Economic Substance Doctrine Felonies

By Jasper L. Cummings, Jr.

In a little-noticed development, flunking the economic substance doctrine (now codified in section 7701(o)) has become a felony. It’s one thing for courts below the Supreme Court to make up a positive rule of law (as occurred with the economic substance doctrine). It’s an entirely different thing for those courts to sentence lawyers to jail for advising clients in 2000 and 2001 that the law as written provided them a deduction for transactions that actually occurred in law and fact but will not be accorded the tax result desired by the taxpayer because of a construction of the code to deny that result, see Goldstein v. Commissioner, 364 F.2d 734 (2d Cir. 1966).

The subject of this article is not “sham transactions” that did not occur (such as the loan Mr. Knetsch claimed to pay interest on when no funds were borrowed). Nor is it a code section into which Congress has been unable to define when it applies and what exactly it is. Treasury and the IRS refuse to give any indication of when they will assert it, and tax professionals have spent untold hours in continuing legal education programs in which the best-informed experts search for clarity. However, the Justice Department and federal courts, particularly the Second Circuit, are sure that they know economic substance when they see it, and are directing juries to convict lawyers of criminal tax evasion if the lawyer knew the transaction had no business purpose or profit potential.

The courts should have asked the jurors whether the transactions occurred rather than telling them that the transactions were presumed not to occur for tax purposes if they had no business purpose or profit potential.

What Were They Thinking?

On October 30, 2000, Tax Notes published a letter to the Senate Finance Committee from a Brown & Wood partner disagreeing with a proposal to “impose penalties on a lawyer who advises his or her client that the client would more likely than not prevail and such advice is ‘unreasonable.’” That lawyer recently filed a petition for certiorari in the Supreme Court seeking review of his conviction for tax evasion. He had been indicted along with eight KPMG LLP employees (later expanded to 18) for an alleged conspiracy to defraud the government through tax evasion planning for clients, and for tax evasion. In December 2008 he was convicted of tax evasion along with two KPMG employees. By January 6, 2009, Tax Notes was calling the story “old news.”

A quick review of Tax Notes articles suggests that no one, at least no bar group, came to the defense of the only law firm attorney convicted — the lawyer

1See Knetsch v. United States, 364 U.S. 361 (1961). For a discussion of the distinction between the sham transaction and the transaction that occurred in fact but will not be accorded the tax result desired by the taxpayer because of a construction of the code to deny that result, see Goldstein v. Commissioner, 364 F.2d 734 (2d Cir. 1966).

who had sought fairness for legally justifiable opinions in his 2000 letter to the Senate: R.J. Ruble. What were we thinking?

The Transactions

One of the transactions on which Ruble advised was called BLIPS (bond-linked issue premium structures). The Senate Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations report describes his involvement with BLIPS in a way that sounds like a lawyer trying to find a taxpayer-favorable result for a client based on legal analysis:

A memorandum dated December 3, 1998, from R.J. Ruble to KPMG demonstrates the detailed technical nature of the assistance contributed by Mr. Ruble to the development of BLIPS. Mr. Ruble writes:

In looking at the bond premium rules in another context (i.e. a legitimate deal), I found an issue that we need to address for BLIPS. As I read it, the treatment of bond premium received by an issuer is governed by Treas. Reg. 161-12(c) and Treas. Reg. 1.163-13. The latter treats the premium as an offset to the issuer’s interest deduction. The former provides that it not included [sic] in income when received and by reference to the latter—When the investor transfers the assets subject to the loan to the partnership, I have always assumed that the partnership’s acquisition of the property is governed solely by section 721 etc. Is this true? Could 1.61-12 over ride. Even if it did could we also say that the drop down of [the] amount equal to the premium would create an offsetting deduction. Am I worrying too much?

