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JURISPRUDENCE

MORAL AND ETHICAL CONSIDERATIONS IN TAX PRACTICE

To deny that the duty to pay taxes creates many serious moral problems is to imply that there is a double standard of morality—one for paying taxes and another for governing the rest of life. Is it unusual to find a man who would not even think of cheating in business, but who gloats over the amount of undeclared income he receives or the number of unauthorized deductions he takes?

However, we cannot condemn the taxpayer too strenuously for he comes by his attitude honestly. History shows that the tax collector under our original laissez faire theory of government was regarded as an intruder.¹ One of the motives of the American Revolution was the abolition of excessive taxation. The rugged individualists of early American history manifested a great abhorrence of taxes in any form and though admitting that taxes were necessary to maintain the government, they strove to keep the levy at a minimum. This attitude is evidenced by the fact that, although the taxing power is inherently implied in sovereign existence, it is specifically “granted” to the legislative body in the United States Constitution.² The fact that there are at least five limitations upon the federal power to tax in the United States Constitution and at least ten limitations upon the taxing powers of the states emphasizes this attitude.³ The courts also promulgated this attitude in the past by placing the burden of proving tax liability squarely on the government and allowing the citizen to use any sort of device to evade the tax so long as he adhered to the mere form of legality, thus staying within the letter of the law.⁴ That is not the attitude of the courts today. Since the advent of the direct tax on income,⁵ taxes are no longer looked upon as mere nuisances, the avoidance of which would give little or no advantage over others. Today, tax evasion gives a great advantage to the evader over the competitor who faithfully and conscientiously pays his taxes. For this reason, if for no other, the courts have looked beyond the mere legal form to the substance of the transaction to see whether, in point of fact, a taxable event actually occurred.⁶

³ Schultz and Harris, American Public Finance 172-178 (1949).
⁴ U.S. v. Isham, 17 Wall. 496 (U.S. 1873).
⁵ U.S. Const. Amend. XVI.
⁶ Helvering v. Clifford, 309 U.S. 331 (1940); Helvering v. Horst, 311 U.S. 112 (1940); Commissioner v. Court Holding Co., 324 U.S. 331 (1945).
The more fundamental reason for the modern juridical attitude toward would-be tax evaders seems to be the cognizance which the courts have taken of the basic and immutable natural law concept that each citizen in a society must bear a fair share of the burden of maintaining the common well-being of society; in short, every person should carry his fair share of the tax burden.°

It is not a difficult process of reasoning by which we arrive at this basic natural law concept. Since man is by nature a social animal, i.e., destined to live in a political society; and since a political society cannot exist without a principle of authority whose purpose is to direct citizens to the end for which a political society exists, i.e., the common good of all, and since man derives benefits from his membership in a political society, he has the obligation of contributing his proportionate share to the common well-being of the whole community. Since the common good is promoted by the revenue received from taxes, it follows that every person has the duty to carry his fair share of the tax burden. Finally, since the means whereby a government (which is the principle of authority) directs citizens to the common good are laws, we arrive at the basic natural law principle that the just laws of legitimate authority are to be obeyed.8

Granting the validity of these basic principles, there arise two specific and practical questions: How do we determine whether a law is just? Must an unjust law be obeyed?

On the part of government, the legislators, in enacting any law, must be guided by the standards of distributive justice which is that species of justice which inclines the wills of the rulers to confer benefits, and impose burdens on the citizens in just proportion. Just as the citizen owes his proportionate contribution to the common good, so the state has a reciprocal obligation to the citizens. The citizen, precisely as a citizen, has a right, by natural law, to demand of the state or society that he be assisted by society in attaining his end. Conversely, there devolves upon the government the duty of providing, in just proportion, opportunities for the moral, intellectual, and physical advancement of the members of the society. This duty requires that the government make a proportionate distribution of common advantages, and of common burdens. The distribution must be, according to the natural law, governed by the needs, abilities, and merits of the citizens.°

It follows then that a law which is not enacted in accordance with these principles of distributive justice is unjust. However, an unjust law is not solely on that account devoid of obligation. An unjust law is devoid of obligation only if it prescribes an immoral action, such as,

7 MILLER, supra, note 1 at 1068.
8 SPAULDING, MORAL PHILOSOPHY 184-191 (1924).
9 RICKABY, MORAL PHILOSOPHY 102-108 (1929).
assassination, adultery, or perjury. A tax law which agrees neither with distributive justice nor with the principle of expenditure in the general interest does not justify a person in defrauding the revenue. The natural law principles of obedience and truthfulness take precedence. It should be apparent that to give to the citizen such an uncontrolled power to obey or disobey the law according to the individual's interpretation of its justice or injustice would obviously lead to a chaotic society, which would frustrate the very object of the society, the common good. Thus, we see that a private citizen cannot morally justify his disobedience of a tax law by deciding that it is not just. The proper remedy is not disobedience but use of the means through which the laws may be changed as provided by the Constitution.\(^\text{10}\)

Having established these basic natural law concepts as being at the foundation of the tax laws and as the source of the duty to pay taxes, we turn next to moral and ethical considerations in particular tax problems.

