

INTERNATIONAL TAX PLANNING: RECENT CONSPIRACY PROSECUTION OF TAX ATTORNEYS

I. INTRODUCTION

In a recent article, Sheldon M. Sisson¹ expressed concern that the current interest of the Internal Revenue Service (IRS) in attacking tax shelters may lead to a number of tax practitioners² facing both criminal charges of conspiracy to defraud the United States Government³ and prosecutions under the Internal Revenue Code.⁴ Sisson's concerns have been largely substantiated by several recent criminal prosecutions.⁵

Several tax attorneys have invited a great deal of United States governmental scrutiny by employing tax haven countries in their tax saving schemes. To date there have been relatively few prosecutions of attorneys engaging in an international tax practice, but the Government position on further prosecuting these practitioners is quite clear. M. Carr Ferguson recently suggested that the Government build a strong line of attack to halt abusive foreign tax shelters.⁶ Ferguson observed:

1. Sisson, *The Sandman Cometh: Conspiracy Prosecutions and Tax Practitioners*, 31 TAX LAW. 805 (1978) [hereinafter cited as *Sandman Cometh*]. An interesting note here is that Sisson represented the Government in *Audrey M. Thompson*, 66 T.C. 91 (1976). *Thompson* was the civil case revolving around the same set of transactions that led to the Government's prosecution of Harry Margolis, a case which will be discussed at length in this paper.

2. Sisson uses the term "tax practitioner" to refer to the attorney involved in tax planning or tax litigation. He does not use the term to refer to one who engages in the practice of filling out income tax returns. See generally *Sandman Cometh*, *supra* note 1. For the purpose of this paper, the author adopts Sisson's definition.

3. 18 U.S.C. § 371 (1976). See note 29 *infra*.

4. I.R.C. §§ 7206(2), 7212. See note 30 *infra*.

5. *United States v. Margolis*, No. 75-849 (N.D. Cal., filed Oct. 3, 1975) (no reported decision, Margolis acquitted by jury) and *United States v. Baskes*, No. 76-585 (N.D. Ill., filed Mar. 15, 1976) (no reported decision, Baskes convicted by jury), *appeal docketed*, No. 77-218 (7th Cir. Dec. 5, 1977) (*argued* Mar. 28, 1978). See also *United States v. Baskes*, 442 F. Supp. 332 (N.D. Ill. 1977) (illegal search in "briefcase affair" and prosecutorial misconduct in grand jury investigations); *United States v. Baskes*, 433 F. Supp. 799 (N.D. Ill. 1977) (illegal government conduct, illegal search in "briefcase affair," whether an indictment for conspiracy to defraud the United States as a result of tax evasion scheme which defendants developed can be sustained even though no person had been indicted for tax evasion); *Kanter v. I.R.S.*, 433 F. Supp. 812 (N.D. Ill. 1977) (whether certain information was exempt under the Freedom of Information Act).

6. *The Use of Offshore Tax Havens for the Purpose of Evading Income Taxes: Hearings before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 96th Cong., 1st Sess. (1979) (statement of M. Carr Ferguson).

[I]f the abuses of tax havens by United States taxpayers are to be reduced, the first order of business would seem to require the Internal Revenue Service to devote substantially more manpower to auditing and investigating United States taxpayers who engage in transactions with foreign entities.⁷

Ferguson went on to state that the IRS must establish regional groups "of specially trained revenue agents who would be assigned responsibility for auditing or assisting in auditing foreign transactions"⁸ because "transactions between the ordinary United States taxpayer and a foreign entity are still sufficiently unusual to be singled out for audit attention."⁹ Accordingly, the Government has been flexing its muscles in several cases which have brought attention to the Government's latest efforts.

This paper will closely examine the U.S. Government's pursuit of tax practitioners involved in devising international tax shelter schemes, or what Sisson refers to as "imaginative tax planning" and the problems the practitioner may confront when one of his tax planning schemes comes under Government attack. While this paper will not address the constitutional questions raised by the use of illegally obtained evidence, hopefully it will serve as a warning to the practitioner of the U.S. Government's campaign to put a halt to what it views as abuses of the tax laws.

II. HISTORICAL BACKGROUND OF THE GOVERNMENT'S EFFORTS TO PUT AN END TO ABUSIVE TAX SHELTERS

On October 26, 1977, Jerome Kurtz, the current Commissioner of the IRS, addressed the 30th Annual Federal Tax Conference at the University of Chicago Law School.¹⁰ The topic of his address was the Government's position on abusive tax shelters. Commissioner Kurtz stated:

Congress substantially curtailed many of the known tax shelters in the Tax Reform Act of 1976. But no sooner were the apparent leaks in the dike plugged than new ones appeared. The newer shelters that I've seen indicated that some promoters are pushing harder and harder against the edges of the tax law to produce new shelter products and in some cases may be passing the bounds of tax avoidance and entering the world of tax evasion.¹¹

7. *Id.*

8. *Id.*

9. *Id.*

10. Kurtz, *Commissioner's Remarks on Abusive Tax Shelters*, 55 TAXES 775, 769 (1977).

11. *Id.* at 774.

In this same speech, Commissioner Kurtz described the IRS's stepped-up attack on the various tax shelter schemes, especially those relating to the oil and gas industry, real estate partnerships, and motion picture production and distribution. The devices used by the Government include audit procedures,¹² as well as revenue rulings issued as soon as the schemes are discovered before they can become widely accepted and used.¹³

It must be noted that while Commissioner Kurtz may represent an IRS which is more active now than in the past,¹⁴ the Government has been actively prosecuting the tax shelter abusers for some time now, especially with regard to the use of foreign corporations and banks.¹⁵ In hearings before a House subcommittee looking into IRS methods of investigation,¹⁶ former Commissioner of Internal Revenue Donald C. Alexander stated:

For some time the Service has been concerned about the use of foreign trust accounts, for example in the Bahamas, as part of a tax evasion scheme. During the early 1960's the IRS received information that certain organized crime figures were using foreign trust accounts, or alleged accounts, as part of an attempt to evade U.S. taxation. In some instances funds allegedly transferred to Bahamian accounts were not actually transferred or, if transferred, may have represented amounts

12. In his speech Kurtz said that during the fiscal year of 1978 the IRS plans to audit 3% of the partnership returns filed, which is approximately double the number of audits the Treasury Department planned for fiscal 1977. Kurtz said that almost all of the additional coverage will be directed at abusive tax shelters. He said:

We have divided partnership returns into four audit classes: Losses of \$25,000 and over; losses under \$25,000; profits under \$25,000; and profits of \$25,000 and over. The examination increases have been allocated to those returns we feel are most in need of examination. For example, we plan to examine approximately 24% of the partnership returns showing losses exceeding \$25,000. Most of the abusive tax shelters in partnership form will fall into this category.