Another transaction involved taxpayers’ use of the IRS’s victory in Helmer v. Commissioner, T.C. Memo. 1975-160. As to this transaction, complaints filed by several clients in suits against tax advisers stated, for example:

The Ernst & Young Defendants, acting pursuant to an arrangement with Jenkens & Gilchrist, Brown & Wood, Daugerdas, and Ruble, further advised the Individual Plaintiffs that the precise amount of capital loss to be generated by the COBRA transaction could be chosen beforehand, and advised them not to choose a loss so large that it would offset the capital gains entirely.

Helmer was relied on for the transaction engaged in by taxpayer Carlos Sala, who paid Ruble $75,000 for a tax opinion supporting the favorable reporting of the transaction. The IRS denied Sala’s deductions. Sala paid the assessment, sued for refund, and won after a bench trial in 2006. The Tenth Circuit reversed. Sala docketed a petition for writ of certiorari in the Supreme Court on February 22, 2011.

Meanwhile, on account of the Ruble opinions to Sala and other taxpayers who had similar transactions or who had engaged in other “tax shelters,” the U.S. attorney’s office indicted Ruble and two others for tax evasion, and a jury convicted them. On April 15, 2009, Ruble’s conviction and sentence were entered, and he was sentenced to jail (bail was granted pending appeal). The Second Circuit affirmed the convictions in an amended summary order dated October 26, 2010. Ruble has petitioned

\[3\] Ruble was suspended from law practice in New York solely on account of the criminal tax evasion conviction. Matter of Ruble, 883 N.Y.S.2d 36 (2009).

\[9\] See Senate report, supra note 3.

the Supreme Court to issue a writ of certiorari, which was docketed February 25. The grounds of
the petition are (1) the objective lack of clarity of the substantive tax law said to have been the subject of
the evasion; (2) whether an attorney providing a legal opinion rather than preparing a return could be
guilty of evasion; and (3) lack of proof that Ruble knew the transactions lacked economic substance
(whatever that means).

Second Circuit’s Reasoning in Ruble

The Second Circuit’s amended summary order stated as to defendant Ruble:

• the trial judge correctly instructed the jury that a transaction lacks nontax economic effect when there is no reasonable possibility of profit (citing Goldstein);16
• the evidence supported the lack of nontax economic effect;
• sufficient evidence supported the jury’s finding that the transaction was solely tax motivated;
• vagueness of the law does not necessarily negate a jury finding of willfulness; “‘Knowability,’ except perhaps as probative of a defendant’s subjective belief in the lawfulness of his conduct, is only relevant insofar as it bears on constitutional vagueness”17; “economic substance law is not unconstitutionally vague: It has been applied in criminal cases before, and (as discussed) is not unsettled in the way Appellants contend,” which is that its imposition of a legal duty is an open question;
• the evidence was sufficient to find that Ruble either knew or consciously avoided knowing that the clients could not make a profit; and
• no case has held that an attorney’s opinion cannot be a ground of a tax evasion charge.18

The Second Circuit’s opinion is terse. The dispatch with which it was written is reflected in the opening statement: “We assume the parties’ familiarity with the underlying facts and the case’s procedural history.” One gets the impression that the Second Circuit thought Ruble was a bad guy, or at least a bad lawyer, and that was all it needed to know. The opinion’s brevity makes it necessary to resort to the trial court opinion on Ruble’s motion for acquittal.

Trial Court Jury Charge

The trial judge’s denial of Ruble’s motion for acquittal stated:

In order to convict on the tax evasion counts, the government was obliged to prove that (1) the relevant taxpayer owed substantially more federal income tax than he declared due on the income tax return for the year in question, (2) the defendant committed one or more affirmative acts of evasion described in the Indictment, and (3) the defendant did so knowingly and willfully.

In this case, the government claimed that any tax deductions attributable to BLIPS were improper — and, in consequence, that the taxpayers who took the deductions owed substantially more tax than they reported — because the BLIPS deals lacked economic substance. This was so, it said, because, among other things, (1) the taxpayers’ sole motive in doing the deals was to obtain the tax benefits, and/or (2) there was no reasonable possibility of profit (defined as investment return in excess of transaction costs) on the so-called investment component of BLIPS, the forward currency contracts.

