the defendant pleads as is typical in a tax case. The plea agreement provides: (i) the single count of conviction under the plea is a *Klein* conspiracy, a Title 18 offense, for the years 2002–2006; (ii) the tax loss is $100,000 in each year, for a total of $500,000; and (iii) restitution is not addressed. In this example, the sentencing tax loss and the amount for restitution is the same, provided that the defendant has not paid any of the tax loss. The sentencing court can order restitution to the IRS for the tax loss in the years 2002–2006, aggregating $500,000.\(^{41}\) But, if in addition to the charged conspiracy, there was a different but similar uncharged *Klein* conspiracy covering the years 2000 and 2001, with $100,000 tax loss in each of those years, the tax loss arising from that conspiracy could be included in the tax loss as relevant conduct for sentencing (thus increasing the tax loss to $700,000) but could not be

\(^{38}\) See DOJ CTM, *supra* note 9, § 44.02[2] (“Although the MVRA does not apply to criminal violations of Title 26, the MVRA does apply to criminal tax cases involving violations of Title 18, when the offenses are committed by fraud or deceit and are offenses against property, such as conspiracy to defraud the United States or to commit tax fraud, in violation of 18 U.S.C. § 371, or mail fraud, in violation of 18 U.S.C. § 1341.”). The *Klein* conspiracy is a term of art in criminal tax matters, referring to the defraud conspiracy under 18 U.S.C. § 371. The defraud conspiracy textually is a conspiracy “to defraud the United States, or any agency thereof in any manner or for any purpose . . . .” 18 U.S.C. § 371. The defraud conspiracy in a tax setting is usually stated as a conspiracy to impair or impede the lawful functions of the IRS and, as articulated in *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957), hence, in a tax setting, the defraud conspiracy is often referred to as a *Klein* conspiracy.

\(^{39}\) See 18 U.S.C. § 3572(b); see also U.S. SENTENCING GUIDELINES MANUAL § 5E1.1(c) (2013).

\(^{40}\) See *Hughey* v. United States, 495 U.S. 411, 413 (1990). Despite the post-*Hughey* enactment of the MVRA and subsequent amendments of the Victim and Witness Protection Act (VWPA), the holding of *Hughey* remains good law. See United States v. Scheuneman, 712 F.3d 372, 380–81 (7th Cir. 2013) (allowing restitution for multiple years within scope of section 7212(a) tax obstruction conviction because pattern of conduct subject to charge and conviction covered multiple years, so related to count of conviction and not relevant conduct); United States v. Batson, 608 F.3d 630, 637 (9th Cir. 2010); United States v. Nolen, 523 F.3d 331, 392 n.2 (5th Cir. 2008); United States v. Maturin, 488 F.3d 657, 660–61 (5th Cir. 2005); United States v. Inman, 411 F.3d 591, 595 (5th Cir. 2005) (citing United States v. Mancillas, 172 F.3d 341, 343 (5th Cir. 1999)) (noting that MVRA only permits “restitution for the conduct underlying the offense for which he was convicted”).

\(^{41}\) See *Scheuneman*, 712 F.3d at 380 (holding that restitution order could encompass losses “directly attributable” to section 7212 conviction, which unlike many tax crimes, but like conspiracy, can be course of conduct over many years, thus expanding scope of potential restitution); *Maturin*, 488 F.3d at 660–61.
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included in restitution, because it is not within the scope of the offense of conviction. There are other possible differences between the tax loss and the amount of restitution, but you will note that both key off the evaded tax, with differences then created for other reasons.

Even if otherwise not covered by these statutory restitution provisions (title 26 crimes are not covered), the court is authorized by statute to impose restitution as a condition of some benefit to the defendant, such as probation or supervised release as opposed to incarceration.42

c. Contractual Restitution

The sentencing court may order restitution to the extent provided in a plea agreement.43 The Department of Justice Tax Division’s (DOJ Tax) policy is generally to require contractual restitution in the plea agreement for the tax loss for both the pled counts and for counts that are dismissed pursuant to the plea.44 Presumably, DOJ Tax might also require contractual restitution for relevant conduct, which includes uncharged tax crimes.45

II. TAX LOSS

A. A Simple Example to Illustrate the Key Role of Tax Loss

1. Introduction

Consider this example, following the format for the Guidelines to illustrate how the Guidelines work in a tax setting: The taxpayer is convicted on one count of tax evasion for one year, the 2001 tax year, with the return being filed on April 15, 2002.46 In that return, the taxpayer fraudulently omitted an item of income of $250,000 from a legal source, resulting in a tax underpayment—tax evaded—of $85,000. I assume that $85,000 is the “criminal number” and, for present purposes, also the “tax

42. See 18 U.S.C. § 3563(b)(2) (discussing restitution as condition of probation); id. § 3583(d) (referencing section 3563(b)(1)–(10)); see also United States v. Perry, 714 F.3d 570, 577 (8th Cir. 2013); United States v. Hassebrock, 663 F.3d 906, 923–24 (7th Cir. 2011); Batson, 608 F.3d at 635.


45. This would depend upon the parties’ respective bargaining positions and often really turns upon limitations in resources allocable to determine tax loss attributable for other years. For example, IRS CI often does not investigate earlier years that could include relevant conduct simply because of a lack of resources and, perhaps, a feeling that the crime is adequately punished by the tax loss in the years investigated.

46. I choose this year in order to use the 2001 Sentencing Guidelines, which generally establish a higher Base Offense Level (BOL) for tax loss numbers than under the prior Guidelines.
loss,” which means that it is the tax on the components of income or de-
duction that results from evasion. The evasion was simple, garden-variety
evasion, with no evasive or “sophisticated” measures to hide the omitted
income or implement the evasion, such as using fictitious names, offshore
accounts, and the like. The first step in the application of the Sentencing
Guidelines is to determine the offense conduct and the Base Offense
Level (BOL) that is determined by the offense conduct.47

2. Applicable Offense Guideline

Chapter 2 of the Guidelines is the starting point. Chapter 2 deter-
mines the offense conduct and lists the various federal offenses and statu-
tory provisions. Tax crimes are addressed in part T of chapter 2. Tax
crimes for this purpose may be divided analytically into two parts: (1) the
crime itself and (2) the amount of tax that was the object of the crime (the
tax loss).

The starting point is the BOL. Section 2T1.1 of the Sentencing
Guidelines provides a BOL of six, unless the BOL under the graduate tax
loss table in section 2T4.1 is higher.48 I encourage readers to review the
tax loss table in section 2T4.1 of the 2013 Sentencing Guidelines. In our
example ($85,000 of tax loss), the tax loss table provides a BOL of
sixteen.49

We then go to the Specific Offense Characteristics in section 2T1.1(b)
of the Sentencing Guidelines, which provides two level increases for illegal
income for the tax loss and for “sophisticated means.”50 The example we
consider provides that the income is legal income and that no sophisti-
cated means were involved.51 Coming out of chapter 2 then, the offense
level is sixteen (which is the BOL derived above). After this, the BOL is
commonly called the offense level, which is subject to some adjustments.

3. Adjustments

Guidelines chapter 3 allows adjustments to the offense level. There
are victim-related adjustments (upward, but not applicable in tax cases),
role in the offense (leader, minimal participant) adjustments (upward or
downward), obstruction of justice adjustments (upward), multiple counts

47. See U.S. SENTENCING GUIDELINES MANUAL § 1B1.1(a)(1)–(2) (2013).
48. Id. § 2T1.1(a).
49. Id. § 2T4.1 (providing tax table).
50. Id. § 2T1.1(b)(2).
51. A straight-forward reading of the presentation in the Guidelines would
suggest that the upward adjustment for sophisticated means is reserved for excep-
tional tax crimes cases. There has been some concern among practitioners that
sophisticated means has become the rule and not the exception in tax cases. See
Letter from Richard M. Lipton, Chair, ABA Section of Taxation, to Donald A.
Purdy, Jr., Chief Deputy, Gen. Counsel, U.S. Sentencing Comm’n, Comments Con-
adjustments (upward in some cases), and acceptance of responsibility adjustments (downward). These are the types of matters judges considered before the Guidelines in determining appropriate sentences, but now they are formalized as steps in the Guidelines calculations.

The adjustment relevant in our example is a reduction for “acceptance of responsibility,” which is most commonly achieved by entering a plea agreement. The reduction is at least two levels. An additional one-level reduction is allowed if the level prior to the two-level reduction is sixteen or greater and the Government states that the defendant timely assisted by notifying the Government of intention to plead prior to preparation for trial.

You are comfortable that your client has accepted responsibility and will qualify for this benefit if your client agrees to plead guilty. But, your client still wants to know what the sentencing range is before pleading. A plea qualifying for this adjustment would reduce the offense level by three. Now your client is at offense level thirteen.

4. Criminal History or Livelihood

Chapter 4 then provides for upward adjustments on the sentencing table for significant criminal history. In this case, as is common in tax prosecutions, the defendant has none, so we will move on, carrying forward the offense level of thirteen.

5. Application of the Sentencing Table

The final Guidelines step is to apply the adjusted offense level, which is now thirteen, to the sentencing table contained in chapter 5, part A. The sentencing range is twelve to eighteen months.

53. Id. § 3E1.1(a).
54. Id. § 3E1.1(b).
55. The better part of wisdom is to commit the prosecutors to the full three-level downward adjustment in the plea agreement. The sentencing judge does not have to accept that commitment, but it usually is persuasive to the judge.
56. See U.S. Sentencing Guidelines Manual ch. 5, pt. A (2013). These ranges do not take into account the good time credit that may be available to the actual sentence to require incarceration less than imposed by the judge. Section 3624(b) provides that, if the term is more than one year, the defendant may receive “up to 54 days at the end of each year of the prisoner’s term of imprisonment, beginning at the end of the first year of the term . . . .” 18 U.S.C. § 3624(b)(1) (2012). As interpreted, a prisoner will get about 12.88% per year for good time credit, meaning that the allowable number of days’ credit per year is forty-seven. For example, a sentence of one year requires time served of 365 days, while a sentence of one year and one day requires time served of 319 days. Practitioners and judges know this phenomenon; rarely is a sentence for one year given.
6. The Final Sentence—18 U.S.C. § 3553(a)/Booker Discretion

The foregoing completes the Guidelines calculations of a sentencing range. The Supreme Court’s opinion in United States v. Booker57 mandates that the Guidelines are advisory and are to be considered along with the other section 3553(a) factors in determining the final sentence.58 The tax evaded will already be known to the judge because it is the key component of the Guidelines advisory calculations. So, the judge will undoubtedly consider the tax evaded in fashioning the final sentence under his Booker discretion.

7. Summary—Key Role of the Tax Loss Number

Returning to the Guidelines calculations, notice how key the starting point—the BOL—is to the process. In tax cases, the BOL is determined by the tax loss. In this example, the tax loss is $85,000, which drives the BOL (prior to adjustments) to sixteen, and the sole adjustment is for acceptance of responsibility, driving the offense level to thirteen.

If you can drive the tax loss down $5,000 to $80,000, the process produces a sentencing range of ten to sixteen months.59 Note correspondingly, however, that if the tax loss were $200,000, you would still be in the same Guideline range and you would have a long way to reduce the tax loss to the next break point of $80,000. But to turn that thought, the Government would only have a short way to go to ratchet your client into the next higher level, producing a sentencing range of eighteen to twenty-four months.

B. More on the Tax Loss

1. General

In the usual criminal prosecution, the initial investigation is conducted by IRS CI. The “criminal tax figure” and, if different, the tax loss60 is initially calculated by the IRS based on its investigation and included in the Special Agent’s Report (SAR) that is sent to DOJ Tax with the recommendation for prosecution or further grand jury investigation.61 Where the investigation is a grand jury investigation, CI special agents will be assigned to assist the grand jury under Rule 6(e) and will prepare an SAR

58. See id. at 245; see also 18 U.S.C. § 3553(a).
59. The Base Offense Level is fourteen, but the adjustment for acceptance of responsibility is two, rather than three.
60. Remember that these figures could be different if relevant conduct brings in non-conviction years or tax evaded provable only by a preponderance of the evidence is included.
61. See IRS, Special Agent Report (SAR), IRM 9.5.8.6 (Jan. 25, 2006), available at http://www.irs.gov/irm/part9/irm_09-005-008.html#d0e291. Note that one of the required inclusions is “relevant conduct.” See id. There will also be sentencing calculations.
when the grand jury investigation is complete. In both instances, the CI special agent may be assisted by a civil agent. At least when the IRS CI is involved, the defendant’s attorney may have some opportunity to have meaningful input in the criminal and tax loss calculations, both involving tax evaded numbers.