Id. at 775.

13. Kurtz mentions several revenue rulings which came out in response to some of the tax shelters created after the Tax Reform Act of 1976 and stated, "We are making a concerted effort to learn of new schemes as they are developed and to confront them as quickly as we can. It is important to give this guidance to investors who might otherwise be misled as to the Service's position." *Id.* at 776.

14. An article appearing in the *Wall Street Journal* makes note of the fact that Kurtz has doubled the number of audits of returns reporting large losses by partnerships which the *Journal* describes as a "recurring tax shelter feature" and quotes an unidentified private tax lawyer as saying, "I've rarely seen the service move with such speed and sophistication." Lehner, *Tax Chiefs Are Always Unloved, and This One Is Surely No Exception*, *Wall St.J.*, Apr. 4, 1978, at 1, col. 1.

15. In 1955, the Government prosecuted the case of *United States v. Klein*, 247 F.2d 908 (2d Cir.), cert. denied, 355 U.S. 924 (1957).

16. *Oversight Hearings into the Operation of the IRS (Operation Tradewinds, Project Haven, and Narcotics Traffickers Tax Program): Hearings Before a Subcomm. of the House Comm. on Government Operations*, 94th Cong., 1st Sess. (1975) [hereinafter cited as *Oversight Hearings*].

that were never subject to U.S. taxes, although they should have been.

So the Jacksonville district office commenced an information gathering project named Operation Tradewinds, later named Operation Haven.¹⁷

Operation Haven, more often called Project Haven, has been the center of a great deal of controversy in the media, but it is only one of the Government's many programs aimed at curbing the use of foreign tax havens.¹⁸ For example, in one such program during the late 1960's, IRS investigators attempted to break the secrecy laws of Swiss banks. To accomplish this goal, IRS agents sent letters expressing a personal interest in setting up accounts in various suspected Swiss banks. The banks sent replies in unmarked envelopes stamped with a meter. The IRS agents subsequently recorded the meter numbers, copied all letters coming through New York from Switzerland, and traced those letters stamped with the same meter numbers used by the banks. The IRS then conducted audits of the individuals to whom the letters had been sent and discovered several Swiss bank accounts.¹⁹ The tactics employed by the IRS in the Swiss bank affair reflect the Government's increasingly active pursuit of the international tax connection, a pursuit which has become ever more zealous in Project Haven.

III. PROJECT HAVEN AND THE RESULTING CASES

A. *Project Haven*

Project Haven has not been one of the Government's more successful operations to secure criminal prosecutions.²⁰ Not only has the

17. *Id.* at 23.

18. The term "tax haven" refers to foreign countries, most notably the Bahamas, Cayman Islands, Netherlands Antilles, and Panama, which have bank secrecy laws and minimal, if any, taxes. See note 27 *infra*. See also Norr, *Jurisdiction to Tax and International Income*, 17 TAX. L. REV. 431 (1962). Norr describes the tax haven corporation in the following way:

Let us recall at the outset that a tax haven or a foreign-base corporation generally means a foreign corporation which pays little or no tax in the country of its incorporation.

Id. at 453. In footnote 76, Norr cites to Treasury Dep't Release, July 28, 1961, 7 CCH 6479 (1961) which said:

In general, tax haven transactions are those between related enterprises in which one of the parties to the transaction derives its income from sources outside the country in which it is created. A foreign corporation which engages in manufacturing activity abroad would not be considered as engaging in tax haven transactions.

Id.

19. *Oversight Hearings*, *supra* note 16, at 911-12.

20. In the cases prosecuted thus far, evidence obtained through *Project Haven* operations has been ruled inadmissible in a criminal tax trial. See, e.g., *United States v. Payner*,

IRS been relatively unsuccessful in the prosecution of tax attorneys who were the primary targets of the investigation, but the IRS actions also generated controversy in both the Congress and the media.

The most notorious escapade undertaken by IRS investigators in Project Haven is known as the "briefcase affair,"²¹ which involved prostitution,²² secret informants, and clandestine trips to the Bahamas.²³ The basic plot of the "briefcase affair" was best summarized in the *New York Times*:

[T]he agents investigating these defendants became interested in the alleged use of Castle Bank and Trust, a Bahamian financial institution, as part of defendants' purported tax avoidance schemes. Norman Casper was employed by an IRS investigator as an informant. He managed to ingratiate himself with the managing director of Castle Bank, Michael Wolstencroft, and learned that Wolstencroft was flying to Chicago, via Miami, with a list of bank clients to be taken to the defendants' law firm. Casper arranged an assignation for Wolstencroft with a certain Sybil Kennedy. Ms. Kennedy succeeded in getting Wolstencroft to leave his briefcase, containing the desired documents, in her apartment. She then detained Wolstencroft outside the apartment during a dinner engagement, and engaged in sexual intercourse for compensation. By the time Wolstencroft returned to her apartment, IRS agents had taken the briefcase out of the apartment, forced its lock, and photographed the contents.²⁴

The "briefcase affair" was followed by a trip to the Bahamas by Kennedy. During her stay, Kennedy was able to remove from Wolstencroft's desk at the Castle Bank a Rolodex file containing the names and addresses of Castle Bank clients. Kennedy then brought the file back to the United States and turned it over to IRS investigators.²⁵

434 F. Supp. 113 (N.D. Ohio 1977). The Government unsuccessfully prosecuted Harry Margolis and associates in *United States v. Margolis*, No. 75-849 (N.D. Cal., filed Oct. 3, 1977). Also, in *United States v. Baskes*, No. 76-585 (N.D. Ill., filed Mar. 15, 1976), *appeal docketed*, No. 77-218 (7th Cir. Dec. 5, 1977) (*argued* Mar. 28, 1978), the Government was only able to obtain a conviction of one of the four defendants charged, Roger S. Baskes.

21. A lengthy article on the "briefcase affair" appeared in the *New York Times*. Kramer, *The I.R.S. and Its Briefcase Caper*, N.Y. Times, Jan. 30, 1977, § 6, at 2, col. 1, and was a focal point in the *Oversight Hearings*, *supra* note 1.

22. From various accounts of the affair, the woman involved has been described as a former policewoman by I.R.S. informant TW-24 appearing before the *Oversight Hearings*, *supra* note 16; a prostitute by Judge Decker in *United States v. Baskes*, 433 F. Supp. at 801; and as an I.R.S. informant and former policewoman in Kramer, *The I.R.S. and Its Briefcase Caper*, N.Y. Times, Jan. 30, 1977, § 6, at 2, col. 1.

23. 433 F. Supp. at 801-02.

24. *Id.* The activities described here would lead one to conclude that Casper is, in fact, informant TW-24. See note 22 *supra*.