In order to establish that the BLIPS transactions lacked economic substance for criminal tax purposes, the Court held, the government had to prove, among other things:

“‘That the relevant taxpayer had no business purpose for engaging in the transaction apart from creating the tax deduction[,] and]

“‘That there was no reasonable possibility that the transaction would result in a profit.’”

The jury was charged further, in accordance with United States v. Cheek, in relevant part as follows with respect to willfulness:

“The government must prove also that a defendant acted willfully in evading or attempting to evade taxes.

“A willful act for this purpose is defined . . . as a voluntary and intentional violation of a known legal duty. Thus, the government must prove beyond a reasonable doubt not only that the defendant you are considering knew that the relevant taxpayer owed substantially more tax than was declared on the taxpayer’s return for given year, but also that the defendant possessed the specific intent to defeat or evade the payment of those taxes.
"A defendant does not evade taxes willfully if he is merely careless. He must intend to evade taxes.

"You may find that a defendant acted willfully in this respect only if the government has persuaded you beyond a reasonable doubt that the defendant, first of all, knew that the relevant taxpayer was motivated by no business purpose apart from the creation of a tax deduction. Secondly, knew that the strategy in question had no reasonable possibility of making a profit, in excess of the costs incurred without regard to tax benefits. And, thirdly, knew that the tax due and owing absent the deduction attributable to the strategy in question, would have been substantially greater than the tax reported on the taxpayer’s tax return."

Thus, in order to convict Ruble of tax evasion, the government was obliged to prove, in addition to other elements not material to this motion, that (1) the taxpayer on a given count had no nontax motive for doing the transaction, (2) the transaction had no reasonable possibility of producing a profit, and (3) Mr. Ruble knew each of these things.19

The trial court held that the jury could have reasonably convicted under this charge because there was evidence sufficient to find that Ruble knew the clients were engaging in the transactions solely to save taxes and that they would not make any profit because they would likely exit the investments too early to profit economically, although they might profit if they stayed invested longer.

In effect and substance, the charge to the jury said that if the jury believed beyond a reasonable doubt that the transactions flunked the civil tax economic substance doctrine test (not that the transactions represented to him that they did. One told Ruble that the transactions did not have a profit potential, and the parties involved with the transactions represented to him that they did.

If Ruble had been convicted for issuing tax opinions in knowing disregard of the facts, or even in willful violation of Circular 230 standards about assumption and fact verification, that conviction might be factually sustainable (assuming those acts are crimes). If Ruble had been charged with a common law crime that the facts supported, that would be understandable. But that is not the course taken by the trial court or the Second Circuit.

Because they also had to accept that Ruble’s disregard of facts assisted evasion of taxes that ultimately were due, the courts had to deal with the primary ground asserted by the IRS for the deficiency adjustments: the economic substance doctrine. Therefore, the case was not about whether Ruble knew beyond a reasonable doubt that he was issuing opinions based on false assumptions; it was about whether Ruble knew beyond a reasonable doubt that under the economic substance doctrine the taxpayers would lose, based on having no substantial business purpose or profit potential.

There is nothing unusual about that subtle shift from the beyond a reasonable doubt standard for criminal liability to the more likely than not civil standard. If a tax lawyer advises a client on the technical grounds for the claimed tax deductions (that is, Helmer or the bond premium deduction rules), the lawyer has committed the felony of tax evasion. The "knowledge" that damned Ruble purportedly was knowledge that the clients were seeking tax deductions and not economic profits. Ruble has denied that knowledge.20

Analysis of the Second Circuit’s Reasoning

The Second Circuit agreed with the trial court’s view that if a lawyer has reason to know that a client’s transaction will fail the economic substance doctrine and he nevertheless advises the client on the technical grounds for the claimed tax deductions (that is, Helmer or the bond premium deduction rules), the lawyer has committed the felony of tax evasion. The "knowledge" that damned Ruble purportedly was knowledge that the clients were seeking tax deductions and not economic profits. Ruble has denied that knowledge.20

In his petition for certiorari, he said that (1) he supplied only second opinions to KPMG, which KPMG supplied to its clients; (2) all the opinions were predicated on the stated condition that a reasonable pretax profit be expected; (3) the opinions stated they could not be relied on if the condition were untrue; and (4) no one told Ruble that the transactions did not have a profit potential, and the parties involved with the transactions represented to him that they did.