Also keep in mind that the practitioner will have opportunities to continue the process of reducing the tax evaded number as the case proceeds through the process (CI to DOJ Tax to United States Attorneys’ Office (USAO)), but the key is to start the process as early as possible. It helps for the CI special agent to not include a higher loss in his calculations to start with because later players in the process may not be likely to reconsider that decision.

2. Get the Criminal Tax Number as Low as Possible

The criminal number is the evaded taxes provable beyond a reasonable doubt for the counts of prosecution. If the Government has to or does introduce in the case in chief a tax evaded figure, it should be the criminal number for the crimes having evaded taxes as an element. Early in the investigation, you should try to drive down that number. If that number comes down enough, the Government may decide not to prosecute. At a minimum, by driving the number down, the practitioner can positively affect any ultimate sentence that may be imposed.

Practitioners need a good investigative team, including a forensic tax accountant, to try to get the numbers down. One avenue to pursue is the opportunity offered by James v. United States and its progeny, to exclude from the criminal equation tax items as to which the law does not offer sufficiently clear guidance that it can be the subject of criminal prosecution. The willful element of most tax crimes requires “intentional viola-

62. See USAM, supra note 9, § 6-4.125. This section, titled “IRS Transmittal of United States Attorney’s Recommendation, Special Agent’s and Criminal Tax Counsel’s Reports, and Exhibits from Grand Jury Investigation,” provides: When a grand jury investigation is complete and the United States Attorney concludes that the Government has gathered sufficient evidence to proceed with prosecution, the United States Attorney should request that the special agent assigned to the matter prepare a SAR. After the SAR is completed, the special agent should request that the SAC forward the SAR, with copies of the relevant exhibits, and the CEM to the Tax Division for review and authorization.

63. Everyone from the IRS participating in any way in the grand jury investigation must be subject to the secrecy requirement of Rule 6(e) of the Federal Rules of Criminal Procedure. See Fed. R. Crim. P. 6(e)(2)(B).

64. At this stage, the taxpayer is not yet a defendant. I refer to the taxpayer as defendant only for consistency in the reference throughout the Article.


66. See generally id.; see also United States v. Dahlstrom, 713 F.2d 1423, 1429 (9th Cir. 1983); United States v. Garber, 607 F.2d 92, 98–99 (5th Cir. 1979) (en banc); United States v. Critzer, 498 F.2d 1160, 1163 (4th Cir. 1974). The CTM
tion of a known legal duty.” 67 This means that, at an objective level, the duty must be knowable and, at a subjective level, the defendant must know of the knowable duty.

3. **Get the Tax Loss as Low as Possible**

The Guidelines provide that the calculation can include relevant conduct, such as the tax loss for years other than the years of conviction and tax loss resulting from conduct the defendant aided or abetted or conspired to commit. 68 Relevant conduct may be included in loss from (i) uncharged conduct (both state and federal taxes), (ii) charged conduct of which the defendant was acquitted, and (iii) conduct beyond the criminal statute of limitations. 69

For example, assume that, through a common pattern, the taxpayer commits tax evasion for years one through six, evading $100,000 in each year. The Government indicts him on April 14 of year nine, charging tax evasion (under section 7201) for all open years three to six (open years is a statute of limitations concept). The Government cannot indict for years one and two. Assume that the taxpayer pleads guilty to two counts of tax evasion for years five and six. The tax loss for purposes of setting the BOL is $600,000. And, this result is not changed even if, for example, the jury determines guilt (rather than by plea) for the two years and then determines that, for the remaining years charged, the Government did not prove guilt beyond a reasonable doubt (i.e., the jury acquits the defendant). 70 What this means is that the defendant rides up the scale, gets a higher BOL, and a greater advisory sentencing range, as a result of conduct for which he was not convicted.

Indeed, this phenomenon can result in the BOL being the same in many plea situations where counts are dropped, as compared to going to trial and being convicted on all counts. In these situations, except for the acceptance of responsibility downward adjustment and possibly a section 5K1 substantial assistance adjustment, the defendant will get no benefit from the Government’s plea concession in dropping counts or not including counts in the first place.

Relevant conduct is negotiable because the relevance of the conduct outside the count(s) of conviction depends a lot upon perspective and bargaining dynamics. If the CI agents do not determine the relevant conduct during the investigation, for whatever reason (including lack of re-provides prosecutors with arguments to blunt what I call the James defense. See DOJ CTM, supra note 9, § 8.08[2] (“When the underlying tax law at issue in a case is vague or highly debatable, it may be difficult, if not impossible, to prove that a defendant acted willfully.”).

68. See U.S. Sentencing Guidelines Manual § 1B1.3 (2013) (providing section titled “Relevant Conduct (Factors that Determine the Guideline Range”).
69. See, e.g., United States v. Maken, 510 F.3d 654, 657–58 (6th Cir. 2007).
And, even if the CI agents do determine relevant conduct, perhaps the prosecutors can be talked into perceiving less relevance to the conduct or reducing the numbers in order to achieve a plea. But, it is important to make this attempt as early and often as possible, rather than leaving it for determination in a sentencing hearing. And, of course, the defendant should not in the process agree to a tax loss number that the defendant is not willing to live with.

I share an anecdote. In one of the first criminal prosecutions I handled under the Guidelines, I was trying to convince the Assistant United States Attorney (AUSA) that the Government should not prosecute, by trying to create doubt as to willfulness. He listened politely but then said my arguments as to the client’s lack of willfulness were unconvincing. He said I would be better off to “work the numbers hard.” Our team did that. The numbers fell by over two-thirds from the original SAR, at least for purposes of reaching a plea agreement that the client would accept. As a result, the client was given six months of home confinement, substantially lighter than the pre-Booker, virtually mandatory incarceration that would have been required if the sentencing court had adopted the special agent’s original calculation of the tax loss.

I mentioned in the anecdote that we reached an agreement as to the reduced tax loss in the plea agreement. Perhaps 90%, more or less, of tax crimes cases are resolved by plea agreement. The process of reaching the

Sources), then the conduct would not be counted.\textsuperscript{71} And, even if the CI agents do determine relevant conduct, perhaps the prosecutors can be talked into perceiving less relevance to the conduct or reducing the numbers in order to achieve a plea. But, it is important to make this attempt as early and often as possible, rather than leaving it for determination in a sentencing hearing. And, of course, the defendant should not in the process agree to a tax loss number that the defendant is not willing to live with.\textsuperscript{72}

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\textsuperscript{71} This omission of otherwise relevant conduct occurs often where the pattern of conduct persisted over a number of years. Say a taxpayer convicted of failure to file for four years that were open when indicted has not filed for the twenty preceding years. For resource and other reasons (perhaps not wanting to appear to be piling on or overpopulate the jails by longer sentences), the relevant conduct presented for sentencing may be from zero to perhaps two or three years, but not the entire twenty years for which determining the loss would require devotion of resources disproportionate to the criminal enforcement needs (the limited number of years will suffice). The same is true for a pattern of evasion for filed returns.

\textsuperscript{72} See United States v. Yoooho Weon, 722 F.3d 583, 590 (4th Cir. 2013) (holding defendant to plea agreement tax loss of $2,400,000, despite his later claim at sentencing that tax loss was really $40,000 and rejecting argument that, even if stipulated amount is binding for sentencing, lower tax loss amount can be considered under section 5553(a) and Booker); see also Jack Townsend, Fourth Circuit Holds Defendant to His Tax Loss Stipulated in the Plea Agreement, FED. TAX CRIMES BLOG (July 24, 2013, 1:50 PM), http://federaltaxcrimes.blogspot.com/2013/07/fourth-circuit-holds-defendant-to-his.html.

\textsuperscript{73} All of the numbers were good civil tax numbers (tax deficiency). Where we succeeded was in moving the key two-thirds from the tax evaded category because we convinced the AUSA that he would not be able to prove that the taxpayer intended evasion and the components of the two-thirds so moved.

\textsuperscript{74} Now, if we could have lopped off, say one-half of the remaining one-third of the tax loss, perhaps we could have convinced the Government that there was not enough tax evaded to pursue the criminal case at all. But, we just could not get there. This was pre-Booker; I suspect that, with Booker, we would have gotten a sentencing equivalent of this benefit.
agreement is the last time in most tax cases to really work the numbers. Without getting into the details of the dynamics of the plea process, suffice it to say that prosecutors have systemic pressures to resolve cases by plea. Pleas are deals; in the deal metaphor, there must be a willing buyer and a willing seller. The plea has to be sweet enough that the defendant will agree, and one way to sweeten the pot is to get the tax loss sufficiently low so that the taxpayer’s Guidelines range is as low as possible. This dynamic may assist the AUSA in a revelation that, well, some material component item(s) of income, deduction, or credit in the prior calculations of the tax loss number, involve civil issues rather than criminal.\textsuperscript{75} There may be other items considered in the plea negotiations as to which the AUSA can have properly guided revelations favorable to the defendant, but the tax loss is the most obvious.

4. Presumptions, Extrapolations, and Guesses in Computing Tax Loss

a. Presumptions

The Guidelines require certain presumptions as to the amount of the tax loss “unless a more accurate determination of the tax loss can be made.”\textsuperscript{76} To illustrate, in the case of an individual filing a fraudulent return, those presumptions are: 28% of unreported income or improperly claimed deductions, plus the full amount of false tax credits.\textsuperscript{77}

In the case of individual failure to file, the tax loss is “the amount of tax that the taxpayer owed and did not pay.”\textsuperscript{78} In making the tax loss calculation, in the absence of “a more accurate determination,” the pre-

\textsuperscript{75} In this process, the risk is that (i) the probation officer in the Pre-sentence Report (PSR) may recommend higher numbers than agreed in the plea agreement or that (ii) the sentencing judge may do so \textit{sua sponte}. These are risks that, for a number of reasons, virtually never become a reality. I do note in the text below an example where the sentencing judge did intervene on the tax loss stipulated in the plea agreement and recommended by the probation officer, but when you read the example you will realize that it was a situation where the sentencing court easily determined that, if the tax loss definition said that, that definition was an ass. \textit{See} CHARLES DICKENS, OLIVER TWIST 204 (1839) (noting famously that “the law is an ass”). The court did not have to follow the aberrant conclusion to the lowest sentence possible. Rather, the court could fix it by a different interpretation of tax loss or, if necessary, by the discretion to vary upward under section 3553(a) and \textit{Booker}. \textit{See} 18 U.S.C. § 3553(a) (2012); United States v. Booker, 543 U.S. 220, 222 (2005).

\textsuperscript{76} U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(1)(A)–(C) (2013); \textit{see also} id. § 2T1.1 cmt. n.1 (“In these situations, the ‘presumptions’ set forth are to be used unless the government or defense provides sufficient information for a more accurate assessment of the tax loss.”).

\textsuperscript{77} \textit{Id.} § 2T1.1(c)(1)(A)–(C).