25. 433 F. Supp. at 801-02. The IRS investigator referred to here is Richard Jaffe. An interesting note here is that after Judge Manos refused to admit evidence gathered in the

The investigators' purpose in carrying out such extreme activities was to obtain information protected by the Bahamian banking laws.²⁶ The following discussion will focus on two of the criminal prosecutions resulting from the Government's Project Haven efforts.

B. *The Project Haven Cases*

In his article, Sisson warns that the tax practitioner's use of "creative" tax planning methods may lead to criminal prosecutions for the client and the attorney who devised the scheme:

The lesson of the *Klein* case cannot be over-emphasized. Tax planning, regardless whether that planning is advanced, novel, unorthodox or enters uncharted areas, is not a conspiracy or any other crime. White-collar crime, however, currently is a favorite preoccupation, and a prime target, of the Department of Justice. Further emphasis on the conspiracy prosecution under inventive interpretations of other statutes can therefore be anticipated. The practitioner, especially the tax practitioner, is a highly visible target for a conspiracy investigation and prosecution, and is well-advised to be on his guard when his practice leads to inventive tax planning.²⁷

Sisson states that the Government's arsenal for use in its attack against inventive tax planning includes the general conspiracy statute, as well as various sections of the Internal Revenue Code.²⁸ He suggests

"briefcase affair" in the trial of *United States v. Payner*, 434 F. Supp. 113 (N.D. Ohio 1977), because it had been obtained illegally, the IRS suspended Jaffe from further work on the case. In a *New York Times* story Jaffe was described as an agent, "Who has been awarded numerous commendations for cases he developed against organized crime figures." Gage, *I.R.S. Agent Who Used Informer to Obtain Bank Data Is Suspended*, N.Y. Times, May 2, 1977, § M (Magazine), at 22, col. 3.

26. *Oversight Hearings*, *supra* note 16, at 161. The Banks and Trusts Companies Act, 1965, c. 10 (Bahamas) reads:

10. —(1) Except for the purpose of the performance of his duties or the exercise of his functions under this Act or when lawfully required to do so by any court of competent jurisdiction within the Colony or under the provisions of any law of the Colony, no person shall disclose any information relating to any application by any person under the provisions of this Act or to the affairs of a licensee or of any customer of a licensee which he has acquired in the performance of his duties or the exercise of his functions under this Act.

—(2) Every person who contravenes the provisions of his section shall be guilty of an offense against this Act and shall be liable on summary conviction to a fine not exceeding one thousand pounds or to a term of imprisonment not exceeding one year as to both such fine and imprisonment.

Id.

27. *Sandman Cometh*, *supra* note 1, at 844. The *Klein* case Sisson refers to is *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957), *cert. denied*, 355 U.S. 924 (1957). In *Klein*, the defendants, including two attorneys, were found guilty under 18 U.S.C. section 371 of conspiracy to defraud the United States by impeding and obstructing the Treasury Department in the collection of income taxes. 247 F.2d at 908. The Government's claim was that the defendants had organized no less than seventeen foreign corporations to carry on their business operations to hide income and evade taxes. 247 F.2d at 910.

28. *Sandman Cometh*, *supra* note 1, at 826.

that the general conspiracy statute²⁹ gives the Government a very broad means of attack and that the Internal Revenue Code sections³⁰ give "ample authority for conspiracy prosecutions within the framework of the Code. There is no need to seek an indictment under the more general statute; the Code contains all the penalties needed for its enforcement."³¹

Several recent cases resulting from the Government's Project Haven investigation seem to point to a new trend in prosecutions which may eventually prove Sisson correct. The most notable of the cases are *United States v. Margolis*³² and *United States v. Baskes*.³³

1. *United States v. Margolis*

In *Margolis*,³⁴ all four defendants were charged under the general conspiracy statute,³⁵ and Harry Margolis was charged with twenty-

29. 18 U.S.C. § 371 (1976) reads:

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor.

Id.

30. I.R.C. § 7206(2) provides that any person who:

(2) Willfully aids or assists in, or procures, counsels or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim or document . . . shall be guilty of a felony and, upon conviction thereof, shall be fined not more than \$5,000, or imprisoned not more than 3 years, or both, together with the costs of prosecution.

Id. I.R.C. § 7212(a) provides that:

Whoever corruptly . . . endeavors to . . . impede any officer or employee of the United States acting in an official capacity under this title, or in any other way corruptly . . . obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title, shall upon conviction thereof, be fined not more than \$5,000, or imprisoned not more than 3 years, or both. . . .

Id.

31. *Sandman Cometh*, *supra* note 1, at 840.

32. No. 75-849 (N.D. Cal., filed Oct. 3, 1977).

33. No. 76-585 (N.D. Ill., filed Mar. 15, 1976), *appeal docketed*, No. 77-218 (7th Cir. Dec. 5, 1977) (*argued* Mar. 28, 1978). See note 5 *supra* for other matters arising out of *Project Haven*.

34. No. 75-849 (N.D. Cal., filed Oct. 3, 1977). Also named as defendants in this case were Quentin L. Breen, an attorney and an associate of Margolis; Ronald H. Adolphson, an accountant; and Banco Popular Antiliano, N.V., a banking concern. Since all of the defendants were acquitted by a jury, there is no court summary of the facts as would be available if the case had been reported. Any references this author makes to the facts of the case will be as they have been stated in the indictment or in newspaper accounts. A copy of the indictment may be found at *Oversight Hearings*, *supra* note 16, at 1244-64.

35. See indictments in *Oversight Hearings*, *supra* note 16, at 1244-64. The general conspiracy statute is found in 18 U.S.C. § 371 (1976). See note 29 *supra*.

three counts of willfully aiding and assisting in the preparation and presentation of false returns.³⁶ Quentin L. Breen was charged in two of the aiding and assisting counts.³⁷ The indictment charged the defendants with causing transfers of funds among various bank accounts in the Banco Popular Antiliano, N.V., and Union Bank; when in fact the accounts involved lacked sufficient funds to effect the transfers.³⁸ The indictment further alleged that the purpose of the transfers was to create deductions and other expenses in the Federal income tax computation.³⁹ Additionally, the indictment charged that the defendants, primarily Margolis, had participated in such overt acts in furtherance of the conspiracy as: (1) directing clients to write and mail letters composed by Margolis describing various financial transactions and required systematic backdating,⁴⁰ (2) concealing planning memoranda from IRS agents during investigations,⁴¹ and (3) including various individuals in partnerships as limited partners for the sole purpose of taking deductions for alleged partnership losses, when in fact the individuals had not sustained any such partnership losses.⁴² The indictment also alleged that at the direction of Margolis, his clients had written letters indicating that Aruba Bonaire Curacao Trust Company Limited (A.B.C.) and the various trusts of which it was a trustee had taken independent actions, when all the form and content of the documents and letters were actually dictated and controlled by Harry Margolis.⁴³

The indictment further alleged that defendants Margolis and

36. See indictments in *Oversight Hearings*, *supra* note 16, at 1244-64. The applicable statute is I.R.C. § 7206(2). See note 30 *supra*.