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There is nothing unusual about that subtle shift from the beyond a reasonable doubt standard for criminal liability to the more likely than not civil standard. If a tax lawyer advises a client to deduct his personal living expenses, the lawyer can be guilty of tax evasion even though the IRS need prove only that more likely than not the deduction will be disallowed. But of course the difference is that everyone knows that living expenses are not deductible (well, almost everyone — see discussion of United States v. Cheek below), so a beyond a


20See Petition for writ of certiorari, Ruble, supra note 4.
reasonable doubt standard could be applied to the civil tax liability, and the taxpayer still would lose.

Ruble hinges on — or at least Ruble asserts it should hinge on — the fact that everyone does not know (or at least did not know in 2000) that taxpayers always lose economic substance doctrine cases if they can’t prove a sufficiently large profit motive. Indeed, Sala did not lose in the trial court in 2006. However, the trial court and the Second Circuit in Ruble’s case knew that. As a result of the courts’ self-certainty about the law, they chose the third of the three possible approaches to the Ruble jury charge:

- guilty if the jury finds beyond a reasonable doubt that Ruble believed, on a subjective basis, that the taxpayers to whom his opinions were directed would more likely than not lose their deductions if audited;
- guilty if the jury finds beyond a reasonable doubt that Ruble believed, on a subjective basis, that the taxpayers to whom his opinions were directed would more likely than not lose their deductions if audited, and his belief was not rational [Note to readers: This is the alternative I believe is correct.]; and
- guilty if the jury finds beyond a reasonable doubt that Ruble knew facts that cause tax benefits to be denied under the economic substance doctrine, which is presumed to apply to the transactions on which he opined, whether that presumption is reasonable, widely held, or even rationally subject to rejection in these cases.

Because the court chose the third alternative, it walked right into forcing on the jury a binding presumption of the sort that Justice Byron R. White said was improper in Cheek. The Ruble courts made the jury presume that the economic substance doctrine was a positive rule of law that could override normal legal analysis in 2000 and 2001 if lack of profit motive for the transaction were proven, whether Ruble thought so or not. Thus, advising that a tax benefit could be had, when you knew there was no profit motive, was a felony, even if you told the client there must be a profit motive. In contrast, Ruble argues in effect that a lawyer should not be held to a higher standard than the tax protester in Cheek.

On the face of it, Ruble appears to have the worse of that argument. As an attorney, he should be held to a higher standard and should not be allowed to defend on the basis of a personal belief that a reasonable lawyer should not hold. But the court did not give the jury the chance to find that a reasonable lawyer could give the advice Ruble gave. Rather, the court burdened the jury with the irrebuttable presumption that the economic sub-

stance doctrine would trump Ruble’s judgment if he knew the taxpayers had no profit potential.

Cheek

Generally, ignorance of the law is no defense to a criminal prosecution, but due to the complexity of the tax laws and the possibility of bona fide misunderstandings of what the tax law requires, some criminal tax laws include the word “willfully” to make specific intent to violate the law an element of the crime. In Cheek, a so-called tax protester case in which the taxpayer thought wages were not income, the Supreme Court interpreted the word “willfully” to require an intentional violation of a known legal duty, which could be negated by a belief that no duty existed, no matter how irrational, as long as the belief was not based on a claim that the statute was unconstitutional. The Court differentiated belief in unconstitutionality on the grounds that Congress intended other ways of contesting constitutionality besides not paying the tax; however, that differentiation does not explain how it makes the defendant’s act any the more willful.