\textsuperscript{78} \textit{Id.} § 2T1.1(c)(2). I discuss a case later in this Article where this definition was critical to permit a taxpayer, who was at the center of a failure to pay over withheld taxes, to claim the credit and thus reduce tax due for withheld taxes not actually paid over.
The calculation of the net tax due (tax less payments) is the criminal figure concept, which excludes anything that the taxpayer could not have had an intent to evade (i.e., it is not the unpaid civil tax liability/deficiency). There may be an opportunity to lower the tax loss in some cases by arguing that the taxpayer had no intent to evade as to some or all of the tax loss the Government seeks to apply. To illustrate, I gave the example above where there were two components of omitted income—embezzlement income, clearly taxable, and personal injury income, not sufficiently certain of taxation that it should be included. In the case of fraudulent return evasion, the latter component would be excluded from the evaded tax calculation. Now apply that to a failure to file a return where those two items were the only components of gross income and the 20% presumption would apply. You could assert that the 20% should only apply to that component of income—embezzlement income—that was sufficiently certain of taxation under the same standard. In other words, it is not the tax deficiency, but the lower tax evaded amount.80

The Government, of course, has the burden to establish the tax loss at sentencing, but these presumptions may kick in to meet that burden if the taxpayer fails to produce a more accurate calculation.81 Keep in mind, however, that as noted above, the percentage assumptions apply to the items that meet the historic definition of criminal conduct—evaded tax—and thus should not apply to those items historically excluded in determining the criminal figure. The discussion immediately above related to failure to file is instructive, because it is also applicable in other contexts. Moreover, in some cases, the Government will want to present the more accurate determination to generate a higher tax loss than the presumption might generate.

79. U.S. SENTENCING GUIDELINES MANUAL § 2T1.1(c)(2)(A).
80. I made this genre of argument in an early case involving a failure to file syndrome defense to a section 7203 charge where the taxpayer’s income was reported on W-2s and 1099s, thus assuring that the IRS would know of the income and, eventually, it would be resolved. At least, that was my story and I stuck to it. In effect, as to any unpaid tax, the taxpayer was just deferring but not evading his tax liability, and the tax loss concept goes to evasion and not to deferring. One of the arguments I made to the AUSA was that, on this basis, even if the Government got a conviction, it may end up getting no incarceration because the tax loss might be zero. The potential for incarceration is an important factor in determining whether the Government should indicted. Whether for that reason or some other (that I did not know about), the AUSA returned the case to DOJ Tax without indictment.
81. See generally United States v. Sullivan, 255 F.3d 1256 (10th Cir. 2001) (illustrating example of reliance on presumption involving earlier Guideline where presumption was 20%).
b. Extrapolations and Guesses

The Government may attempt to use extrapolations that it thinks are persuasive to a court in determining a reasonable tax loss for sentencing. This often occurs, for example, in a prosecution of tax preparers who have prepared many fraudulent returns. The Government may audit only a small portion of the returns prepared by the preparer but will then attempt statistical extrapolation for a sentencing tax loss larger than the sampled returns. The use of such extrapolations has been addressed only infrequently by the courts, but the logical rule that has developed is that, if persuasive, this type of evidence can be used.82 By contrast, guesses that do not have a firm basis in logic and reasonableness will not be accepted.83

5. Unclaimed Deductions and Credits

Courts have divided over whether a defendant’s tax loss can account for unclaimed deductions (i.e., deductions that the defendant did not claim on the return the taxpayer filed or deductions that were never claimed because the defendant did not file a return). The issue turns upon the respective courts’ interpretations of the general definition of tax loss—the tax that was the object of the defendant’s criminal tax offense. I will not get into the interpretations that split the courts over the years, because the Sentencing Guidelines have recently been revised, effective November 1, 2013, to provide the courts uniform guidance on the issue.84

The interpretation, effective November 1, 2013, is reflected in Application Note 1. The amendment to the Application Note is:

82. See, e.g., United States v. Ahanmisi, 324 F. App’x 258, 260 (4th Cir. 2009) (involving tax preparer sentencing in which, at Government’s request, tax loss was projection to total universe of returns prepared from sample of returns). The Court of Appeals reversed on the ground that the sample was not random and thus could not be the basis for an inference that it represented the universe. See id. In another case, the Fourth Circuit later sustained a sentencing court’s extrapolation. See United States v. Mehta, 594 F.3d 277, 283–84 (4th Cir. 2010). Even though the sampling was not random (a baseline requirement for statistically valid extrapolations to the universe), the error was harmless because the tax loss determined by the sentencing court was reasonable under the facts. See id. The Fourth Circuit distinguished Mehta from Ahanmisi by stating that, unlike in Mehta, the sentencing court in Ahanmisi was unable to compensate for the skewed sample. See id. at 283–84; see also id. at 284–85 (Shedd, J., concurring); United States v. Simmons, 420 F. App’x 414, 418 (5th Cir. 2011) (focusing on reasonableness of extrapolations).

83. See Ahanmisi, 324 F. App’x at 260.

3. Unclaimed Credits, Deductions, and Exemptions.—In determining the tax loss, the court should account for the standard deduction and personal and dependent exemptions to which the defendant was entitled. In addition, the court should account for any unclaimed credit, deduction, or exemption that is needed to ensure a reasonable estimate of the tax loss, but only to the extent that (A) the credit, deduction, or exemption was related to the tax offense and could have been claimed at the time the tax offense was committed; (B) the credit, deduction, or exemption is reasonably and practicably ascertainable; and (C) the defendant presents information to support the credit, deduction, or exemption sufficiently in advance of sentencing to provide an adequate opportunity to evaluate whether it has sufficient indicia of reliability to support its probable accuracy.

However, the court shall not account for payments to third parties made in a manner that encouraged or facilitated a separate violation of law (e.g., “under the table” payments to employees or expenses incurred to obstruct justice).

The burden is on the defendant to establish any such credit, deduction, or exemption by a preponderance of the evidence. 85

The Commission’s reasons for the amendment (the legislative history, if you will):

This amendment reflects the Commission’s view that consideration of legitimate unclaimed credits, deductions, or exemptions, subject to certain limitations and exclusions, is most consistent with existing provisions regarding the calculation of tax loss in § 2T1.1.

The new application note first provides that courts should always account for the standard deduction and personal and dependent exemptions to which the defendant was entitled. The Commission received public comment and testimony that such deductions and exemptions are commonly considered and accepted by the government during the course of its investigation and during the course of plea negotiations. Consistent with this standard practice, the Commission determined that accounting for these generally undisputed and readily verifiable deductions and exemptions where they are not previously claimed (most commonly where the offense involves a failure to file a tax return) is appropriate.

The new application note further provides that courts should also account for any other previously unclaimed credit, deduction, or exemption that is needed to ensure a reasonable estimate of the tax loss, but only to the extent certain conditions are met. First, the credit, deduction, or exemption must be one that was related to the tax offense and could have been claimed at the time the tax offense was committed. This condition reflects the Commission’s determination that a defendant should not be permitted to invoke unforeseen or after-the-fact changes or characterizations—such as offsetting losses that occur before or after the relevant tax year or substituting a more advantageous depreciation method or filing status—to lower the tax loss. To permit a defendant to optimize his return in this manner would unjustly reward defendants, and could require unjustifiable speculation and complexity at the sentencing hearing.

Second, the otherwise unclaimed credit, deduction, or exemption must be reasonably and practicably ascertainable. Consistent with the instruction in Application Note 1, this condition reaffirms the Commission’s position that sentencing courts need only make a reasonable estimate of tax loss. In this regard, the Commission recognized that consideration of some unclaimed credits, deductions, or exemptions could require sentencing courts to make unnecessarily complex tax determinations, and therefore concluded that limiting consideration of unclaimed credits, deductions, or exemptions to those that are reasonably and practicably ascertainable is appropriate.

Third, the defendant must present information to support the credit, deduction, or exemption sufficiently in advance of sentencing to provide an adequate opportunity to evaluate whether it has sufficient indicia of reliability to support its probable accuracy. Consistent with the principles set forth in § 6A1.3 . . . this condition ensures that the parties have an adequate opportunity to present information relevant to the court’s consideration of any unclaimed credits, deductions, or exemptions raised at sentencing.

In addition, the new application note provides that certain categories of credits, deductions, or exemptions shall not be considered by the court in any case. In particular, “the court shall not account for payments to third parties made in a manner that encouraged or facilitated a separate violation of law (e.g., ‘under the table’ payments to employees or expenses incurred to obstruct justice).” The Commission determined that payments made in this manner result in additional harm to the tax system and the legal system as a whole. Therefore, to use them to reduce the tax loss would unjustifiably benefit the defendant and
would result in a tax loss figure that understates the seriousness of the offense and the culpability of the defendant. Finally, the application note makes clear that the burden is on the defendant to establish any credit, deduction, or exemption permitted under this new application note by a preponderance of the evidence, which is also consistent with the commentary in § 6A1.3.86

I am not sure that, given the opening paragraph, the Commission makes a compelling case for excluding unclaimed deductions or credits that are not related to the criminal offense. Can or should it be that the measure of punishment is not based on the real tax number rather than a notional one calculated by ignoring unclaimed deductions? I think that depends upon one’s concept of fairness and the goal of making the punishment fit the crime. And, of course, to the extent that unrelated deductions might materially reduce or eliminate the real tax deficiency, I think the court could have *Booker* discretion to make some adjustment in the final sentence.

One thing to consider early in the process is whether to file an amended return claiming the previously unclaimed, unrelated deductions. In order to do that, of course, the taxpayer will effectively admit the omitted income or overstated deductions and credits that generated the IRS’s interest in the first place. But, if the unclaimed deductions or credits are large enough, it may thwart either a civil agent referral to CI or a CI referral to DOJ Tax. These types of strategies must be planned by experienced attorneys aware of all the risks they entail.

6. **Corporate Diversions to Shareholders**

a. The Unclaimed Compensation Deduction Issue

In situations where the taxpayer cheats on taxes through a closely held “C Corporation,” there will be the double level tax loss to consider. For example, if a taxpayer diverts gross income from the corporation to himself without reporting the income by either of them, the corporation will have evaded tax and the taxpayer will also have evaded tax. Both levels of unpaid tax can be included in the tax loss for the shareholder as defendant. A frequent gambit in order to avoid including the corporate level tax in the tax loss is to urge that the constructive payment from the corporation to the shareholder was really additional deductible compensation, entitling the corporation to a deduction, thus producing no corporate level tax loss. The courts generally reject that argument, for the corporation did not in fact pay the amount as salary.87 And, even if that hurdle is


87. See, e.g., United States v. Gordon, 291 F.3d 181, 187 (2d Cir. 2002); United States v. Martinez-Rios, 143 F.3d 662, 671 (2d Cir. 1998).
cleared, the use of the deduction to lower the tax loss will have to pass muster under the new unclaimed deductions rule. It probably would where, as posited, the defendant’s shareholder level tax is alleged as evaded tax.

b. The Dividend Issue

Treating the transaction as a constructive receipt by the corporation and distribution to the shareholder is pretty much a no-brainer from a civil tax perspective. However, complexity may lie in how the distribution is taxed to the shareholder. Under the Code, a corporate distribution is taxed to the shareholder as a dividend only to the extent of the corporation’s cumulative or current earnings (E&P). The balance of the distribution, if any, is taxed either as a nontaxable return of capital to the extent of basis in the stock, or a capital gain to the extent of the excess of the distribution over basis.88 These determinations require that E&P be calculated. Therein lies the potential problem/opportunity.

Without getting into the complexities of determining E&P, suffice it to say here that E&P can be very difficult to calculate.89 Since the November 2001 Guidelines, the difficulties inherent in E&P are resolved by permitting presumptions to apply (34% of diverted amount at corporate level and 28% at individual level).90 In the tax loss calculations, the amount of the corporate diversion is taxed to the corporation and in full to the diverting shareholder without reduction for the corporate tax and without any other E&P calculations.

The really troubling point is that the presumption can create a tax loss for sentencing purposes where proper analysis of E&P could show that, in fact, there was no tax evaded at the shareholder level. Indeed, in the restitution calculation or the civil case usually following after conviction, it may well be that the taxpayer can establish for civil tax purposes (where the truth,91 and not presumptions, control) that there is no dividend and no shareholder level tax.92 Should our criminal tax system require that sentencing be driven by presumptions inconsistent with the truth (or more precisely, without regard to truth)?

Finally, there may still be some play in the E&P issue at the guilt determination phase. Remember that in a tax evasion case the Government must prove tax evaded beyond a reasonable doubt. What if a foray into the murky swamp of E&P could show that there is really no shareholder level tax or, if there were such a tax, it was not material or it is too murky.