Probably there is nothing which is more obviously illegal than deliberate fraud or misrepresentation. Moreover, there is probably nothing more difficult to detect and prove, especially in the field of taxation, than that the taxpayer or tax counselor is guilty of such conduct. Not only is this charge difficult to prove when a particular return is doubtful on its face, but due to the present method of auditing, it is unlikely that in the great majority of cases, the return will ever be questioned.\(^\text{11}\)

This obvious inadequacy in the enforcement of the sanctions of the tax laws makes it very evident that if true justice is to be attained, it will be necessary to emphasize the fact that fraud is also contrary to the natural law as not conforming to the truth, and thus bring into play the moral sanction of a guilty conscience.

A few illustrations will make this clear. Suppose a taxpayer enters your office in January, 1954 and says that he has just sold his boat and realized a profit of $500. He has a non-deductible capital loss carry-over from 1948, and he wants to know if he can offset his gain with that loss. You tell him that he cannot since the gain was made in 1954 and not in 1953, the last year in which his 1948 loss may be carried over.\(^\text{12}\)

Should you suggest or agree to his suggestion that the contract of sale be pre-dated December, 1953 in order to take advantage of the capital-loss carry-over?

Pre-dating that contract is obviously fraud and yet everyone knows that with the government three or four years behind in its auditing, the fraud may never be discovered and therefore the sanctions of the tax

\(^\text{10}\) Rommen, The Natural Law 255-257 (1947).
\(^\text{11}\) Bickford, Successful Tax Practice 199 (1950).
\(^\text{12}\) Int. Rev. Code §117 (e) (1).
law may never be enforced. On the other hand, there can be no doubt that whether the fraud is discovered by the government or not, such pre-dating is immoral.

Now take the case of the taxpayer who wants you to "pad" his deductions for business expenses away from home. Of course, here too the fraud may never be discovered or challenged, but even if it is, you have the added incentive that if you "pad" the deduction enough, a compromise may be effected which will still be a fraud because it exceeds the actual amount that should have been deducted.\(^3\) Here again, the sanctions of the tax law are sadly inadequate, whereas a realization that such conduct is contrary to the moral law would produce a consciousness of guilt which could not be avoided by the rationalization that the actions are permissible as long as they are not discovered.

Any thinking lawyer will agree that to perpetrate an obvious fraud like the examples above, is neither legally nor morally justifiable.\(^4\) However, a problem which will probably present no little practical difficulty to the tax practitioner is the problem of whether there is a duty of full and fair disclosure of a particular taxable transaction.

Assuming that such disclosure will not lead to criminal prosecution, the question may be stated thus: Is the tax lawyer required to effect a full and fair disclosure of all the material facts of a particular taxable event? Generally, the answer to this question is "yes," but since there are different reasons for that conclusion in different circumstances, the reasons will be given in relation to the particular situation.

First, is there a duty of full disclosure at the original filing of the return if the proper treatment of the event is questionable at law? The moral principle to be applied here is that a man may not act with a doubtful conscience, i.e., a man may not decide to do an act if he does not know whether it is right or wrong. To do so is to say: "I don't know whether this is morally right or not, but even if it is wrong, I will do it." Thus, for the lawyer to act with a doubtful conscience is morally wrong because he is, in effect, reasoning that he does not know whether this act is in accord with the law or not, but even if it is not, he will do it.\(^5\)

Second, does the tax practitioner have this duty if he is certain that the courts would be favorable to his client although the Internal Revenue Bureau would not? Again, the answer is "yes" for to withhold some of the pertinent facts or to color them so that they appear to be what they are not is to misrepresent the true position of your client and

\(^3\) Ethical Problems of Tax Practitioners, 8 Tax L. Rev. 1, (Nov. 1952).
\(^4\) The lawyer "must not be guilty of any fraudulent acts, and he must be free from any unlawful conspiracy with either his client, the judge, or any other person, which might have a tendency either to frustrate the administration of justice or to obtain for his client something to which he is not justly and fairly entitled." Langen v. Borkowski, 188 Wis. 277, 302 (1925).
thus make him a party to an attempted fraud. No lawyer is morally justified in participating in a fraud. For him to do so violates both his moral and professional duty.