The real basis of the Court’s holding was the jury instruction that a good-faith objection to paying taxes on wages was inherently unreasonable and impossible to hold, rather than the jury instruction that an objection had to be reasonable. The trial court had effectively taken from the jury the question whether the belief could be reasonably held, and the court of appeals went as far as to list seven beliefs about the tax system that were unreasonable as a matter of law. The Supreme Court’s opinion worried about the application of irrebuttable presumptions in criminal cases. Presumably, the
Court concluded that if the word “willful” is to mean anything, it has to refer to subjective intent.

_Cheek_ turned on the assumption that if the belief were required to be unreasonable to convict, that “transforms the inquiry into a legal one and would prevent the jury from considering it.” But that is not a necessary result. If willfulness were defined as unreasonable disregard of law, what a reasonable person would conclude based on all the facts about the state of the law would be a question of fact that could be submitted to the jury. Thus, the jury charge in _Cheek_ was half right: The belief had to be unreasonable to convict. But the charge was half wrong in taking the issue from the jury.

The path to _Cheek_ did not forecast its conclusion:

- **United States v. Murdock**: This opinion is treated as the beginning of the line of cases. The Court reversed the conviction for criminally withholding information from the IRS because the trial judge in effect had told the jury the defendant could not reasonably hold the view that he did about the law (that the Fifth Amendment privilege against self-incrimination extended to state crimes), and so the defendant must have acted willfully. The Court found that instruction to be error, not because it had inserted a reasonableness requirement into the law (the Supreme Court said the taxpayer’s belief must be “bona fide” and held “in good faith”), but because the defendant’s view of the law was not unreasonable at that time. That was because the law was in fact unsettled (it was settled only in the same defendant’s first appeal to the Supreme Court), which is exactly the reason for the willfulness requirement in tax crime cases. The Court said: “The trial court could not, therefore, properly tell the jury the defendant’s assertion of the privilege was so unreasonable and ill founded as to exhibit bad faith and establish willful wrongdoing. This was the effect of the instructions given. We think the Circuit Court of Appeals correctly upheld the respondent’s right to have the question of absence of evil motive submitted to the jury, and we are of opinion that the requested instruction was apt for the purpose.” But to repeat: The Court said that in the context of a belief that the taxpayer could reasonably hold as a matter of law because the law was unsettled.

- **United States v. Bishop**: Affirmed a conviction of tax fraud in which the trial judge had charged the jury to convict if it found “the defendant intended with evil motive or bad purpose either to disobey or to disregard the law.”

- **United States v. Pomponio**: Affirmed a conviction of tax fraud in which the trial judge instructed the jury that motive did not matter. The court of appeals initially reversed and said the jury should have been told that the defendants had to act in bad faith, which they may not have since they may have legitimately thought that disputed distributions were loans. The Supreme Court wanted to extract any reference to bad motive from the jury charge and leave the issue as whether the defendant intentionally violated a known duty. The Supreme Court agreed with the trial court’s charge that “good motive alone is never a defense.”

_Cheek_ somehow read the per curiam opinion in _Pomponio_ to preclude not consideration of subjective state of mind of the defendant (which the disputed references to motive would seem to have addressed), but consideration of the objective reasonableness of the belief. It is unclear how that reading occurred.

In sum, the cases leading up to _Cheek_ did not support its rejection of a standard of reasonableness of belief, as asserted by Justice Harry A. Blackmun in his dissent in _Cheek_.