91. At least the truth based on the evidence presented.
92. I note below that there may be a problem if the tax loss gross of the deductions were included in the restitution amount, but presumably restitution is not subject to the potential denial of reduction for unclaimed deductions.
to know beyond a reasonable doubt? There is no such presumption that the Government can rely upon in the guilt determination phase.93

7. Timing Issues

On the original return, a taxpayer may have improperly claimed a tax benefit (deduction or credit) that he is entitled to in a later year. This is sometimes referred to as a timing difference. The issue is how the tax loss in the improper earlier year is to be calculated and, specifically, whether the amount of the tax loss is adjusted downward in that year to account for the fact that the taxpayer may have not claimed the deduction in the later proper year. To take an extreme case, assume that a defendant improperly claimed a $1,000 deduction in year one that he is entitled to take in year two but does not claim in year two. Assume further that the tax saved by claiming the deduction, focusing only on year one, is $250 (actual) or $280 (presumptive). But, is that the real loss to the Government because the Government will make that up in year two when the taxpayer does not claim the deduction?94 In the bare facts given, what is the real tax loss? It is not $250 (actual) or $280 (presumptive), but rather (assuming constant or materially the same marginal rates), it is zero, except for, perhaps, the time value of money for that short one-year timing period. Normally, except in collection evasion cases, the time value of money is not considered in calculating the tax loss.

In the only opinion to address the issue, United States v. Stadtmauer,95 the timing issue was in the context of depreciation where a current deduction was claimed for items that could be depreciated over future years.96 The Government wanted to apply the 28% presumptive rate to the entire deduction claimed without any mitigation for the future tax revenue the Government did or would collect.97 The defendant cried foul and the court listened. The court opined:

Mr. Stadtmauer argues that since the issue is only one of timing there is no tax loss associated with these deductions. The Government disagrees, arguing that there is at least a loss due to the time value of money. However, the Government does not argue that the loss is the time value of money, rather the Govern-

93. See United States v. Bok, 156 F.3d 157, 163–64 (2d Cir. 1998). The defendant will likely have to put the issue in play by meeting some type of production burden. See id.
94. Note that there is a real sweet civil mitigation issue that could be addressed here if the defendant were to attempt to deduct the same item in year two, but let us not get bogged down in noncriminal matters here because I assume that the defendant did not claim the deduction in year two. The civil mitigation rules are found in 26 U.S.C. §§ 1311–1314 (2012).
95. No. 05-249, 2009 WL 361115 (D.N.J. Feb. 9, 2009), aff’d, 620 F.3d 238 (3d Cir. 2010).
96. See generally id.
97. See id. at *12.
ment argues that because there is some loss due to the time value of money the 28% presumptive rate should be used. This Court agrees with the Government that the time value of money should be considered as a tax loss, but disagrees that using the 28% rate is appropriate; the 28% rate does not “fit the circumstances” for these deductions.

The Court recognizes, and the Government conceded at the sentencing hearing, that as a general matter, tax loss under the Guidelines for the crimes at issue here does not include interest and penalties. The Court also recognizes that interest calculations are meant to account for the time value of money, so arguably any interest based calculation should not be included under the Guidelines. But, the Court also finds that recognizing a time value of money effect for these deductions is completely different than the general case of calculating and adding interest, as addressed in Application Note 1. Under § 2T1.1(c), “the tax loss is the amount of loss that was the object of the offense.” Here, the purpose of taking the deductions in full in the year incurred was to receive the time value of money benefit from paying less taxes now rather than spread over time; it was not merely some ancillary benefit to the primary object of avoiding taxes by taking a deduction that was not permissible at all, the time value of money benefit was the object of the offense.

The question, then, is what is a reasonable way to estimate this loss. As noted above, to accept the presumptive 28% rate as the Government argues would be unfair and drastically overstate the tax loss. The Court finds that the most reasonable way to account for this loss is by using the Government’s own method for compensating itself for the time value of money related to underpayments of tax. Interest on underpayments is calculated by the IRS pursuant to 26 U.S.C. § 6621(a)(2). This rate is determined quarterly. For the years 1997 to 2001, the IRS rate for non-corporate underpayments varied between 7% and 9%, with the rate declining in the years after 2001. This Court finds that using a rate of 8%, a rate in the middle of the range, is reasonable. This approach is not perfect. It does not account for compounding, but it also does not account for the exact timing of the deductions. However, exact precision is not required. This Court finds that the other methods suggested either understate or overstate the intended loss and that this method is the most fair and reasonable estimate of the loss intended for these items.98

This is a creative solution to the problem.

98. Id. at *15–16 (citations omitted).
8. **Tax Loss Numbers from Others’ Conduct (Related or Joint Criminal Activity)**

a. General

The concept of relevant conduct includes criminally related harm attributable to the conduct of others with whom the defendant had a relationship of the type that would normally make the defendant criminally liable for crimes committed by another.99 The first type of relevant conduct is defined as “all acts and omissions committed, aided, abetted, counseled, commanded, induced, procured, or willfully caused by the defendant . . . .”100 We have already considered the “committed” concept whereby tax loss can include conduct of a defendant for non-conviction years. The remainder of the quoted conduct describes standard criminal concepts of aiding, abetting, and causing incorporated in 18 U.S.C. § 2, which make a defendant criminally liable even if the defendant is not otherwise guilty of the crime.101

The second type of relevant conduct includes: “[I]n the case of a jointly undertaken criminal activity (a criminal plan, scheme, endeavor, or enterprise undertaken by the defendant in concert with others, whether or not charged as a conspiracy), all reasonably foreseeable acts and omissions of others in furtherance of the jointly undertaken criminal activity . . . .”102

This second type is technically, as worded, related to the concept of conspiracy but is actually drawn more narrowly than the criminal concept of conspiracy. However, subject to the caveat that it may not always be the same, it probably is substantially coterminous in most cases.103

99. The consideration of relevant conduct is consistent with section 3661, which provides: “No limitation shall be placed on the information concerning the background, character, and conduct of a person convicted of an offense which a court of the United States may receive and consider for the purpose of imposing an appropriate sentence.” 18 U.S.C. § 3661 (2012).


102. U.S. SENTENCING GUIDELINES MANUAL § 1B1.3(a)(1)(B). There is some conceptual overlap between at least some type of conduct that could be viewed as aiding and abetting and conduct that is viewed as within the scope of a conspiracy. I do not think there is any practical significance to such nuance in the context of this discussion.

103. For those wanting the nuance on this, obviously the starting point is the language of the Guideline itself. Then, the Guideline provides useful examples. See id. § 1B1.3(a)(1)(B); id. § 1B1.3 cmt. 2 (discussing concepts in some detail). The CTM also discusses the concepts. See DOJ CTM, supra note 9, § 43.04. In a Simplification Draft Paper for discussion purposes, the U.S. Sentencing Commission wrote the following as the view of the training staff about this provision: [B]ecause the Commission defined sentencing liability for conspiracies more narrowly than traditional criminal law conspiratorial liability and because the Commission’s definition of sentencing liability for conspiracies is intricate and fact specific, the training staff believes that applying this definition has been a struggle for attorneys, probation officers, and
In each of these cases, some additional nexus to the tax loss harm is required, but for purposes of this outline, these nuances are not material. Suffice it to say that tax loss within the scope of a tax conspiracy—that is reasonably foreseeable—will be included as relevant conduct. A good rule of thumb is that the reasonably foreseeable tax loss from the time the defendant joins the conspiracy until the defendant effectively withdraws from the conspiracy will be included.

For example, if an object of the conspiracy is to have the participants not report their illegal income, all conspirators’ tax loss numbers will be relevant conduct. Similarly, if the conspiracy is to promote illegal tax shelters, the tax loss numbers for the taxpayers—whether active participants in the conspiracy or not—will be included.

Even if the defendant in question is not indicted for conspiracy, the tax loss from “jointly undertaken criminal activity” can be included if proved by a preponderance of the evidence. Such activity will usually

courts since the advent of the guidelines. Specifically, unlike criminal conspiratorial liability, relevant conduct limits sentencing conspiratorial liability to “jointly undertaken criminal activity.” This prong of relevant conduct often requires courts to hold significant hearings to determine what part of a defendant’s criminal law conspiratorial liability “the particular defendant agreed to jointly undertake (i.e., the scope of the specific conduct and objectives embraced by the defendant’s agreement)” as well as all reasonably foreseeable conduct of others in furtherance of the jointly undertaken activity. [U.S. SENTENCING GUIDELINES MANUAL § 1B1.3 cmt. n.2 (2013).] Because this determination is case- and fact-specific, and because the determination can drive a guideline sentence, it is litigated in many cases. Commission research shows that after the drug guideline, relevant conduct is the most frequently appealed guideline issue. These data further show that most of the appeals surround the definition of conspiratorial liability.

U.S. SENTENCING COMM’N, RELEVANT CONDUCT AND REAL OFFENSE SENTENCING (simplification draft paper), available at http://www.ussc.gov/Research/Working_Group_Reports/Simplification/RELEVANT.HTM (last visited June 1, 2014). 104. See, e.g., U.S. SENTENCING GUIDELINES MANUAL § 1B1.3(a)(2) (2013). The Guidelines require that the relevant conduct be “part of the same course of conduct or common scheme or plan as the offense of conviction” and that it be groupable, under section 3D1.2, with the counts of conviction had the defendant been convicted of the relevant conduct. Id. § 1B1.3(a)(2); see also id. § 1B1.3 cmt. n.8.

105. See id. § 1B1.3 cmt. n.2 (last paragraph); see also Grunewald v. United States, 353 U.S. 391, 401–02 (1957) (addressing scope of conspiracy, specifically as to whether subsequent acts after main object of conspiracy are within scope of conspiracy).


107. U.S. SENTENCING GUIDELINES MANUAL § 1B1.3 cmt. n.2 (2013). As to the general proposition that sentencing factors need to be proved only by a preponderance of the evidence, the CTM cautions, “the Supreme Court has specifically left open the question whether, under exceptional circumstances in which the sentencing enhancement was ‘a tail which wags the dog of the substantive offense,’ due process might require the relevant conduct to be proven by clear and convincing evidence.” DOJ CTM, supra note 9, § 43.04 (quoting United States v. Watts, 519 U.S. 148, 156–57 n.2 (1997)).
fit the definition of a conspiracy\footnote{For this purpose, there is no practical distinction between the offense conspiracy and the \textit{Klein} defraud conspiracy. In both cases, it is the tax loss that is the object of the conspiracy—in conspiracy lingo, within the scope of the conspiracy—that is included.} and, as a result, the Government will usually indict for conspiracy\footnote{See United States v. Reynolds, 919 F.2d 435, 439 (7th Cir. 1990). Judge Easterbrook lamented in a tax case (but for federal criminal charges generally), that the federal conspiracy charge is “inevitable because prosecutors seem to have conspiracy on their word processors as Count I; rare is the case omitting such a charge.” \textit{Id.}} and, in tax cases, will usually require a plea to the conspiracy count in a plea agreement.

So, generally, there is a huge potential downside to being convicted of tax conspiracy. In this regard, in the major tax shelter prosecutions, the prosecutors were quick to point out to persons within the potential scope of the criminal investigations (referred to as subjects, but also including targets) that the intended losses from the conspiracy were in the billions—meaning, at least in terms of sentencing, the Guidelines range calculation was to be as high as it gets. And, when the prosecutors first started this mantra, the Guidelines were considered binding rather than just advisory as a result of \textit{Booker}. Judges could still depart, and no one representing criminal defendants really believed that a judge would sentence based on those Guideline ranges without a departure to achieve better justice. Still, it was a risk that could not be ignored. So, as to how one of these defendants attempted to mitigate the risk, see the next section of this Article.

\section*{b. Is There a Tax Loss Benefit to a Conspiracy Conviction?}

I illustrate here a possible benefit with the right plea in tax cases. I noted above that conspiracy charges are often encountered in tax cases and in federal criminal cases generally. And, in the plea process, the conspiracy charge is often considered the major count under DOJ Tax’s major count policy.\footnote{See \textit{DOJ CTM}, \textit{supra} note 9, § 5.01[1]; \textit{USAM}, \textit{supra} note 9, § 6-4.310.} Under that policy, a defendant may be offered a single plea, frequently the conspiracy plea, with dismissal of the substantive counts. The tax conspiracy Guideline is section 2T1.9, which establishes a BOL of ten or, if higher, the BOL from the regular tax Guideline in section 2T1.1 under the tax loss table. But, if the count of conviction is solely for the tax conspiracy and not for any substantive tax crime (such as evasion), section 2T1.1 may have no application because of the definition of tax loss in section 2T1.1.