37. See indictments in *Oversight Hearings*, *supra* note 16, at 1244-64.

38. *Id.* at 1247-48.

39. *Id.* at 1248.

40. *Id.* at 1248-49. But see Drinkhall, *Intricacy of Margolis Tax-Haven Case Appears to Confound U.S. and Jury*, Wall St.J., July 26, 1977, at 28, col. 5 [hereinafter cited as Drinkhall].

Other crucial ingredients in the scheme, according to the prosecutors, were the "planning memoranda" drawn up by Mr. Margolis. In them, he would describe a lengthy scenario of how to structure the transactions, and these memos dictated that there would be "systematic backdating" of documents, the government says.

Hogwash, says Mr. Margolis. In his words, the backdating was simple a "memorialization of transactions that had already occurred."

Even though a number of witnesses testified about backdating, and hundreds of pages of documents were introduced to back them up, William A. Ingram, the federal judge presiding over the trial, finally remarked from the bench: "I fail to see any evidence of criminality. . . . I don't know of any lawyer who doesn't day in and day out, backdate documents and correspondence, predate documents and correspondence, predate, front date. . . . That doesn't cut any ice at all."

Id.

41. *Oversight Hearings*, *supra* note 16, at 1248.

42. *Id.* at 1248-49.

43. *Id.* at 1249.

Breen had maintained a double set of books—one set for viewing by agents of the IRS and the United States Tax Court investigating Margolis' clients' financial positions, and the other reflecting "the true financial positions of the clients' participation in various tax planning schemes"⁴⁴ devised by Margolis and Breen. According to the indictment, Margolis concealed this second set of books from the IRS investigator.⁴⁵ The indictment also alleged that certain documents relating to the scheme were turned over by Margolis to IRS agents although Margolis actually knew that these documents were false and misrepresented the true circumstances regarding the transactions.⁴⁶

Counts Two through Twenty-four charged violations of I.R.C. Section 7206(2) by Margolis and Breen.⁴⁷ These counts charged that the defendants "did willfully and knowingly aid and assist in, conceal, procure, and advise the preparation and presentation to plaintiff's Internal Revenue Service"⁴⁸ of joint and individual income tax returns which were false and fraudulent as to material fact because they contained overstated deductions.⁴⁹

After the fourth week of the trial, Margolis took over his own defense because he felt the circumstances surrounding the transactions were so technical that he was the only "[l]ogical choice to conduct much of the questioning coming up."⁵⁰ After the Government attorneys rested their case, Judge William Ingram dismissed all of the charges against Breen and eighteen of the I.R.C. charges against Margolis.⁵¹ This action left the Government with the major conspiracy

44. Drinkhall, *supra* note 40, at 28, col. 5. Drinkhall says:

One major element that the government contends was essential to the scheme was the "system accounting", that second set of books the prosecutors say showed the client's real financial position, but never got to the IRS. Thus, a person's tax return might show a loss for the year, but the "system accounting" would show that he had a credit within the "system" companies that he could still invest for further tax deductions.

Though Mr. Margolis hasn't yet defined it in court, a memo he prepared recently described system accounting as "basically a diary, a cash flow" used as a tax-planning technique. Mr. Margolis says he recognizes that everyone has a definition different from his but in his sometimes dogmatic manner, he dismisses all of them because they "simply don't know what they're talking about."

Id.

45. *Oversight Hearings*, *supra* note 16, at 1249.

46. *Id.* at 1249-50.

47. *Id.* at 1251-64, Breen was only charged in Counts Fifteen and Twenty-one, in addition to the Conspiracy Count (Count One).

48. *Id.*

49. *Id.*

50. *Margolis to Conduct Own Defense*, N.Y. Times, Apr. 14, 1977, § 4, at 1, col. 1 (statement made to the press by Margolis).

51. *Judge Dismisses 18 of 24 Counts in U.S. Tax Case Against Lawyer*, N.Y. Times, July 28, 1977, § 4, at 5, col. 3. Both counts involve violations of 18 U.S.C. § 371 (1976) and I.R.C. § 7206(2). See notes 29 and 30 *supra*, respectively.

count and five of the substantive counts. Judge Ingram, in dismissing the charges, was quoted as saying, "the jury could not find, beyond a reasonable doubt, in my opinion, that the money movements involved anything other than real money."⁵²

Throughout the trial, Margolis contended that his prosecution by the Government was merely a form of harassment because he had been so successful in using the tax laws to save money for his clients.⁵³ Whether or not Margolis had actually been the subject of Government harassment is a question which cannot be readily answered but the lengths that the Government went to to bring him to trial indicate that Margolis was viewed as a menace; however, it must be noted that the transactions upon which the Government based its conspiracy charges were found to be a sham transaction in the Tax Court in *Audrey M. Thompson*.⁵⁴ In that case, the Tax Court struck down the interest deduction Margolis had created in the amount of \$1,070,000 and questioned the sale which had generated the interest, finding the whole sale to be a sham transaction which could not be recognized for tax purposes.⁵⁵ Focusing on Margolis' role in the sale, the Court in *Thompson* said:

It is inconceivable that Kahan or Margolis would have advised their clients to purchase, in a *bona fide* transaction, property for \$6,800,000, which could have been acquired less than three months earlier for approximately one-tenth of that amount. Our doubts about the *bona fides* [*sic*] of such a transaction are reinforced by the relationship of Harry Margolis and A.B.C., the initial purchaser (through McAvoy) of the property from Sunset.⁵⁶

The Court went on to describe Margolis' position in the following way:

In any event the connection between Harry Margolis and the

52. *Judge Dismisses*, *supra* note 51, 4, at 5, col. 4.

53. *Margolis Tax-Fraud Trial Opens With Focus on Offshore Havens*, N.Y. Times, Mar. 21, 1977, § L, at 43, col. 4. The article states that:

According to an I.R.S. memorandum introduced by Mr. Margolis' lawyers, he has been under investigation since 1959. His clients have been audited more than 500 times since then, although—according to the memorandum—in most instances they were able to support their deductions with documentation.

Id. Another article, *Drinkhall*, *supra* note 40, supports Margolis' contention:

Since the early 1960's, the IRS has looked askance at Mr. Margolis' offshore tax-planning activities. In hundreds of civil cases, he won. One IRS memo says the Los Angeles and San Francisco audit divisions "have had 10 years of frustrating experience attempting, with little success, to cope with Margolis' schemes. He is extremely adept. . ."

Id. at 28, col. 3.