That being so, it is incomprehensible to me how, in this day, more than 70 years after the institution of our present federal income tax system with the passage of the Income Tax Act of 1913, 38 Stat. 166, any taxpayer of competent mentality can assert as his defense to charges of statutory willfulness the proposition that the wage he receives for his labor is not income, irrespective of a cult that says otherwise and advises the gullible to resist income tax collections. One might note in passing that this particular taxpayer, after all, was a licensed pilot for one of our major

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27498 U.S. at 203.
28United States v. Murdock, 290 U.S. 389 (1933) (at the time the defendant refused to answer revenue agents on grounds of self-incrimination, the Supreme Court had not yet determined that incrimination under state law did not count).
29290 U.S. at 396.
32329 U.S. 10 (1976). But see Bryan, 524 U.S. at 195, n.17 (1998), which describes the jury instruction approved in _Pomponio_ as not typical of the high _mens rea_ bar set in tax cases.
33_Pomponio_, 429 U.S. at 11. See also _Cheek_, 498 U.S. at 200-201.

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commercial airlines; he presumably was a person of at least minimum intellectual competence.

The District Court’s instruction that an objectively reasonable and good-faith misunderstanding of the law negates willfulness lends further, rather than less, protection to this defendant, for it adds an additional hurdle for the prosecution to overcome. Petitioner should be grateful for this further protection, rather than be opposed to it.

This Court’s opinion today, I fear, will encourage taxpayers to cling to frivolous views of the law in the hope of convincing a jury of their sincerity. If that ensues, I suspect we have gone beyond the limits of common sense.34

So the Ruble courts did what the Supreme Court said could not be done in Cheek: Take the issue of the criminal tax evasion defendant’s state of mind away from the jury by presuming that belief about specific things (the economic substance doctrine) could not be reasonable. The Ruble courts might have justified the distinction on the different level of knowledge of a lawyer, but they did not attempt to do so. Even if they had, it does not appear the courts were in any mood to brook any objection to the economic substance doctrine.

Vagueness

Ruble’s petition for certiorari also argues that the law was too uncertain to support a criminal conviction. A criminal indictment violates the due process clause of the Fifth Amendment and the Sixth Amendment’s guarantee of the right to be informed of the nature and cause of the accusation when the statute on which the criminal charge is based is so vague that it fails to warn the defendant of the public interest when unjust and unreasonable in the estimation of the court and jury. And that this is not a mere abstraction, finds abundant demonstration in the cases now before us, since in the briefs in these cases the conflicting results which have arisen from the painstaking attempts of enlightened judges in seeking to carry out the statute in cases brought before them are vividly portrayed. . . . And again, this condition would be additionally obvious if we stopped to recur to the persistent efforts which, the records disclose, were made by administrative officers, doubtless inspired by a zealous effort to discharge their duty, to establish a standard of their own to be used as a basis to render the section possible of execution.35

The Supreme Court addressed the issue most recently in deciding the appeal of former Enron executive Jeffrey Skilling:


The Court in Skilling stressed its obligation to avoid a void-for-vagueness finding if possible by construing the statute.37 It did so by construing a 1988 amendment of the mail fraud statute to include “a scheme or artifice to deprive another of the intangible right of honest services”38 to refer only to bribery, based on the inferred intent of Congress to

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35United States v. L. Cohen Grocery Co., 255 U.S. 81, 89-91 (1921). See also United States v. Brewer, 139 U.S. 278 (1891) (statute was not sufficient enough to support the criminal charge).


37Id.
reverse a 1987 Supreme Court opinion limiting the crime to property crimes.\textsuperscript{38}

In contrast to a case with an impossibly vague statute is a case involving a clear statute but disputed facts. It is not unconstitutional, for example, to leave to the jury the determination whether a payment from a corporation to shareholders is a dividend or a commission and to allow the jury to find criminal tax evasion if the taxpayer willfully mischaracterized the payments.\textsuperscript{39} The Court has upheld prosecutions under what might seem to be vague statutes, in reliance on the statutes’ additional requirement of willfulness or bad faith.\textsuperscript{40} This appears to mean that if the defendant thought he was violating the statute, that was enough to give it constitutional definiteness in his case. But this cannot mean that a subjective belief that one is breaking the law results in a felony, when the belief is unreasonable. The correct meaning of this line of authority is illustrated by the opinion to which it is traced: A brief opinion by Justice Louis Brandeis holding that a rancher could be convicted of allowing sheep to graze where cattle had previously grazed.\textsuperscript{41} The sole explanation in the opinion was: “Men familiar with range conditions and desirous of observing the law will have little difficulty in determining what is prohibited by it.” Justice Brandeis was not announcing a subjective interpretation of the statute but rather found that it was not ambiguous as an objective fact. Whether cattle had grazed the land was generally knowable and known.