This counterintuitive opportunity played out in \textit{United States v. Coplan},\footnote{703 F.3d 46 (2d Cir. 2012), \textit{cert. denied}, 134 S. Ct. 71 (2013).} involving a major prosecution of several defendants for Son-of-Boss fraudulent tax shelters.\footnote{See \textit{id.} at 92–94.} The sentencing court found that the conspiracy intended $400 million in tax loss from the taxpayers to whom the conspirators sold the shelters. However, apparently because the defen-
dant in question, Bolton, pled only to the conspiracy count, the prosecutors stipulated in the plea agreement that there was no tax loss and the probation office’s PSR also concluded that there was no loss. That conclusion was based on a literal interpretation of tax loss in section 2T1.1(c)(1) of the Guidelines, which defines tax loss as follows: “If the offense involved tax evasion or a fraudulent or false return, statement, or other document, the tax loss is the total amount of loss that was the object of the offense (i.e., the loss that would have resulted had the offense been successfully completed).”

The offense referred to is the offense of conviction. The offense of conviction was conspiracy and, hence, not included in the definition of tax loss, even though that tax loss was the object of the conspiracy. Not liking that result because the indicated Guidelines range understated the gravity of the defendant’s conduct, the prosecutors asked the court to impose a section 3553(a)/Booker upward variance. The sentencing court also did not like the result and did not interpret the term “tax loss” so narrowly as to preclude its application simply because the count of conviction was conspiracy rather than a substantive tax crime. The tax loss within the scope of the conspiracy was $400 million, thus making the BOL substantial, under the tax tables in sections 2T1.1 and 2T1.4, with a resulting Guidelines range (after all adjustments) of 210–260 months. The sentencing court then made a 95% Booker downward variance to fifteen months, under section 3553(a), saying that the court would have imposed the same sentence had there been no “tax loss.” The Second Circuit held that the sentencing court had properly included the tax loss in the Guidelines calculations, but that the sentencing court’s statement that the same sentence would have applied without a tax loss made any error “harmless.”

So, is this “benefit” of the conspiracy plea available or not? I do not know. It does not sound right, which, of course, is what grabbed the sentencing judge’s attention (and, I think, the appeals judges’ attention). On the other hand, I do not think the prosecutors would have stipulated to it or the probation office would have agreed if there were not a strong basis for it. Defendants attempting to exploit this opportunity must also be prepared for a similar response from the prosecutors (grudging acceptance with a request for upward variance) and from sentencing courts (a stiffer sentence based on interpretation or Booker variance).

113. Id. at 94 (emphasis added) (quoting U.S. Sentencing Guidelines Manual § 2T1.1(c)(1) (2013)).
114. Id. at 92–94.
115. I throw out one consideration for those wanting to exploit the opportunity. It seems to me that the argument is better if the count of conviction is solely for the Klein defraud conspiracy and is not for the offense conspiracy.
116. This feature of the Coplan case is not discussed in the CTM.
C. FBAR Violations

Report of Foreign Bank and Financial Accounts (FBAR) criminal and civil tax initiatives have been a major component of tax enforcement recently. United States persons with a financial interest or signatory authority over foreign accounts are required to file FBARs by June 30th of each year.\footnote{117} The FBAR form is just an information form. Civil and criminal penalties apply if the FBAR is not filed or if an erroneous FBAR is filed.\footnote{118} Taxpayers often fail to file FBARs in order to conceal tax evasion through not reporting the income from the accounts on their income tax returns.\footnote{119} When FBAR violations relate only to tax crimes, the courts determine the Guidelines BOL under the tax crimes provisions in section 2T1, which is driven by the tax loss. This requires some explanation.

The starting point in the Guidelines for monetary report violations, including FBARs, is chapter 2, part S. The starting point for tax violations is chapter 2, part T. You will recall that the methodology in chapter 2 of the Guidelines is to determine a BOL with certain adjustments before moving on to the other adjustments in chapters 3 and 4.

The chapter 2, part S calculations, specifically Guidelines section 2S1.3, are at first glance very ugly. The chapter 2 offense level is calculated as a monetary crime (theft) keyed to the amount that is not reported on the FBAR. The chapter 2, part T calculations, by contrast, key the chapter 2 offense level to the amount of tax evaded. The result is that the offense level under part S can move up far quicker than the offense level under part T. I will not get into the details of how that works, but I do provide a summary guide with precautions in the footnote.\footnote{120}
D. Tax Loss in the Section 3553(a)/Booker Phase of Sentencing

We observed an instance of where the sentencing court’s dissatisfaction with the tax loss calculations was fixed by application of a section 3553(a)/Booker variance. In that case, the Guidelines calculation was too low because of an underinclusive interpretation of the definition of tax six. So, the “holy grail” is to make sure that the part S offense level is reduced to six. Otherwise, the part S offense level will usually greatly exceed the part T offense level, and the part S offense level will apply. To repeat, you get to offense level six only if the first two adjustments in section 2S1.3(b) and certain other conditions do not apply.

For those wanting to follow through on that (particularly important if the defendant is charged or agrees to plea to an FBAR violation), you will have to parse the first two exceptions in section 2S1.3(b). See id. § 2S1.3(b). They are not models of clarity, and I am not aware of any authoritative interpretations of those first two exceptions. You will have to research and reach your own conclusions, but, as noted, you do not want either of those exceptions to apply, because the resulting part S offense level will be higher than the part T offense level, which requires that the part S offense level apply. I would offer more of a discussion of those two exceptions, except that certain anecdotal evidence from the recent plea agreements to FBAR violations in tax crime settings suggests that all of the parties—the defendants, the prosecutors, the probation office, and the courts—seem to assume that the base offense level is under part T rather than part S, which necessarily means that they believe the first two section 2S1.3(b) exceptions do not apply, and thus, the third exception applies and drops the part S minimum offense level to six. Having said that, I should also note that one experienced litigator commented—during the meeting of the Civil and Criminal Penalties Section at the 2011 ABA Tax Section Meeting—that the USAO for the Southern District of New York interpreted FBAR violations in a tax setting to invoke one of the two adjustments in section 2S1.3(b), thus precluding application of the Tax Guidelines under section 2T1.

I think the concern related to section 2S1.3(b)(2)(B) is that it applies and increases the BOL by two levels if the defendant “committed the offense [the FBAR] as part of a pattern of unlawful activity involving more than $100,000 in a 12-month period . . . .” Id. § 2S1.3(b)(2). In a legal source and use of proceeds case, the question would be whether this could apply if more than $100,000 is involved in each year and there is a failure to file the FBAR for several years, making it a pattern of “illegal” activity.

Therefore, anyone representing a person charged with an FBAR violation must reach his or her own level of comfort on this issue. I do not think it is self-evident from the actual words used. I do think, however, that the sense of the exceptions is that they should not apply in a legal source and use income tax case. Note that a similar issue of interpretation of this language is presented in 31 U.S.C. § 5322(b) that, on parallel language, doubles up the criminal penalties for FBAR and other BSA violations. See 31 U.S.C. § 5322(b). I reached a similar conclusion in discussing that statute not because the text compels it, but because the anecdotal evidence indicates that the language is interpreted not to apply to legal source income tax violations. I should finally caution that this anecdotal evidence may even be a form of dicta, because in these anecdotal plea settings it was clear that the actual Booker sentence would never get above the base level provided in section 5322(b) and would not be as prescribed in Guidelines section 2S1.3 by reference to the theft table. See id.; see also U.S. SENTENCING GUIDELINES MANUAL § 2S1.3 (2013). Caution is in order. See Jack Townsend, Sentencing Simon (Preliminary and Final), FED. TAX CRIMES BLOG (Mar. 18, 2011, 3:07 PM), http://federaltaxcrimes.blogspot.com/2011/03/preliminary-sentencing-findings-in.html (providing example of calculation under Guidelines section 2S1.3).
loss. Let's look at a recent case where the defendant urged that the Guidelines tax loss calculation stipulated in the plea agreement was too high, and, if the defendant could not fix the problem in the Guidelines calculation itself, he should have been allowed to fix it via section 3553(a)/Booker discretion.

In that case,121 the defendant pled to five counts of tax evasion.122 Based on a stipulated loss of $2.4 million, the indicated Guidelines range was thirty-three to forty-one months. Exercising its variance authority under section 3553(a), the sentencing court sentenced the defendant to thirty months, a three-month variance from the bottom end of the Guidelines range.123 At sentencing, the defendant attempted to revise the stipulated $2.4 million tax loss down to $40,000, obviously a substantial reduction. Apparently concerned about the veracity of the $40,000 tax loss claim, the sentencing court refused to change the tax loss for sentencing or to relieve him from the plea agreement. The defendant had waived his right to object and, the sentencing court reasoned, a deal is a deal. The defendant argued that, notwithstanding the sentencing court’s refusal to relieve him of the $2.4 million stipulation for purposes of the Guidelines calculations, the court could and should nevertheless consider the $40,000 tax loss for purposes of calibrating a just sentence under the mandate of section 3553. The court of appeals held that the stipulation by its terms was binding “for sentencing” and not just for the Guidelines range calculations.124 That stipulation, of course, is not binding on the sentencing court, but even where the sentencing court could reject the stipulation, there is no requirement that the sentencing court reject the stipulation. And, of course, the sentencing court’s skepticism about the validity of the claimed $40,000 tax loss was a factor.125

Basically, I surmise, the defendant just did not convince the court that the quality of his evidence or proffer raised a real legitimate claim that the tax was $40,000 rather than $2.4 million (or some material number less than $2.4 million). If the defendant had done so, I suspect that the prosecutors or the sentencing court would have found some way to give the defendant all or most of the credit for the reduction, notwithstanding the stipulation in the plea agreement.

122. Id. at 585. It is not clear why the Government insisted on a plea to five counts, because the Guidelines range considering relevant conduct or, it seems to me, any reasonably expected variance, would all fit within the incarceration permitted by a single count of tax evasion (sixty months). Often more counts are required in order to get the number of maximum months via stacking indicated by the pattern of conduct, but that seems not to have been the case in Yooho Weon. See id.
123. Id. at 587.
124. Id. at 589.
125. See id. at 587.
III. RESTITUTION

A. General

Statutory restitution (as opposed to contractual restitution) is permitted only for the count(s) of conviction and thus, unlike tax loss, does not include relevant conduct.126 However, if the count of conviction is broadly worded to cover a scheme, conspiracy, or pattern of criminal activity, the scope of restitution can include reasonably foreseeable tax loss attributable to that activity, even if not separately charged or convicted.127

B. Restitution in Tax Cases

Tax crimes under title 26 are not included among the offenses for which restitution is authorized in the statutes. Statutory restitution is thus not allowed for a pure tax offense of conviction.128 Of course, if the count(s) of conviction include(s) a conspiracy (either an offense conspiracy or a Klein defraud conspiracy), or some other title 18 offense, statutory restitution is permitted.129 Finally, given the charging choices the prosecutors have and the incentives for a defendant to plead with a requirement of contractual restitution, the DOJ Criminal Tax Manual (CTM) notes that “in virtually every criminal tax case in which it is appropriate, there is a way to obtain restitution.”130

126. DOJ CTM, supra note 9, § 44.03[2][a].

127. See 18 U.S.C. § 3663(a)(2) (2012). This provision can apply even to acquitted conduct within the scope of the broader convicted conduct. See DOJ CTM, supra note 9, § 44.03[2][b] (citing United States v. Foley, 508 F.3d 627, 635–36 (11th Cir. 2007)) (observing that restitution amount properly included acquitted conduct and district court could award restitution to any victim of scheme furthered by defendant’s mail fraud offense); see also United States v. Brock-Davis, 504 F.3d 991, 998–99 (9th Cir. 2007) (noting that restitution may be ordered for losses to persons harmed in course of defendant’s scheme even beyond counts of conviction).