54. 66 T.C. 1024 (Sept. 21, 1976).

55. *Id.*

56. *Id.* at 1052.

McAvoy investors on the one hand and Harry Margolis and *A.B.C.* on the other, leads to the impression that in planning the Thousand Oaks transactions with Sunset, *A.B.C.* may have been intentionally interpositioned between Sunset and the McAvoy investors for the purpose of altering the appearance of the transaction in order to artificially create income tax deductions.⁵⁷

Regardless of what the Tax Court thought about Margolis' transactions or of how well-intentioned the IRS may have been in its pursuit of Margolis, on October 4, 1977, after a trial lasting six months, including seven days of jury deliberations, Margolis was found innocent of all charges.⁵⁸ Apparently, the members of the jury did not feel the contempt for the tax practitioner⁵⁹ that some authors had anticipated.⁶⁰

2. *United States v. Baskes*

Project Haven was not a total loss for the Government. The IRS has been satisfying its appetite for tax evaders by turning its attentions

57. *Id.*

58. *Margolis and Bank Are Freed by Jury in Tax-Fraud Case*, Wall St.J., Oct. 5, 1977, at 16, col. 3.

59. Miller, *Morality in Tax Planning*, in PROFESSIONAL RESPONSIBILITY IN FEDERAL TAX PRACTICE 55 (B. Bittker ed. 1970). Miller described the public concept of a tax practitioner in the following manner:

So it is that many people who feel themselves doing worth while [*sic*] things today must feel sorry for us. In their eyes we toil not, neither do we spin—other than fanciful tax schemes to be later found invalid by the courts or declared retroactively ineffective by Congress. In their minds' eye they can see us as our grandchildren climb upon our knee and ask what we did in the great battle between the West and East. They can see us flush with shame, avert our eyes, and slowly mumble, "Grandchild, I spend my nights working out phony family partnerships, I developed my present literary style from dictating glowing minutes depicting reasons for not paying out dividends, and I wrote long instruments setting up tricky trusts so that those who came to me would not stand their full share of the tax load."

Id. And Sisson said:

The amount of money alleged to have been saved in tax conspiracy, or the wealth or identity of the defendants, may taint a juror's attitude. For example, assume that the members of the jury consist of twelve working class persons. Their income is withheld and reported to the government on a Form W-2. They are subject to the ravages of inflation and the inability to engage in "imaginative" planning. The defendants' tax plan, which calls for the "imaginative" exploitation of a situation is presented. When the large dollar amounts involved in the case are combined with the tendency of the prosecutor to use terms that are colored or loaded (such as "manipulation" or "sham"), the predicates for a hostile reaction on the part of the jurors are present.

Sandman Cometh, *supra* note 1, at 827.

60. No. 76-585 (N.D. Ill., filed Mar. 15, 1976), *appeal docketed*, No. 77-218 (7th Cir. 1977) (*argued* Mar. 28, 1978). See note 5 *supra* for other matters arising out of *Project Haven*.

to a Chicago attorney, Roger S. Baskes,⁶¹ an appetite which has increased as the Government has watched great amounts of dollars escape taxation through the use of tax haven planning. The Government's concern was evidenced in the following testimony:

MR. ROSENTHAL. Before we get to the "briefcase incident", how much money can you conjecture in any way, shape, or form that was taken from the United States to the Bahamas? That is, in an effort to wash the money or escape taxes?

MR. WOLFE. It is difficult to estimate how much money because money at times was not even taken. For example, fictitious loans were set up and interest allegedly was charged on these loans for example, and deducted on a tax return by an American citizen.

MR. ROSENTHAL. To cover all these contingencies, how much money are we talking about? Is there any way of speculating?

MR. WOLFE. I would be afraid to guess.

MR. ROSENTHAL. Is it enough to whet your appetite?

MR. WOLFE. Absolutely.

MR. ALEXANDER. Not only whet our appetite, Mr. Chairman, but to demand our interest and our concern.⁶²

In *Baskes*, Roger S. Baskes, Burton W. Kanter, Alan H. Hammerman, and Samuel Zell were charged with conspiracy to defraud and impede the IRS in the performance of its functions.⁶³ Three of the defendants, Baskes, Kanter and Hammerman, were members of the same Chicago law firm,⁶⁴ and the fourth defendant, Zell, was admitted to practice in Illinois, but "was actively engaged in acquiring real estate, including improved real estate, in and about Reno, Nevada."⁶⁵ The allegations of the indictment were summarized by the court during an evidentiary hearing.⁶⁶ The court stated:

The allegations of the indictment assert that [the defendants] structured certain real estate sales "to disguise and falsify the

61. *Chicago Tax Specialist Charged Third Time*, THE AM. LAW., Feb. 1979, at 10 [hereinafter cited as *Chicago Tax Specialist*]. Baskes has been convicted in two tax fraud and conspiracy cases and was recently indicted for the third time under I.R.C. § 7206(2). *Lawyer Is Convicted of Helping 2 Clients Evade Federal Taxes*, Wall St.J., Aug. 31, 1978, at 23, col. 3.

62. *Oversight Hearings*, *supra* note 16, at 24 (questioning of Donald C. Alexander, Commissioner, Internal Revenue, and Singleton Wolfe, Assistant Commissioner for Compliance, conducted by Benjamin S. Rosenthal, Chairman, Commerce, Consumer, and Monetary Affairs Subcommittee).

63. *Id.* at 1178.

64. Levenfeld, Kanter, Baskes & Lippitz, 10 South LaSalle Street, Chicago 3, Illinois.

65. *Oversight Hearings*, *supra* note 16, at 1179.

66. 433 F. Supp. 799.

true tax consequences, falsely attributed the purchase price of real estate to another purchase, and devised, promoted, and caused a series of manipulations through the use of a corporate entity, corporate stock, foreign and domestic trusts, partnerships, back-dated documents, and ostensible transfers of ownership, so as to disguise and conceal from the Internal Revenue Service the true nature of the sale of Arlington Towers and Arlington Plaza."⁶⁷

At trial, the evidence established that Baskes had structured the sale of the properties to overcome the capital gains consequences which would result from the sale. He accomplished this objective by allocating \$700,000 of the purchase price of the Arlington properties to an unpatented mining claim of nominal value and not making reference to this allocation in any of the papers executed in connection with the sale of the property. The \$700,000 was placed in a numbered trust account in a foreign bank, and the beneficiaries of the trust were the children of the sellers of the Arlington properties. The court found that by disguising the \$700,000 transaction, Baskes' clients avoided the payment of gift taxes on the transfer of the funds to the trust.⁶⁸

The evidence, as presented, also established that by including the worthless mining claim in the transaction, Baskes was able to set up a device for obtaining a substantial deduction for one of his other clients. According to the evidence, this objective was achieved through a series of transactions involving sham foreign corporations created for the purpose of transferring their stock in exchange for the mining claim through Castle Bank and Trust Company.⁶⁹

In *Baskes*, Kanter was acquitted by the jury,⁷⁰ while defendants Zell and Hammerman were severed from the trial and the indictments against them dismissed after they testified pursuant to an agreement with the Government against Baskes and Kanter.⁷¹ As Sisson noted, "One popular method of splitting the defense and securing testimony is through a grant of immunity from prosecution in exchange for testimony, or a dismissal of a charge against a particular defendant in exchange for testimony."⁷²

Baskes has since been indicted on two more occasions.⁷³ Both in-

67. *Id.* at 801.