The next in the line of cases is the same: A criminal statute using the word “kosher” is no vaguer than the commercial law requirement of fair dealing that would apply in contract disputes whether the goods supplied as kosher were in fact kosher.\textsuperscript{42} Similarly, the Court upheld the prosecution of a trucking company for knowingly failing to follow the shortest route. Liability requires both proof of the fact of a shorter route and proof that the defendant knew it and failed to follow it.\textsuperscript{43} However, the \textit{mens rea} concept took the odd turn seemingly toward subjective self-indictment in the prewar case of \textit{Gorin v. United States}.\textsuperscript{44} The Court affirmed the conviction of a Russian spy who had both obtained information related to national defense (which might be a vague concept) and also intended to use it to the advantage of a foreign nation. The Court thought the term “national defense” was sufficiently well understood, but it implied that whether the definition of information related to national defense is by itself too vague, the requirement of intent to use it against the United States is an independent and objective grounds for prosecution. Similarly, while conspiring to interfere with interstate travel might be vague (for example, does it include robbing a person who happens to be traveling interstate?), if a defendant is proven to have intended to interfere with interstate travel as such, the statute is not vague as to that defendant.\textsuperscript{45}

The government’s ability to rehabilitate a vague statute through use of a willfulness requirement carries with it the added burden of proving willfulness. The government encountered this burden in \textit{Screws v. United States}.\textsuperscript{46} Justice William O. Douglas reversed the conviction of a Georgia sheriff who had killed a black man in the course of arresting him for stealing a tire. The conviction had occurred in federal court for willfully depriving the victim of his civil right to be tried and not summarily executed. However, the trial judge had simply instructed that the sheriff should be found guilty if he applied more force than was necessary to make the arrest, rather than if he intended to deprive the victim of his civil rights. In other words, the willfulness requirement could save the civil rights act from vagueness, but willfulness must be proven to convict.

The suspect nature of the emphasis on willfulness to save a vague statute was pointed out by the dissenting opinion in \textit{Screws}:

> It is as novel as it is an inadmissible principle that a criminal statute of indefinite scope can be rendered definite by requiring that a person “willfully” commit what Congress has not defined but which, if Congress had defined, could constitutionally be outlawed.\textsuperscript{47}

Nevertheless, the approach has been justified under the theory that it is better to have some light than to curse the darkness, or that the existence of some gray does not destroy the black and white.\textsuperscript{48}

\textsuperscript{38}Id. (referring to McNally v. United States, 483 U.S. 350 (1987)).
\textsuperscript{39}United States v. Ragen, 314 U.S. 513 (1942).
\textsuperscript{40}See Screws v. United States, 325 U.S. 91, 102 (1945). See also Skilling, 130 S. Ct. at 2933 (citing Screws for the statutory mens rea requirement, which ensures constitutionality).
\textsuperscript{41}Omaechevarrua v. Idaho, 246 U.S. 343 (1918).
\textsuperscript{42}Hygrade Provision Co. v. Sherman, 266 U.S. 497 (1925).
\textsuperscript{43}Boyce Motor Lines Inc. v. United States, 342 U.S. 337 (1952).
\textsuperscript{44}312 U.S. 19 (1941).
\textsuperscript{45}Id. (referring to McNally v. United States, 483 U.S. 350 (1987)).
\textsuperscript{48}325 U.S. at 153.
Vagueness and the Economic Substance Doctrine

Was it criminal tax evasion to advise taxpayers in 2000 and 2001 how they might apply to their benefit the strange result of the IRS victory in Helmer and to advise them of the strange workings of the bond premium rules while at the same time warning them that they should have a profit motive and that your opinion could not be relied on if they did not? According to the Ruble decisions, it was. The Second Circuit believes the economic substance doctrine was then settled law not only in civil cases, but also in criminal trials; after all, it had been applied before in criminal trials.