128. See United States v. Minneman, 143 F.3d 274, 284 (7th Cir. 1998) (citing United States v. Gottesman, 122 F.3d 150, 151 (2d Cir. 1997)); see also United States v. Stout, 32 F.3d 901, 905 (5th Cir. 1994).

129. See 18 U.S.C. § 3663(a)(1)(A); DOJ CTM, supra note 9, § 44.02[1]–[2]. For a case discussing restitution when title 18 hooks into what is really a tax offense, see Minneman, 143 F.3d at 284 (citing United States v. Helmsley, 941 F.2d 71, 101 (2d Cir. 1991)). For this reason, the Government will charge some tax offenses under title 18 rather than title 26. See DOJ CTM, supra note 9, § 22.02[1] (noting that false refund claim cases can be prosecuted as tax crimes under title 26, for example, under section 7206(1)–(2), but are charged under title 18 “because restitution for Title 18 offenses is more readily available than for Title 26 offenses”).

130. DOJ CTM, supra note 9, § 44.01. The DOJ CTM also provides the following statement in a footnote, expanding on the statement in the text above: “Of course, there are exceptions. There are a number of factors the district court will have to consider in determining whether to impose discretionary restitution. An important factor is the defendant’s ability to pay.” Id. § 44.01 n.2 (citing 26 U.S.C. § 3663(a)(1)(B)(i)(II)).
The amount for restitution is not the same as for the tax loss, even for the count(s) of conviction. The CTM explains:

The calculation of the amount of loss for purposes of restitution when the IRS is the victim may be closely related to the calculation of the tax loss used to determine a defendant’s base offense level. But tax loss under the Sentencing Guidelines is usually the intended loss, while the amount of restitution is always limited to an actual loss. Thus, tax loss may be greater than the amount of restitution. Generally, however, the district court may rely upon the same “quantity and quality of evidence” to determine the amount of loss in both contexts.\textsuperscript{131}

Restitution, being the actual loss, thus would not be subject to the denial of the benefit of unrelated, unclaimed deductions now required for tax loss calculations. Furthermore, the defendant often will have paid some of the tax loss prior to sentencing. Hence, the restitution amount will often be less than the tax loss amount.

One incentive for the defendant to agree to restitution beyond the count(s) of conviction is that it permits the defendant to argue that the defendant has made what some practitioners call “extraordinary restitution,” which I am led to believe simply describes restitution beyond that which a court could impose without the taxpayer’s contractual agreement or voluntary payment. The statutes and Guidelines do not address that concept, but, based on anecdotal hearsay evidence, some practitioners believe that it plays well with some sentencing judges.

That statutory restitution is not required for title 26 tax crimes is not an anomaly. In tax cases, of course, the victim is the United States, and the harm is the tax not paid. The United States has “elaborate procedures” for determining and collecting tax independent of the criminal system.\textsuperscript{132} As noted below, this system will be engaged after the criminal case is concluded, at least when the taxpayer is the criminal defendant. The IRS will conduct such further investigation as necessary to determine the correct civil tax liability and then send a notice of deficiency for the taxes due. As also noted, the amount the taxpayer may owe for civil tax purposes may be larger—sometimes much larger—than the tax evaded number used in the prosecution or in sentencing.\textsuperscript{133} Accordingly, restitu-

\textsuperscript{131.} Id. § 44.03[5]. The Seventh Circuit has recently cautioned: District courts can get into trouble if they rely unquestioningly on these figures [the equation of tax loss and restitution], however, because the loss amount for sentencing considers not just the conduct underlying the conviction but “relevant conduct” accompanying it. Calculations for restitution are not so permissive. They are rigidly compartmentalized to the actual losses resulting from the conduct of the convicted offenses. United States v. Berkowitz, 732 F.3d 850, 853 n.3 (7th Cir. 2013) (citation omitted).

\textsuperscript{132.} See Minneman, 143 F.3d at 285–86.

\textsuperscript{133.} See DOJ CTM, supra note 9, § 44.06. The CTM provides:
tion is not available in tax cases, except where the defendant consents to it in the plea agreement or the sentencing judge orders it as a condition of some benefit that the defendant is not otherwise entitled to.\textsuperscript{134}

For the taxpayer defendant, an obligation of restitution for the tax evaded is, of course, redundant with the underlying obligation (at least the portion of the tax obligation—underpayment or “deficiency” in tax speak—attributable to fraud).\textsuperscript{135} As noted, the IRS has elaborate mechanisms to determine and assess the amount of the tax and to collect the amount so assessed. So, the imperative to order restitution in the criminal phase, even if there is a required title 18 offense, is not so great. As to taxpayers who are defendants ordered to pay restitution, therefore, there is some redundancy, although there are some differences discussed later in this section.

But, enablers—persons other than the taxpayer whose taxes are involved—may be convicted of tax crimes, including tax evasion. Particularly where the Government is for some reason unable to collect from the taxpayers, the Government may seek an order of restitution from convicted enablers who are often convicted for a title 18 crime, such as the \textit{Klein} conspiracy.\textsuperscript{136} If the Government does seek restitution, it will have

Prosecutors should remember that, as discussed in Section 44.03 above, restitution in criminal tax cases is limited only to losses caused by the criminal conduct of the defendant and generally does not include penalties or amounts of tax related to purely civil items. Therefore, in all criminal tax cases in which a restitution order is contemplated, care should be taken not to compromise the ability of the IRS to attempt to collect the civil tax liability, interest, and penalties.

\textit{Id.}

\textsuperscript{134} See \textit{Weinberger v. United States}, 268 F.3d 346, 358 (6th Cir. 2001); see also \textit{United States v. \textit{Anderson}, 545 F.3d 1072, 1078–80 (D.C. Cir. 2008)}. The court in \textit{Anderson} permitted plea agreement restitution in what was then the largest tax crime conviction, even though (i) the plea agreement cited the wrong title 18 section, a phenomenon the Government urged and the court held was a scrivener’s error that did not vitiate the parties’ meeting of the minds to agree to restitution; and (ii) the plea agreement did not state an amount for restitution. See \textit{Anderson}, 545 F.3d at 1078–80. In \textit{United States v. Hammon}, the court found that the plea agreement contract restitution provision did not state that the restitution amount was the proper tax liability and that it at most was ambiguous. See \textit{United States v. Hammon}, 277 F. App’x 560, 565 (6th Cir. 2008). Hence, the defendant was permitted to contest the amount in the subsequent civil tax proceeding. \textit{See id.}

\textsuperscript{135} For this reason, the restitution amounts are assessed and payments on restitution for tax liabilities are credited to the corresponding tax liability. \textit{See Restitution Payable to the IRS}, IRM 5.1.5.24.i(3), (5) (Aug. 3, 2009); see also I.R.S. Small Bus. & Self-Emp’d Div. Mem. SBSE-05-0713-0044 (July 10, 2013), available at http:/\slash/www.irs.gov/pub/foia/ig/spder/SBSE-05-0713-0044.pdf. See below for prompt assessment procedures applicable to tax restitution.

\textsuperscript{136} \textit{18 U.S.C.} § 371 (2012); \textit{United States v. Klein}, 247 F.2d 908 (2d Cir. 1957). There might be an issue if the enabler is only convicted of the crime of tax evasion, a title 26 crime, via \textit{18 U.S.C.} § 2 (aiding and abetting and causing liability). \textit{See 18 U.S.C.} § 2. This title 18 provision adopts the construct of making the actor a principal in the crime aided, abetted, or caused. The crime that they are thus made principals of is tax evasion, a title 26 crime, for which restitution is not
to prove the amount of the restitution or get the defendant to agree. In
the sentencing phase where this is relevant, the Government’s standard of
proof is only a preponderance of the evidence, not beyond a reasonable
doubt as required for conviction of the substantive criminal charges.

Although the statute does not permit restitution for title 26 crimes of
conviction, the court may provide restitution for such crimes of conviction
in the following instances. First, 18 U.S.C. § 3663(a)(3) permits a court to
order restitution if the parties agree to it.137 The plea agreement is a con-
tract. It may be enforced as a contract, and the sentencing court may in-
clude the agreements reached in the sentencing terms. Thus, if the
parties in the plea agreement provide for restitution, the court may im-
pose that term.138

Second, the court may impose restitution as a condition of some ben-
efit that it is giving the defendant, such as probation or supervised re-
lease.139 If the defendant wants the benefit, the defendant has to accept
the restitution cost of the benefit.140 Where the court orders restitution
on this basis, like other statutory restitution, it is limited to the tax evaded
for the count(s) of conviction.141

Moreover, the district court can achieve most of the same effect as
restitution by ordering, as a condition of supervised release or pursuant to
the plea agreement, that the defendant file correct delinquent or
amended past year tax returns and pay any resulting unpaid tax.142 The

137. 18 U.S.C. § 3663(a)(3); see also DOJ CTM, supra note 9, § 44.03[8].


139. See 18 U.S.C. §§ 3563(b)(1), 3583(d); DOJ CTM, supra note 9,
§ 44.01[3]; see also United States v. Batson, 608 F.3d 630, 634 (9th Cir. 2010) (“The
district court is therefore authorized by § 3563(b)(2) to order restitution as a con-
dition of probation to the victim of any criminal offense, including those in Title
26, for which probation is properly imposed.”); United States v. Nolen, 523 F.3d
331, 332 (5th Cir. 2008) (ordering restitution as condition of granting supervised
release); United States v. Dahlstrom, 180 F.3d 677, 686 (5th Cir. 1999); cf. Miller,
406 F.3d at 330 (declining to reach issue of whether, absent defendant’s consent to
restitution, sentencing court could order restitution).

140. However, in Miller, the defendant argued, in effect, that he could bifur-
cate the restitution from the supervised release and, because he did not agree to
restitution in the plea agreement, restitution could not be imposed. Miller, 406
F.3d at 328–29. The court rejected that idea. The court side-stepped the technical
point Miller raised by finding that his plea agreement did authorize the restitution
imposed. Id. at 329–30. Restitution as a condition of supervised release may in-
clude years other than the year(s) of the count(s) of conviction. See United States
v. Johnson, No. 10-30911, 2011 U.S. App. LEXIS 22346, at *6–7 (5th Cir. Nov. 4,
2011) (discussing this aspect of Miller).

141. See Nolen, 523 F.3d at 332.

142. See United States v. Thomas, 635 F.3d 13, 21–22 (1st Cir. 2011) (citing
United States v. Miller, 557 F.3d 919, 921–22 (8th Cir. 2009)). In Thomas, the First
Circuit held that (i) a district court can impose these obligations as a condition of
effect of such a generic order may sweep beyond the years for the count(s) of conviction. Such an order also requires the defendant to satisfy a tax obligation the defendant already has. And, since the obligation exists independent of restitution, the Government can rely upon collection tools for that obligation, which, as noted above, are more extensive than restitution collection tools.\textsuperscript{143} Practically, an order to comply with past tax obligations achieves most of the effects of an order of restitution.\textsuperscript{144}

DOJ Tax has a policy that prosecutors “must consider” including a restitution requirement in the plea agreement for a criminal tax case.\textsuperscript{145} Further, restitution is the rule, rather than the exception, and it is available by plea agreement in virtually every criminal tax case.\textsuperscript{146} This means that restitution will be included, barring some compelling reason not to. Furthermore, the plea agreement restitution amount will (i) include not only the amount for the agreed count(s) of conviction, but also relevant conduct for the dismissed counts and non-charged years, and (ii) will avoid language committing the IRS to that amount as the ultimate civil tax liability (there may be noncriminal adjustments that support a higher ultimate tax liability).\textsuperscript{147}

supervised release, and (ii) “[t]he district court was not ordering Thomas to compensate the government for a loss suffered as a result of his criminal actions, though this is a salutary side-effect of its order.” \textit{Id.} at 21; see also United States v. Perry, 714 F.3d 570, 577 n.5 (8th Cir. 2013) (“Another way to impose essentially the same special condition is to require that the defendant while on supervised release comply with the tax laws and cooperate with the IRS by filing tax returns and paying amounts due. . . . [T]his type of condition is not an order of restitution . . . .”); United States v. Shaw, 446 F. App’x 357, 359 (2d Cir. 2011) (citing United States v. Gottesman, 122 F.3d 150 (2d Cir. 1997)) (distinguishing Gottesman, where court’s order was generic to pay past due taxes as agreed in future between defendant and IRS).