68. 442 F. Supp. at 324-25. This opinion is from a post-trial hearing. The bank was Castle Bank and Trust Company which was the center of attention in all of the *Baskes* cases.

69. *Id.*

70. *Chicago Tax Specialist*, *supra* note 61. In *United States v. Baskes*, No. 76-585 (N.D. Ill., filed Mar. 15, 1976), *appeal docketed*, No. 77-218 (7th Cir. Dec. 5, 1977) (*argued* Mar. 28, 1978). Baskes was sentenced to two years in prison for his part in the scheme.

71. *Chicago Tax Specialist*, *supra* note 61.

72. *Sandman Cometh*, *supra* note 1, at 828.

73. *Chicago Tax Specialist*, *supra* note 61.

dictments charged Baskes with conspiracy to defraud the Government⁷⁴ and willfully aiding and assisting in the preparation and filing of false tax returns.⁷⁵

The second indictment came on January 13, 1977, when Baskes was indicted by a Miami grand jury.⁷⁶ The indictment charged Baskes, along with Anthony R. Field,⁷⁷ manager of Castle Bank and Trust Company, Georgetown, the Bahamas, and George C. Schallman, a Chicago accountant, with violating 18 U.S.C. Section 371.⁷⁸ Baskes and Schallman were also charged with violating I.R.C. Section 7206(2).⁷⁹ A news article reports that the three defendants were charged with participating "in a scheme in which two Las Vegas men who weren't charged, were able to use transactions in the trading of foreign currencies and offshore trusts as an income tax deferral device."⁸⁰ According to the article, the indictment alleged that "[t]hrough a series of prearranged transactions by unindicted brokers, these funds resulted in nonexistent capital losses that Messrs. Garb and Stern

74. 18 U.S.C. § 371 (1976). See note 29 *supra*.

75. I.R.C. § 7206(2). See note 30 *supra*.

76. *Three Accused of Conspiracy to Defraud U.S.*, Wall St.J., Jan. 14, 1977, at 8, col. 1. [hereinafter cited as *Three Accused*].

77. See *In re Grand Jury Proceedings*, 532 F.2d 404 (5th Cir. 1976). Anthony R. Field was held in contempt for refusing to answer questions before this grand jury. The court rejected Field's argument that the Fifth Amendment prohibition against self-incrimination would be violated if he was required to answer questions before the grand jury. *Id.* at 406. One of the points the court raises in rejecting Field's argument is that he did not argue that the content of his answers could be used as evidence against him in foreign prosecution, *id.*, for violation of Bank and Trust Companies Regulation Law, 1966 (Law 8) (Cayman Islands). *Id.* at 405.

The court also rejected Field's argument that as a matter of international comity he should not be forced to testify. The court said:

In short, Field seeks to prohibit a United States grand jury from obtaining information that would have been obtainable by officials there for their own investigations. Since the general rule appears to be that for domestic investigations such information would be obtainable, we find it difficult to understand how the bank's customer's rights of privacy would be significantly infringed simply because the investigating body is a foreign tribunal.

Id. at 408. The court went on to say:

In light of the traditional discretion given the grand jury and the significant interest this nation has in tax enforcement, without any specific direction from Congress, we see no reason not to enforce the subpoena.

Id. at 409. The court further noted:

Since the Cayman Bank Secrecy Act prohibits disclosure of any information concerning local banks nothing would be gained by limiting the scope of the grand jury questions. Even if such a limitation might alleviate Field's difficulty, this court would be reluctant to supervise the extent of the grand jury's attempt to obtain evidence.

Id. at 409 n.6.

78. *Three Accused*, *supra* note 76. At the time of the indictment Baskes was still with Levenfeld, Kanter, Baskes & Lippitz. Schallman was a partner in the accounting firm of Oppenheim, Appel, Dixon & Co., Chicago, Illinois. *Id.*

79. *Id.*

80. *Id.*

claimed on their 1973 income tax. . . ."⁸¹

Baskes' reaction to this indictment was very similar to that of Harry Margolis⁸² when the Government accused him of the same crimes: Baskes' law firm claimed the charges were an unjustified attempt by the Department of Justice to justify the costly Project Haven activities.⁸³

Apparently, the jury did not feel the charges were particularly frivolous, for they found Baskes guilty on one count of conspiracy and two counts of hiding and assisting in the preparation and presentation of false income tax returns. Baskes' two co-defendants were acquitted.⁸⁴

On June 8, 1978, Baskes was indicted for the third time in a fifteen-count indictment announced on December 13, 1978.⁸⁵ The indictment charged Baskes, along with two Florida regional Toyota officials, with filing false returns by "allegedly failing to report \$5.5 million in income diverted to offshore trusts at a bank in the Cayman Islands."⁸⁶

In the third indictment, Castle Bank and Trust Company again found its way into the picture. The indictment asserted that the corporate tax returns listed deductions for franchise insurance and freight forwarding services that the corporation never received. According to the indictment, the corporate funds were diverted to trust accounts at Castle Bank & Trust (Cayman), Ltd., for the benefit of a Mr. Moran and his family. For his part in the scheme, Baskes has been charged with four counts of aiding and assisting in the preparation of false returns.⁸⁷ Baskes has not yet gone to trial on these charges.

C. Summary

Sisson suggests that the conspiracy statute⁸⁸ is too broad to allow the tax practitioner to engage in any creative tax planning without risking prosecution for devising a plan that falls apart.⁸⁹ Sisson urges that the sanctions imposed by the I.R.C.⁹⁰ are sufficient.⁹¹ He observes:

81. *Id.*

82. See text accompanying notes 53-54 *supra*.

83. *Three Accused, supra* note 76.

84. *Chicago Tax Specialist, supra* note 61.

85. 241 DAILY TAX REP. (BNA) G-11 (Dec. 14, 1978).

86. *Id.* The other men indicted were James M. Moran, the president and majority stockholder of Lisa Enterprises, Inc., headquartered in Pompano Beach, Florida and Jack Weiss, who was comptroller for Southeast Toyota. Lisa, Inc., is the parent company of Southwest Toyota Distributors, Inc. *Id.* at G-12.