That it is not so settled, even for civil tax purposes, is reflected in comments made by the American Bar Association Section of Taxation to the IRS and Treasury on the need for guidance under section 7701(o):

Notice 2010-62 refers to prior “authorities” in considering when the economic substance doctrine will apply, although it does not cite to any such authorities; and we have not been able to identify any authorities that frame or consider the threshold question in terms of a relevance inquiry, at least as the term “authorities” is defined in Regulation section 1.6662-4(d)(3)(iii). Rather, the economic substance doctrine has historically been applied (and thus been deemed “relevant”) only when the Service asserts it as an affirmative defense to the normative tax treatment of a transaction and the courts (and taxpayers) respond by analyzing it. Thus, the Service has historically acted as the gatekeeper in determining when the doctrine is relevant, although it has never published guidance on the analysis that it applies.

Under the historical framework, the precise contours of when the economic substance doctrine would apply were subject to considerable debate — which debate continues today in the context of cases involving pre-enactment periods. Ambiguity surrounding the relevance inquiry created tension that, on balance, served the Service’s interest of keeping aggressive tax planning in check. . . .

On a more conceptual level, we believe guidance on the threshold question is also needed because, as a default rule, the tax law must be form driven and the rules must be written in terms of forms that may be objectively observed by both taxpayers and revenue agents. An open-ended rule permitting a broad override of the substantive rules in the Code would lead to greater uncertainty in implementation and administration of the tax law. We understand that court opinions and Service pronouncements commonly state that “substance controls form,” but we understand those statements either to refer (in recent years) to the economic substance doctrine, which admittedly has its limits of relevance, or more traditionally to the ability of courts to find facts based on all of the facts and circumstances (i.e., the substance of the event).

Moreover, because Congress legislates with the understanding that the law will be applied based on the forms of transactions that its words describe, as informed by the common law ability of courts to find facts, it is inevitable that taxpayers are able to properly claim tax benefits by complying with the statute’s words in a way that a revenue agent might think was not intended by Congress. Enforcing the law on the basis of such opinions of intent can lead to inequitable application of the tax laws.49

Conclusion

Indicted lawyers make other lawyers uncomfortable. We try to ignore them, and if we think about them at all, some of us may even think: “There but for the grace of God go I.” Alternately, other lawyers may distance themselves from the indicted by assuming them to be very bad actors indeed. After all, Ruble charged a lot of money for identical advice to a transaction that it was criminal tax evasion to advise taxpayers in 2000 and 2001. That is, if you knew your client would be flunk the economic substance doctrine two-prong test in 2000 and 2001.

Perhaps Ruble was a very bad actor, but whether he was is irrelevant to this article and to Ruble’s appeal. What is relevant is that the Second Circuit gives all appearances of approving the felony conviction of a lawyer who “knew” his client would flunk the economic substance doctrine two-prong test in 2000 and 2001. That is, if you knew your client entered into a transaction solely to save taxes, you go to jail, even though a tax protester who sincerely thought wages were not gross income need not go to jail.

If this is the law, so be it, as long as we all know it. If it is not the law, let us hope that the Supreme Court will issue its writ to the Second Circuit and use this case to announce not only that Ruble could not be convicted of this crime, but also that it has never created any economic substance doctrine.50


50See Jasper L. Cummings, Jr., The Supreme Court’s Federal Tax Jurisprudence, ch. V.F. (ABA Section of Taxation, 2010). Portions of this article are from a forthcoming book, The Supreme Court’s Federal Constitutional Tax Jurisprudence.