143. I note below in the text that Congress has provided for the IRS to be able to assess promptly and collect the amount in tax restitution orders in some cases. The IRS cannot assess immediately if the obligation is a general order to comply with past tax filing and payment obligations, and the IRS will then have to go through the Code procedures predicate to assessment—issuing a notice of deficiency permitting the taxpayer to litigate in the Tax Court prior to assessment.

144. \textit{See} \textit{Thomas}, 635 F.3d at 21 (“The district court was not ordering Thomas to compensate the government for a loss suffered as a result of his criminal actions, though this is a salutary side-effect of its order.”).

145. \textit{See} DOJ CTM, \textit{supra} note 9, § 44.01. The Attorney General’s Guidelines state that “[i]n all plea discussions, prosecutors must consider ‘requesting that the defendant provide full restitution to all victims of all charges contained in the indictment or information, without regard to the counts to which the defendant actually plead[s]’.” \textit{Id.} (citing USAM, \textit{supra} note 9, §§ 9-27.230, 9-27.420, 9-27.430); see also USAM, \textit{supra} note 9, § 6-4.370; IRS/DOJ \textit{MEMO RE STANDARD LANGUAGE}, \textit{supra} note 44.

146. \textit{See} DOJ CTM, \textit{supra} note 9, § 44.01.

147. \textit{See id.} § 5.01[7]. The criminal tax process is not suited to determine the actual civil tax liability. From the investigation through sentencing, the process is focused on the criminal tax numbers (usually the same as the tax loss for sentencing). There may be any number of difficult and uncertain civil tax adjustments that do not get resolved any time during the sentencing process and are better resolved later through the civil adjustment processes allowed by the IRS. Having
Restitution of the tax liability may include both the principal and the statutory interest.\footnote{See 26 U.S.C. § 6601 (2012). Interest accrues on a tax liability as a matter of law. The interest represents a loss to the Government and thus may be included in restitution. See United States v. Perry, 714 F.3d 570, 577 (8th Cir. 2013) (citing United States v. Ellefsen, 655 F.3d 769, 782 (8th Cir. 2011) (affirming a restitution award to IRS that included interest); United States v. Hassebrock, 663 F.3d 906, 926 (7th Cir. 2011) (same); United States v. Qurashi, 634 F.3d 699, 703–04 (2d Cir. 2011)).}

This is not true of the tax loss for sentencing except in evasion of payment cases.\footnote{See U.S. Sentencing Guidelines Manual § 2T1.1 cmt. n.1 (2013). Normally, where a defendant pleads to evasion of assessment, the court would not permit including interest and penalties in calculating the tax loss. See id. However, where the defendant committed acts of evasion of payment, the tax loss can include interest on that relevant conduct tax loss. See Thomas, 635 F.3d at 17–18.} Some courts have used fines as a substitute for restitution in tax cases. In a recent section 7202 case involving unpaid taxes withheld from employees, the tax loss substantially exceeded the indicated fine range under the Sentencing Guidelines. The sentencing court noted that it could not order restitution but, at the Government’s request, could impose a fine outside the Guidelines range based upon section 3571’s grant of authority to impose an “alternate fine based upon gain” to the defendant.\footnote{United States v. Ellis, 548 F.3d 539, 546 (7th Cir. 2008). Note that for this type of tax liability, the IRS certainly could have assessed the tax against the defendant under section 6672, so it had the usual tax tools to collect the tax from the defendant. See 26 U.S.C. § 6672. It is unclear from the cryptic Ellis decision why the Government felt that using the power to depart from the Guidelines fine was appropriate in that particular case. See Ellis, 548 F.3d at 546. The reason this is important is that unexplained use of the fine power would seem to be contrary to the intent of Congress not to require restitution in tax cases.} I suggest, however, that use of the fine in this way is only appropriate in cases where the IRS does not have the ability to assess the tax in issue against the defendant, otherwise, there will be double collection of the tax—one as a tax\footnote{Or, in the case posited, as a trust fund recovery penalty under section 6672. See Ellis, 548 F.3d at 539; see also 26 U.S.C. § 6672.} and once as a fine that would not otherwise have been imposed.

IV. TAX LIABILITY AFTER SENTENCING

A. Restitution (Enforcement, Assessment, and Payment)

1. Restitution Generally

Restitution is a lien enforceable like other liens, including tax liens, but does not have the special Code enforcement measures that tax liens
Restitution (whether for taxes or otherwise) may be enforced under the Federal Debt Collection Procedures Act (FDCPA). The Government’s ability to enforce restitution under the FDCPA is made subject to the Consumer Credit Protection Act (CCPA), but if the restitution is for taxes, the garnishment restrictions of the CCPA are not applicable. Restitution also may be enforced by administrative offset under the Treasury Offset Program, whereby the Treasury can offset nontax debts—for this purpose, restitution itself is nontax even though it relates to the tax liability—against other amounts due to the defendant from the Government (including refunds).

Finally, restitution obligations are not subject to discharge in bankruptcy, and the automatic stay provisions of bankruptcy do not preclude enforcement of restitution, including proceeding against the debtor’s property and any property nominally held by the bankruptcy estate and revocation of probation for violation of the restitution order.

2. Tax Restitution

Historically, after sentencing, the IRS would pursue the normal tax assessment and collection measures for tax restitution (plus any additional civil tax liability not included in restitution). Practitioners are quite familiar with those measures, so I will just summarize them here. Since the taxes usually will not have been assessed, the IRS must first assess the tax. At a minimum, assessment will require an open statute of limitations,

152. See 18 U.S.C. § 3664(m)(1)(A) (2012); id. § 3613. As to restitution, see particularly section 3613(c) and (f). See id. § 3613(c) (“[A]n order of restitution . . . is a lien in favor of the United States on all property and rights to property of the person fined as if the liability of the person fined were a liability for a tax assessed under the Internal Revenue Code of 1986.”); id. § 3613(f) (“[A]ll provisions of this section are available to the United States for the enforcement of an order of restitution.”); see also United States v. DeCay, 620 F.3d 534, 541 (5th Cir. 2010).


155. Clayton, 613 F.3d at 596.


157. See United States v. Robinson, 494 B.R. 715, 718–19 (W.D. Tenn. 2013). Section 3613(a) provides that “[n]otwithstanding any other Federal law . . . a judgment imposing [restitution] may be enforced against all property or rights to property of the person [ordered to pay restitution] . . . .” 18 U.S.C. § 3613(a). In a well-reasoned opinion, Robinson held that this language trumps the automatic stay both as to the debtor and to the nominal transfer of the debtor’s property to the bankruptcy estate. See Robinson, 494 B.R. at 718–19; see also United States v. Colasuonno, 697 F.3d 164, 174 (2d Cir. 2012) (holding that probation revocation proceedings for failure to pay restitution imposed as condition of probation are not subject to bankruptcy automatic stay).
which will usually exist if the defendant has been criminally prosecuted. And, the IRS must do all predicate acts for assessment, which, most importantly, include issuing a notice of deficiency for income and estate and gift taxes. This procedure will permit a taxpayer to delay assessment by filing a Tax Court proceeding.

In 2010, Congress enacted provisions to make the amount ordered for restitution of tax immediately assessable and collectible without the usual predicate notice of deficiency. The IRS is required to assess the restitution amount once the criminal judgment becomes final. A notice of deficiency is not required as a predicate to assessment of the restitution amount. The defendant/taxpayer may not thereafter contest civilly the tax restitution amount so assessed. Although it is clear that the provision applies to tax restitution ordered for a count of conviction under title 26 of the Internal Revenue Code, it is perhaps not clear that


159. See id. § 6213(a). I am not sure whether this statute applies as to restitution for taxes for which the defendant is not liable as the taxpayer. For example, assume that the defendant is convicted under section 7202 for failure of the employer for whom he or she worked to withhold and pay over taxes on employees. The defendant may be ultimately liable under section 6672 for the trust fund recovery penalty, but the underlying tax liability is the employer’s tax liability and not the defendant’s. The trust fund taxes can be awarded as restitution (either statutory if the offense of conviction included a title 18 offense or contractual if the defendant pled guilty), but the tax is still not the defendant’s tax and that restitution amount cannot be assessed against the defendant. All that means as a practical matter is that the considerable tax collection measures offered by the Code are not available; the less considerable (but still considerable) general restitution enforcement provisions will be available. See id.


161. See 26 U.S.C. § 6201(a)(4)(A), (B). However, apparently because the statutory language in section 6501(c)(11), dealing with these tax restitution assessments, is the same as the unlimited civil statute for fraud in section 6501(c)(1), there is no statute of limitations on assessing restitution for tax. See I.R.S. Notice ECC 201221014 (May 25, 2012), available at http://www.irs.gov/pub/irs-wd/1221014.pdf. This may not be important, given the authority to assess immediately, which the IRS will surely do in all but rare cases.


163. See 26 U.S.C. § 6201(a)(4)(C). This provision is a bit odd, since even the IRS recently stated that, “[c]riminal restitution and civil tax liability are separate and distinct. The assessment of restitution under section 6201(a)(4) is not itself a determination of the actual civil tax liability for the tax period for which restitution was ordered, and is assessed only ‘as if such amount were such tax.’” I.R.S. Small Bus. & Self-Emp’d Div. Mem. SBSE-05-0713-0044 (July 10, 2013), available at http://www.irs.gov/pub/foia/ig/Spider/SBSE-05-0713-0044.pdf. Is it possible that restitution for the tax can exceed the amount of the tax? And, if so, is the defendant prohibited from contesting the amount of the tax via IRS processes? I have discussed various facets of this particular narrow issue on my Federal Tax Crimes Blog, which can be accessed by either searching “restitution” or clicking the link named “restitution.” See Jack Townsend, Fed. Tax Crimes Blog, http://federaltaxcrimes.blogspot.com.
the provision applies to tax restitution for a count of conviction under title 18 or, for that matter, an FBAR count of conviction under title 31.164

If the IRS determines that the tax liability exceeds the amount ordered as restitution, the IRS must follow the required procedures (notice of deficiency and subsequent assessment as allowed).165

Regardless of which procedure is used to make the tax assessment, the IRS is authorized after assessment to use its powerful non-judicial collection tools (lien and levy) to collect the assessed taxes.166 Amounts paid as restitution for taxes are applied to the taxpayer’s tax liabilities for the year(s) to which the restitution applies.167 Practitioners should note that there is the possibility that restitution might actually exceed the tax liability as finally determined for the year(s) involved. That is particularly a problem under the new procedure discussed above where the taxpayer is not permitted to contest tax restitution assessed as a tax.168 This can require the taxpayer to pay more tax as restitution than is actually due. The only solution, apparently, is to request the sentencing court to modify the order of restitution.169

164. See I.R.S. Tech. Adv. Mem. CCA-111811-10 (Feb. 4, 2011), available at http://www.irs.gov/pub/irs-wd/1105037.pdf. This is an IRS email with an attached outline for a presentation within the IRS. This is not an official pronouncement from the IRS and the author of the outline is not identified. It is therefore not clear that this is anything like an authoritative interpretation of the statute. The outline states: “Our interpretation is that the assessed amount is limited to losses attributable to Title 26 violations and does not include Title 18, tax-related charges.” Id. I have questioned this interpretation in my blog. See Jack Townsend, New Statute for Civil Effect of Restitution in Tax Cases, FED. TAX CRIMES BLOG (Feb. 11, 2011, 9:05 AM), http://federaltaxcrimes.blogspot.com/2011/02/new-statute-for-civil-eff-ect-of.html.

165. Because the defendant is entitled to a notice of deficiency before assessment, under 26 U.S.C. § 6213(a), and to pursue the prepayment remedy in the Tax Court, that portion of the civil tax will be subject to the delays which are now foreclosed for the tax restitution.