87. *Id.* Baskes is charged under I.R.C. § 7206(2). *Id.*

88. 18 U.S.C. § 371 (1976). See note 29 *supra*.

89. *Sandman Cometh, supra* note 1, at 844.

90. I.R.C. §§ 7206(2), 7212(a). See note 30 *supra*.

91. *Sandman Cometh, supra* note 1, at 840.

An investigation conducted by the Service under the Code affords the taxpayer significant rights, such as a right to tell his side of the story, a right to representation by counsel and the possibility that technicians will review technical issues. An investigation through the use of the grand jury, with a view toward an indictment under the general conspiracy statute denies these rights.⁹²

The point Sisson fails to take into account in his analysis is that before the Department of Justice recommends a case to the United States Attorney for prosecution, the investigation goes through several stages, to allow the Government to build as strong a case against the taxpayer as possible before seeking a grand jury indictment. First, an investigation is conducted by the Special Agent.⁹³ If the Special Agent decides to recommend prosecution, he writes a detailed report supporting his recommendation to his Group Chief.⁹⁴ Before the report is approved, the taxpayer and his representative are usually allowed a conference with the Special Agent and the Group Chief.⁹⁵ At this point, the taxpayer's representative has the opportunity to explain his tax planning schemes.⁹⁶ If he does so, the problems may be cleared up. If not, the IRS conferee must inform the taxpayer's representative of the alleged fraudulent features of the case.⁹⁷ After the Special Agent's report is approved by the Intelligence Division it is forwarded to the Regional Counsel's office, and the Chief Criminal Investigation Division ordinarily notifies the subject of the investigation and his representative of the recommendation for prosecution.⁹⁸ If the Regional Counsel approves the report, it is forwarded to the Department of Justice, Tax Division, Criminal Section, which usually offers the taxpayer or his attorney a conference.⁹⁹ If the Department of Justice finds that

92. *Id.* at 841.

93. J. FREELAND, S. LIND, & R. STEPHENS, *FUNDAMENTALS OF FEDERAL INCOME TAXATION*, 981-83 (2d ed. 1977) [hereinafter cited as *FEDERAL INCOME TAXATION*].

94. *Id.*

95. *Id.*

96. Treas. Reg. § 601.107(b)(2) (1979) provides:

A taxpayer who may be the subject of a criminal recommendation will be afforded a district Criminal Investigation conference when he requests one or where the Chief, Criminal Investigation Division, makes a determination that such a conference will be in the best interests of the Government. At the Conference, the IRS representative will inform the taxpayer by a general oral statement of the alleged fraudulent features of the case, to the extent consistent with protecting the Government's interests, and, at the same time, making available to the taxpayer sufficient facts and figures to acquaint him with the basis, nature, and other essential elements of the proposed criminal charges against him.

Id.

97. *Id.*

98. Treas. Reg. § 601.107(c) (1979).

99. *FEDERAL INCOME TAXATION*, *supra* note 93, at 983.

prosecution is warranted, it forwards the case to the United States Attorney's office with instructions to secure an indictment.¹⁰⁰

It must be noted, however, that these conferences are held at the discretion of the IRS and are not mandatory. In *United States v. Goldstein*,¹⁰¹ the defendant claimed he was entitled to a series of conferences such as those described above before the case against him could be presented to the grand jury, and that, because the denial of the conferences was arbitrary, he was denied due process and equal protection of the law.¹⁰² In his case, no conference was offered at the Special Agent's level. "The Special Agent on the case did not specifically recommend prosecution, but instead suggested that the case be referred to the Department of Justice for presentation to a grand jury."¹⁰³ Goldstein was offered a conference at the Regional Counsel level after the grand jury investigation had begun, but the conference was never held.¹⁰⁴ The court rejected Goldstein's argument that his rights had been violated because the IRS did not grant him a conference, stating:

[T]he regulations do not confer any legal right to be free of the necessity of defending a grand jury indictment. It is true that a certain number of cases are dropped after each level of administrative conference, but the conferences are primarily for the benefit of the United States, to avoid the expenditure of effort on unfounded prosecutions, and not for the benefit of defendants.¹⁰⁵

Courts have followed the *Goldstein* decision in several cases. For example, in *United States v. Stofsky*¹⁰⁶ the court stated:

The grand jury's broad powers to investigate and to indict on the basis of evidence which disclosed reasonable grounds for belief that the defendants violated 26 U.S.C. § 7201 are not conditioned upon the taxpayers being given an opportunity to explain their conduct to a government official any more than to the grand jury itself.¹⁰⁷

And, in *Securities and Exchange Commission v. National Student Marketing Corp.*¹⁰⁸ the court, citing *Goldstein*, determined that the failure

100. *Id.*

101. 342 F. Supp. 661 (E.D.N.Y. 1972).

102. *Id.* at 663. The court in *Goldstein* noted that 50% of prosecutions are declined at the district (Special Agent) level and smaller percentages at each succeeding stage. *Id.*

103. *Id.*

104. *Id.* at 663-64.

105. *Id.* at 668.

106. 527 F.2d 237 (2d Cir. 1975).

107. *Id.* at 249.

108. 68 F.R.D. 157 (D.C. 1975). For a full discussion of the case, see *Securities & Exch. Comm'n v. National Student Mktg. Corp.*, 538 F.2d 404 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 1073 (1977).

on the part of the IRS to follow one of its own published rules did not violate the potential defendant's right to due process.¹⁰⁹ The court in this case based its decision on the fact that the defendant would still have a chance to vindicate himself at a trial on the merits.¹¹⁰ Using a similar analysis, the court in *Wellman v. Dickinson*¹¹¹ stated:

While the procedure of affording prospective defendants an opportunity to present their views to the Commission may well be a salutary one, it is not a procedure which is constitutionally compelled. It must be remembered that all that is in issue here is the institution of suit by the government against the Defendants, not the substantive adjudication of their rights. Thus, before any sanction is imposed, the Defendants will be afforded the protections of a full trial.¹¹²

Read in the light of the above cases, Regulation Section 601.701¹¹³ affords potential tax fraud defendants few, if any, of the safeguards that Sisson feels are essential. Moreover, the potential defendant is offered protection only if charges were to be solely under I.R.C. sanctions. The courts seem to be saying that the pre-indictment conference stage exists solely in order to help the Government build its case against the defendant; therefore, if the Government feels it has a strong enough case without need of a conference, the case can go straight to the grand jury.

