

2007

Tax Lawyers are People Too

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Recommended Citation

Claire Hill, *Tax Lawyers are People Too*, 26 VA. TAX REV. 1065 (2007), available at http://scholarship.law.umn.edu/faculty_articles/65.

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TAX LAWYERS ARE PEOPLE TOO

*Claire A. Hill**

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I. INTRODUCTION

Victor Fleischer understands that to increase compliance with tax law, we cannot simply look to a mix of legal penalties and enforcement. He understands, too, that the role of norms in the analysis is not simple: his account suggests that norms should not just echo and reinforce the legal regime. Indeed, he argues that the norms that most favor compliance might stifle desirable innovation. He points out that the firms most likely to have engaged in blatant noncompliance with law in the form of options backdating are “smaller firms, technology firms, and firms with volatile stock prices.”¹ These firms are likely to have looser corporate cultures that foster innovation — but perhaps also “breed noncompliance.”² Firms presumably will be largely comprised of people who find the culture

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¹ Victor Fleischer, *Options Backdating, Tax Shelters, and Corporate Culture*, 26 VA. TAX REV. 1031 (2007).

² *Id.* at 1051.

congenial. And the specific characteristics of those people matter.

Indeed, Fleischer considers as one possible solution to the problem of tax noncompliance getting “corporations [presumably those with looser corporate cultures] to hire, as tax directors, people whose sense of identity prevents them from purchasing tax shelters.”³ He suggests as well forcing “increased participation by outside counsel, who have different professional identities and reputational concerns.” He argues that law firm partners may be more reluctant to write opinions blessing tax shelters than may others.⁴ In his footnotes, he distinguishes, though, between tax lawyers and tax shelter lawyers. Tax shelter lawyers are not at all reluctant to write tax shelter opinions — in fact, they make a living creating and promoting such shelters as well as opining on them.⁵ Fleischer will need a way to ensure that the forced increased participation is by tax lawyers and not tax shelter lawyers.

Fleischer also discusses work by my co-author Erin O’Hara and me on trust.⁶ In our paper, we discuss evidence that strong monitoring against undesirable conduct may have conflicting effects. On the one hand, if a person knows she is being monitored, she may behave well, thinking she is apt to be caught if she does not. But there is also evidence that people who feel distrusted are apt to test limits; they may feel that since they are already paying some of the costs of being distrusted, they might as well get some of the benefits. The result may be “compliance” that honors a narrow literal interpretation of a rule but violates its spirit, using aggressive interpretations and “loopholes.” But if a tax lawyer’s identity is such as to make aggressive tax planning costly, even signals of distrust — say, in the form of heavy-handed regulatory intervention — ought not to cause the lawyer to engage in such planning.⁷

I think Fleischer is on to something. As I have argued in other work,⁸ I think, too, that identity more broadly needs to be part of law and economics analysis. I expand on those arguments as they concern tax lawyers’ views towards compliance with law below.

³ *Id.* at 1061.

⁴ *Id.*

⁵ *See id.* at 1055 n.80 and accompanying text.

⁶ Claire A. Hill & Erin O’Hara, *A Cognitive Theory of Trust*, 84 WASH. U. L. Q. (forthcoming 2007) (manuscript on file with authors).

⁷ This point follows from arguments I make in Claire A. Hill, *The Law and Economics of Identity*, 32 QUEEN’S L.J. (forthcoming 2007) (manuscript on file with author).

⁸ *Id.*

II. TAX LAWYERS, AGGRESSIVE TAX PLANNING, AND IDENTITY

Traditional law and economics scholarship hypothesizes crude instrumentalism writ large. To (only slightly?) caricature: people do things for the benefits those things bring; they can be deterred from doing those things by lessening those benefits or imposing associated costs. Canonically, the benefits at issue tend to be money and power (and leisure).

Law and economics scholars are belatedly recognizing that identity considerations significantly determine what people do, what they value, how they can be influenced, and how they see the world. I can think of many ways in which I could take advantage of others to get benefits I might value. For instance, when I am shopping in a small store, the shopkeeper may be in the back of the store — I could very easily take what I wanted. Instead, I not only do not do so, I wait, perhaps several minutes, for the shopkeeper to come and take my money. Why? In part, because taking something without paying is contrary to my identity as an honest person who generally abides by the golden rule. Indeed, we constantly make assessments such as “that is not the sort of thing person X (or I) would do” in deciding what to do, who to trust, and so on. Hence, potentially, an answer is provided to the puzzle of why people do not cheat, lie, steal, or take advantage of others more often.

What about tax lawyers? There is, it is fair to say, a continuum, from the “(Almost?) Over the Edge Envelope Pushing” tax lawyer to the “Old Venerable Risk-Hating” tax lawyer with, of course, most people falling somewhere along the continuum. Benefits to the “(Almost?) Over the Edge Envelope Pushing” lawyer might include living dangerously on the edge of detection, being more clever than her competitors in coming up with a brilliant shelter idea, being clever in avoiding detection, or the like. For the “Old Venerable Risk-Hating” lawyer, no such benefits would be available and the associated costs would loom large. Indeed, something that would be a cost to Venerable — say, appearing on the front page of the newspaper as somebody who had designed an aggressive shelter — might be a benefit to Envelope Pusher. That being said, it is not as though identities are rigid; they are constantly shaping and evolving. Many forces — government, one’s family and peers, advertisers, norm-entrepreneurs, serendipity, and others — are involved.

Can identity-shaping be done so as to make envelope pushing less glamorous, or to make less aggressive behavior more glamorous? Can the view, espoused by even some very wealthy people such as Warren

Buffett, that people effectively have a duty to pay tax, win out over a Leona Helmsley-esque “only the little people pay taxes” ethos? If so, how might this happen? Should it happen? Certainly, enforcement costs decrease drastically if people think abiding by the law is “the right thing to do.”

What follows for attempts to reign in aggressive tax planning and tax noncompliance more broadly? Regulatory interventions should be designed taking identity into account. And the limits of regulatory interventions, given, among other things, identity considerations, should be recognized. Indeed, so long as the appropriate benefits and costs, including identity benefits and costs, are taken into account, instrumentalism may be a perfectly plausible analytic handle.

But in all this, we need to recall Fleischer’s caveat as to cultures, which applies as well to individuals: we do not necessarily want to eliminate all envelope-pushing. Envelope pushing may somehow be related to innovation, including much desirable innovation. Second, in the particular context of tax, even independent of the benefits of encouraging innovation, there may be upsides to some instances of pushing the envelope — the law may not get it exactly, or even approximately, right; pushing the envelope can help the society clarify what the law should be.⁹

III. CONCLUSION

I mean by this Commentary to do two things. First, I mean to echo what I take to be Professor Fleischer’s core point, that we cannot properly address tax noncompliance, including aggressive tax planning purely through straightforward legal means — that we have to take culture into account. Second, I mean to unpack corporate culture a bit, starting from the ground up. A firm’s corporate culture begins with the individuals through which the firm operates. We need to understand what, beyond classic instrumental motivations, influences individuals’ compliance with the law.

⁹ There may be other ancillary costs of making it too easy to raise revenue; consideration of this argument is beyond the scope of this Commentary.