Finally, does the lawyer have the duty of full disclosure in a dispute with the Bureau over the proper treatment of income or deductions? From the foregoing principles, this question, too, must be answered in the affirmative. It hardly seems open to doubt that a lawyer who fails to disclose all of the pertinent facts in a dispute with the Bureau is guilty of lying by omission, which conduct because it is intentional is fraudulent and therefore immoral. If you agree that pre-dating a contract and "padding" deductions are fraudulent, how is failure to disclose the true nature of a transaction any less of a fraud?

There is still one further situation frequently arising in tax counseling which needs to be mentioned here. It is the moral duty of the tax lawyer to exercise due diligence that he does not counsel a plan of "tax evasion" under the guise of the term "tax avoidance." The distinction between the two terms is fundamental and presents no serious problem of definition.

"Avoidance" connotes a course of action whereby a man may legally avoid a particular taxable event by so arranging his affairs so as to avoid the occurrence of that event. "Evasion" refers to a course of action whereby a man avoids paying tax on a taxable event either by an obviously illegal method or, more often, by arranging his affairs so that, in form, no taxable event occurs, while in substance the apparent ar-

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15 Spaulding, supra, note 8, 55-74.
16 Canon 32, Canons of Professional and Judicial Ethics, American Bar Association (1946). No lawyer should "render any service or advice involving disloyalty to the law whose ministers we are . . ." The lawyer "advances the honor of his profession and the best interests of his client when he renders service or gives advice tending to impress upon the client and his undertaking exact compliance with the strictest principles of moral law."
17 Canon 15, supra. "The lawyer owes entire devotion to the interest of the client . . ." "But it is steadfastly to be borne in mind that the great trust of the lawyer is to be performed within and not without the bounds of the law. The office of attorney does not permit, much less does it demand of him for any client, violation of law or any manner of fraud or chicane."
18 Opinion 131 at 281, Canons of Professional and Judicial Ethics, supra. "When controversies arise and claims are asserted, the interests of justice, to the achievement of which the entire services of the Bar and Bench dedicated, require that the truth in the field of fact as well as of law be ascertained so far as is humanly possible."
"No lawyer should endeavor in any way, directly or indirectly, to prevent the truth from being presented to the court in the event litigation arises."
19 "There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions." Commissioner v. Newman, 159 F.2d 848 (1947). (Dissenting opinion by L. Hand.)
ranging of affairs has not affected the occurrence of the taxable event whatsoever.\(^2\)

It is obvious that the former is both legally and morally justifiable while the latter is not. The lawyer, however, is presented with the practical difficulty of ascertaining whether the plan he suggests is actually one of legal tax avoidance or merely a legal label attached to a tax evasion.\(^2\) Because the problem is sometimes difficult to answer from the available authorities, for the lawyer to exercise less than due diligence before counseling a course of action is to breach his duty, both moral and professional, to his client.\(^2\)

From the foregoing statement of the basic natural law principles which govern in the field of tax counseling, it is apparent that a very great weight of moral responsibility rests upon the tax practitioner. It is he, with his knowledge of the law and his knowledge of the facts in the particular cases, who must make the initial moral decisions. Although in most cases, the moral duty is clear, because of the inadequacy of the present system of tax auditing, it is apparent that the lawyer may be seriously tempted to avoid that duty by one sort of rationalization or another.

If the lawyer succumbs to these temptations, the effects are certain to be far-reaching. Such weakness will not only affect his own character by lowering his own personal habits of integrity, but it will also affect the attitude of society in general. Probably nothing has more effect over the proper observance of law in a society than the conduct of its lawyers, for the citizen properly reasons that if a certain type of conduct is good enough for a lawyer, who purports to know the law, it is good enough for the layman. Moreover, the low moral conduct of one attorney should be of great concern to all attorneys, for it is common knowledge that it takes very few such men to debase the reputation of the entire profession.\(^2\)

From a personal, social, and professional view-

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22 "An attorney at law is an officer of the court. The nature of his obligations is both public and private. His public duty consists in his obligation to aid the administration of justice; his private duty, to faithfully, honestly, and conscientiously represent the interests of his client. In every case that comes to him in his professional capacity he must determine wherein lies his obligations to the public and his obligations to his client, and to discharge this duty properly requires the exercise of a keen discrimination; and wherever the duties to his client conflict with those he owes to the public as an officer of the court in the administration of justice, the former must yield to the latter." Langen v. Borkowski, supra, note 14 at 301.
23 Canon 15, supra, note 16. "Nothing operates more certainly to create or to foster popular prejudice against lawyers as a class, and to deprive the profession of that full measure of public esteem and confidence which belongs to the proper discharge of its duties than does the false claim, often set up by the unscrupulous in defense of questionable transactions, that it is the
point then, the tax practitioner has the duty to inculcate into his pro-
fection and all of society a respect for the tax laws, for no matter what
are his feeling as to their economic or political wisdom, there can be no
doubt of the moral obligation to obey them.

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