The appropriateness of the use of 18 U.S.C. Section 371 in a tax fraud case has been debated for some time and will probably continue to be debated for as long as people have to pay taxes and the Code provides escape mechanisms to avoid those taxes. As Sisson suggested, "[A]t least two people are involved whenever a tax practitioner services a client through tax planning or tax litigation. . . ."¹¹⁴ The potential for a conspiracy to defraud the Government exists if the intent to do so is present in the minds of the parties. It is this joining of forces to commit the crime at which the conspiracy statute is aimed. As one author has observed, "The agreement to accomplish the prohibited purposes furnished, without more, the basis for criminal liability."¹¹⁵ The author furthermore states:

[the] conspiracy doctrine comes closest to making a state of mind the occasion for preventive action against those who threaten society but who have come nowhere near carrying

109. 68 F.R.D. at 164-65.

110. *Id.* at 165.

111. 79 F.R.D. 341 (S.D.N.Y. 1978).

112. *Id.* at 352.

113. *See generally* Treas. Reg. § 601.701 (1979).

114. *Sandman Cometh*, *supra* note 1, at 805.

115. Goldstein, *Conspiracy to Defraud the United States*, 68 YALE L.J. 405, 406 (1959).

out the threat. No effort is made to find the point at which criminal intent is transformed into the beginnings of action dangerous to the community. Instead, the mystique of numbers, of combination, becomes the measure of danger. Even when a statute requires an overt act "to effect the object of the conspiracy," as in Federal law, it may be a completely innocent one which indicates little or nothing of the kind of injury to society which the conspiracy seeks to bring about.¹¹⁶

In *Margolis* and *Baskes*, the Government claimed to be the victim of the conspiracy. Is it not possible, however, that the client who becomes involved in these fraudulent schemes suffers even more than the Government? The client looks to the attorney for advice in reducing his potential tax liability by lawful means: he would not need an attorney to instruct him on how to take fraudulent deduction by unlawful means. It has been observed:

Taken in its plainest sense, tax evasion should connote the attempt, whether successful or not, to reduce or altogether eliminate tax liability by means which the statutes declare to be unlawful; avoidance should connote reaching the same ends by lawful means.¹¹⁷

If we are to accept the idea that the client is also the victim in a fraudulent tax planning scheme, then the conspiracy statute is as valid a tool for the Government to use in stopping illegal tax planners as it is in stopping organized crime. The client does suffer in many ways. When the client goes to an attorney for advice as to how to lawfully avoid paying high taxes, he is placing a great deal of trust in that attorney. When the scheme fails, the client may face paying penalties on the taxes owing and may even find himself facing criminal prosecution for tax evasion. Should the attorney who devised the whole plan be allowed to escape prosecution and continue doing business as usual while involving more taxpayers in his "creative" tax planning schemes?

Canon 7 of the ABA Code of Professional Responsibility states that, "A Lawyer Should Represent a Client Zealously Within the Bounds of the Law." Ethical consideration 7-5 requires the attorney, when acting as advisor, to give "his professional opinion as to what he believes would likely be the ultimate decision of the courts on the matter at hand and by informing his client of the practical effect of such decision." Ethical Consideration 7-5 goes on to say that after the client has elected the course he wishes to pursue, the lawyer is not acting improperly in continuing to represent his client, so long as he does not

116. *Id.*

117. H. BALTER, *TAX FRAUD AND EVASION* 2-6 (4th ed. 1976).

thereby knowingly assist the client to engage in illegal conduct or to take a frivolous legal position. A lawyer should never encourage or aid his client to commit criminal acts or counsel his client on how to violate the law and avoid punishment therefor.

The duties set out in Ethical Consideration 7-5 probably apply more in the area of tax planning than in any other area of legal counseling because of the complexity of the American tax system. An attorney would be hard-pressed to find legal doctrine to support the position of the client who wants to engage in smuggling drugs or illegal betting operations, but this is not so in the area of tax law. The system itself invites legal creative tax planning, and that is the reason the client comes to the tax practitioner for advice. In such a situation an attorney owes his client the duty to advise him on how to stay within the boundaries of the law. If the attorney knowingly does not meet this duty, he should be penalized.

IV. CONCLUSION

In *Margolis* and *Baskes*, the Government concentrated its attack on the tax practitioner. Prior to these cases, the governmental focus had been on the taxpayer and the individual who merely helped the taxpayer fill out his return rather than on the individual who counseled him on tax-saving plans.¹¹⁸ The very fact that *Margolis* and *Baskes* were prosecuted is significant. Up until this point the attorney may have faced a civil malpractice suit brought by a disgruntled client for a tax planning scheme that failed, but now the attorney may find himself

118. See, e.g., *United States v. Crum*, 529 F.2d 1380 (9th Cir. 1976) (Attorney and C.P.A. furnished backdated purchase contracts and false depreciation schedules to brewer purchases, so purchasers could claim depreciation for periods not owned); *United States v. Washburn*, 488 F.2d 139 (5th Cir. 1973) ("Taxpayer consultant" signed his client's estranged wife's name to a joint return for the client, claimed to have her power of attorney, and then took her losses against his own income); *United States v. Brown*, 548 F.2d 1194 (5th Cir. 1977) (Defendant was a part-time income tax preparer whose only tax training was an H & R Block course in income tax preparation. In preparing returns, the defendant relied on both written and oral evidence of expenses furnished by the taxpayers, which the taxpayers had substantially overstated. Defendant failed to double-check the validity of the expenses. The defendant's conviction was reversed on appeal. The judge in the *Brown* case prefaced his opinion with an interesting comment, stating:

This case, one of the very few in the recorded annals of the 85-year history of the Fifth Circuit, involves not the trials and tribulations, attempted frauds and other derelictions of taxpayers, which are common grist for our mill. Rather, it involves fraud by a tax preparer, one whose Twentieth Century occupation is now almost indispensable to all save those taxpayers who can use, or risk the use of, a short form with standard deductions. In this Bicentennial foray we see the hazards both to the system and to the protection of rights of the public and the individuals concerned. To be remembered is that it is the fraud or false statement of the preparer, not the taxpayer, which counts. Indeed, the tax properly due may be of no, or only secondary, significance.

548 F.2d at 1196-97.

facing criminal prosecution for his creative manipulation of the laws. What is more, he may find the disgruntled client testifying against him.¹¹⁹

The Project Haven cases and the Government effort to bring Baskes, Margolis, and Kanter to trial clearly indicate the Government's interest in putting an end to the abuses of tax havens. Practitioners who continue to develop tax-saving schemes which result in their clients taking fraudulent deductions may find themselves facing criminal prosecutions. The comments of Kurtz and Ferguson must not be dismissed as mere rhetoric, but should be taken rather as a call to arms by the Government against its foe, the creative tax practitioner, especially those attorneys who are engaged in an international tax practice.

*Robert M. Rosenberg**

119. In both *Margolis* and *Baskes* the Government offered testimony from former clients of the attorneys. *Margolis Tax-Fraud Trial Opens with Focus on Offshore Havens*, N.Y. Times, Mar. 21, 1977, § L, at 46, col. 2.

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