166. For additional nuances of the statute, see my Federal Tax Crimes Blog, supra note 84.


169. One opportunity to contest the amount possibly exists where the IRS claims tax liability in addition to the amount of the tax restitution, requiring issuance of a notice of deficiency. The defendant could petition the Tax Court and argue that, not only is there no deficiency as alleged by the IRS, but that, by paying the restitution amount previously assessed, the taxpayer has overpaid the tax. The Tax Court has jurisdiction to determine an overpayment. See 26 U.S.C. § 6512(b)(1) (2012). Could the Tax Court determine the overpayment? As a mat-
Practitioners should be alert to creative payments of restitution. There may not be many such opportunities, but consider the recent holdings in two companion United States Tax Court cases. The facts were that the taxpayers were officers and owners of a payroll service company that withheld from employees’ salaries (including their own salaries as employees) but did not pay over the withheld trust fund taxes (or related employer taxes) to the IRS. The defendants alleged, apparently credibly, to the Tax Court trial judge, that they did not know of the alleged failure to pay over. The defendants also failed to file their individual income tax returns and were prosecuted as a result. For purposes of the criminal case, the prosecutors and taxpayers agreed that the employer had withheld about $510,000 in income tax from salaries and therefore that, in computing the tax loss and restitution, the taxpayers were entitled to credit for the withheld income tax. As a result, for tax loss and restitution purposes, they stipulated in the plea agreement, and the sentencing court found, that the tax loss and restitution were only $60,000, representing the net tax due in excess of the deemed “withheld” tax of $510,000. Note that in these calculations, the benefit to employees who fail to file is credit for the withheld tax from the original due dates of the returns, thus saving substantially on any civil penalties and interest that might otherwise apply. But the net $60,000 unpaid on the original due dates of the returns was still due and subject to penalties and interest if the action had stopped there. Orchestrated by their counsel, the taxpayers then belatedly paid about $570,000—representing the aggregate of the withheld tax on their salaries ($510,000) and the unpaid tax due ($60,000)—to the corporation and had the corporation pay it to the IRS with a direction that it be applied to the taxpayers’ income tax liabilities as withholding.

...
The taxpayers received credit as a payment on the original due dates for the originally withheld portion ($510,000) and received credit for the originally non-withheld portion of $60,000 but were only given that credit from the date the corporation paid the amount. Of course, the lion’s share of the amount thus credited avoided penalties and interest at the taxpayers’ level (which is the normal consequence of withholding), but the other portion not actually withheld contemporaneously did not receive credit on the original due date of the taxpayers’ returns and thus was subject to penalties and interest at the taxpayers’ level.173 This type of restitution payment was creative, although not successful in part.

B. The Civil Tax Audit/Notice of Deficiency—The Civil Tax Number/Deficiency

The IRS may also assert the unpaid civil tax liability by audit, which, as noted above, will exceed the amount of the restitution ordered by the court. If the sentencing court does not include interest in restitution, the assessment will include the interest. Further, even if the sentencing court does include interest in restitution, it will include further interest from the date of the restitution order. And, in all likelihood, penalties will be assessed on at least the restitution amount and perhaps some of the other portions of the tax ultimately assessed. The normal tax collection measures will then be available to the IRS to collect any portion of the unpaid assessments.

As noted above, the taxpayer is bound civilly by the amount of restitution determined in the criminal case. But, as noted, the IRS can assert more tax and penalties (with resulting interest) than were determined for restitution.

An issue that may arise is whether either party may be bound by other determinations made during the criminal process. For example, in the sentencing phase, the court is required to make determinations of the tax loss. Is that preclusive? Of course, if the taxpayer has not paid any of the tax loss, the tax loss and the restitution may be in the same amount. But what if the taxpayer has, prior to sentencing, fully paid the tax and even

173. It is unclear whether obtaining avoidance of penalties and interest at the shareholder level was the goal of shuffling the monies through the corporation for payment on withholding tax. The taxpayers’ lawyer testified that the shuffling was intended only to ensure that the corporation got the credit against the $23 million trust fund tax that it owed. The tax court trial judge questioned that because the corporation would be entitled to that credit had the taxpayer paid the $60,000 taxes directly. Rather, that judge seemed to imply that the shuffling through the corporation was an attempt to wipe out the penalties and interest on the $60,000, just as the penalties and interest had been wiped out on the original deemed withheld amount of $510,000. The taxpayers’ lawyer seemed to deny that, though. One of the mysteries is the advantage to the taxpayers of even paying the $510,000 portion for which they were entitled to credit against their liabilities on the original due date of the return. The taxpayers’ attorney testified that they did it to claim extraordinary restitution, which, although not a Sentencing Guidelines factor, could play well to a sentencing judge when sentencing the taxpayers.
the penalties that might apply? Can that taxpayer then assert that the IRS is bound by the tax loss determination? Can the IRS assert that the taxpayer is bound by the tax loss determination?

The traditional way to approach potential binding effects of previously litigated issues in this context is via the doctrine of collateral estoppel. In United States v. Montana, the Supreme Court summarized the doctrine of collateral estoppel as follows: “[O]nce an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation.” Courts have rejected taxpayer attempts to collaterally estop the IRS in subsequent civil cases as to the amount of the tax loss determined by the sentencing court. I think that makes sense. As noted above, the tax loss is not the same as the tax the taxpayer may owe. The tax loss is only the portion of the tax the taxpayer owed that is attributable to fraud. The taxpayer may owe more tax that is not attributable to fraud. The taxpayer should not get a benefit from the criminal prosecution of paying less tax than the taxpayer owes. And, of course, in collateral estoppel analysis, the amount of tax the taxpayer owes was not litigated in the criminal proceeding.

Could the taxpayer make a more subtle argument that at least the tax loss should be preclusive under collateral estoppel as to the amount attributable to fraud for purposes of determining the civil fraud penalty under 26 U.S.C. § 6663? The issue—tax evaded and the portion of the tax attributable to fraud—is the same issue. There are some subtle burden-shifting nuances that, in my opinion, are just not of sufficient weight to forego collateral estoppel on the issue of the portion of the tax attributable to fraud. While I hesitate to get too deeply into the burden of proof rules, I will try to summarize them to introduce them to readers.

At sentencing, the court determines the amount of the tax loss—“the total amount of loss that was the object of the offense.” The courts dealing with the civil fraud penalty do not usually state the standard as the crisp elements in section 7201—affirmative act, tax due and owing, and willfulness. See 26 U.S.C. § 7201; see also Cheek v. United States, 498 U.S. 192, 196 (1991) (describing standard willfulness formulation as “intentional violation of a known legal duty”). Those courts do, however, use words that, in my view, say the same thing. For example, one court stated: “Fraud is the intentional commission of an act or acts for the specific purpose of evading tax believed to be due and owing.” Eriksen v. Comm’r, 104 T.C.M. (CCH) 46 (2012). Fraud requires that the taxpayer has “intended to evade taxes known to
tencing, the court determines the tax loss based on a preponderance of the evidence. In the civil case, the court determines civil fraud under a burden-shifting concept as follows: (i) the IRS must prove some portion of the deficiency is due to civil fraud by clear and convincing evidence and (ii) upon meeting that burden, the balance of the underpayment is deemed to be subject to fraud, except to the extent that the taxpayer shows otherwise.179 Now, the finding of tax loss at sentencing should not be preclusive under collateral estoppel as to the first burden the IRS must meet in the civil case, because the sentencing court determined tax loss by a preponderance of the evidence. In the civil case, the IRS should be required to prove by clear and convincing evidence that some portion of the tax deficiency is attributable to fraud. But, once it has done so, we focus on the burden-shifting in clause (ii).

The key difference is a theoretical one of who has the burden of persuasion as to the portion of the deficiency attributable to fraud. In the sentencing proceeding, the Government had the burden of persuasion to show the tax evaded; in the civil proceeding, the taxpayer has the burden of persuasion to show the part not attributable to fraud. Both burdens are based on a preponderance of the evidence—meaning that the allocation of the burden only affects outcomes where the trier of fact is in equipoise. According to astute observers of trial outcomes, it is not common that triers are in equipoise.180 Hence, I would argue that the tax loss should be preclusive as to the amount attributable to fraud for purposes of section 6663; the possibility that equipoise could affect the outcome is too inconsequential to justify re-litigating the issue. In short, in the civil case, after the IRS has established by clear and convincing evidence that some portion of the deficiency is attributable to fraud, the portion that is then subject to the civil fraud penalty should be the amount of the sentencing tax loss determined for that year.181 Readers should be wary, though, that I cannot cite any authority for the reasoning and conclusion that I have just expounded.

be due and owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes, and that there is an underpayment.” Nelson v. Comm’r, 73 T.C.M. (CCH) 1843 (1997).


180. See Cigaran v. Heston, 159 F.3d 355, 357 (8th Cir. 1998) (“The shifting of an evidentiary burden of preponderance is of practical consequence only in the rare event of an evidentiary tie . . . .”); see also Blodgett v. Comm’r, 394 F.3d 1030, 1039 (8th Cir. 2004); Polack v. Comm’r, 366 F.3d 608, 613 (8th Cir. 2004) (citing Cigaran, 159 F.3d at 357); Knudsen v. Comm’r, 131 T.C. 185, 188 (2008).

181. Some purists may argue that the dynamics of criminal trials may not really place a focus on determining the tax loss, and that it is potentially subject to manipulation by the parties, if for no other reason than to reach a plea agreement. But I would answer that the standard is the same in both situations, and the possibility that the earlier proceeding may not have reached the right result is not a reason to forego collateral estoppel in the second proceeding.
Finally, a recent case has raised the prospect of another type of estoppel—judicial estoppel—that might apply to sentencing determinations. In that case, the taxpayer (in his role as defendant) and the prosecutors stipulated in a plea agreement that “the total tax liability, including interest and penalties, amounted to $448,776.13.” It is not clear what role that stipulation played in the sentencing. In any event, in the subsequent refund suit, the court said that the taxpayer was judicially estopped from claiming a lower amount. The court reasoned that the taxpayer had clearly stipulated as to the amount, but cited no authority that such stipulations should be binding outside the proceeding at hand. The court then reasoned:

Moreover if Mirando was allowed to proceed in this action, he would gain an unfair advantage. By pleading guilty to tax evasion and specifically agreeing to a total tax liability of $448,776.13, Mirando avoided the possibility of a longer sentence and the United States agreed not to prosecute Mirando’s ex-wife or two children. After obtaining this benefit from the United States, Mirando cannot turn around and sue the United States for a refund.

Plaintiff Mirando relies on United States v. Hammon for its position that his refund claim is not barred by estoppel. In Hammon, the Sixth Circuit held that the defendant was not collaterally or judicially estopped from denying the accuracy of the government’s assessments despite pleading guilty to tax evasion and agreeing to pay $2.39 million in restitution. However, the present case can be distinguished from Hammon. In Hammon, the plea agreement only stipulated that the defendant willfully attempted to evade taxes assessed by the government in “the amount of approximately $2.39 million.” Since the plea agreement was ambiguous as to whether the defendant admitted that the $2.39 million assessment was correct, the defendant was not estopped from challenging the accuracy of the tax assessment. In contrast, Plaintiff Mirando specifically agreed in his 2007 plea agreement that “beyond a reasonable doubt . . . as of June 29, 2007, the total tax liability, including interest and penalties, amounted to $448,776.13.” Consequently, Hammon is not controlling, and judicial estoppel prevents Mirando from bringing his refund claim.

I wonder whether the IRS would be bound by that stipulation.

183. Id. at *2.
184. Id. at *8–9 (citations omitted); see also United States v. Hammon, 277 F. App’x 560, 565 (6th Cir. 2008).
V. Conclusion

As indicated, tax evaded—the part of unpaid civil liability the taxpayer intended to evade—is at the heart of prosecution and sentencing in federal tax cases. Practitioners must know the nuances of the concept of tax evaded as it plays out in the process. By understanding the role of tax evaded and working the numbers, practitioners can avoid pitfalls and achieve benefits for clients.