

POINT & COUNTERPOINT: ETHICAL ISSUES IN CROSS-BORDER TAXATION

INTRODUCTION: In the globalized economy and business environment of today, tax practitioners are regularly called upon to assist in planning transactions that cross national borders. And more and more frequently, therefore, U.S. tax practitioners must be familiar with foreign law. But what happens when a client proposes to take an action that might violate some rule of foreign law? Does the U.S. practitioner have an ethical obligation to investigate, or to offer advice concerning that rule? Should the U.S. lawyer be sanctioned for failing to prevent a fraudulent violation of the foreign law? And what practical guidance can we give to clients in this situation?

The contributors to this edition's Point-Counterpoint offer some initial thoughts on a U.S. practitioner's obligations, if any, to respect or follow foreign law. First, Joan Arnold of Pepper Hamilton LLP in Philadelphia, PA, suggests that attorneys have an ethical obligation to not engage in the fraudulent avoidance of foreign law and can be sanctioned in the U.S. for so doing. David Rosenbloom of Caplin & Drysdale, Chartered in Washington, DC, replies that foreign law is beyond the scope of a U.S. lawyer's practice and that U.S. ethical principles may at any rate conflict with the rules of foreign law.

This is a potentially enormous topic, and our contributors make no pretense that they have exhaustively considered every issue. The *NewsQuarterly's* editors hope, however, that the essays below will stimulate further analysis of this issue, whether near the water cooler, in the lunchroom, or by written replies. — Chris Rizek

POINT: ETHICAL OBLIGATIONS EXTEND TO FOREIGN LAW

by Joan C. Arnold,
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The question to be addressed sounds so simple: What are the ethical constraints placed on a U.S. tax lawyer involved in a cross-border practice? More specifically, may a U.S. tax lawyer be sanctioned for activities that do not impact the U.S. fisc, but that are improper under the tax laws of another jurisdiction? For tax lawyers involved in multi-jurisdictional practices, this issue arises all the time, and their answers are all across the board. Often the bottom line is that the lawyers involved simply do not want to take on the reputational risk of being engaged in transactions that may be questionable under foreign law. But, that is by no means the approach of all lawyers, and it's time to address it directly, under our rules of conduct.

The debate focuses on U.S. tax lawyers involved in transactions that implicate another country's tax laws, as well as U.S. federal and (when we are being complete) U.S. state and

local tax laws. But there's an error in the question. The question presumes that there are "U.S." lawyers. From an ethical perspective I think there is no such thing as a "U.S." lawyer. There are Pennsylvania lawyers, District of Columbia lawyers, New York lawyers, etc., but there is no such thing as a "U.S." lawyer. We are admitted to the bar and regulated by a particular state or the District of Columbia. Compare that to a lawyer admitted to the bar in France, or England. She is truly a French *avocat*, or a British barrister.

What's the impact of this not-so-startling revelation on the question raised? It puts the review of the ethical rules in context. Some lawyers will take the position that because we are admitted state by a state, a lawyer's ethical allegiance is to the substantive laws of that state. That is, some will say that if the activity doesn't offend a law in the state of admission, it is not the basis for sanction by that jurisdiction. Perhaps that has some appeal when you are considering non-U.S. activities, but after reflection, I don't see how it can be the right answer.

Would anyone claim that a Pennsylvania lawyer could not be sanctioned in Pennsylvania for assisting a client to commit fraudulent behavior

in New York? Rule 1.2 of the Model Rules of Professional Conduct (2003) provides in part that a lawyer shall not assist a client in conduct the lawyer knows is fraudulent. It does not go on to say "in the state of admission," and the commentary specifically notes that the obligation applies whether or not the defrauded party is a party to the transaction. So, for instance, a tax lawyer must not participate in a transaction to effectuate fraudulent avoidance of tax liability. That rule is not limited to "tax liability in the state of admission." The case law and the actions of the various state disciplinary boards make it very clear that a Pennsylvania lawyer may be sanctioned in Pennsylvania for activities that occur in another state.

Moving the analysis up a notch, assume a lawyer subject to the Model Rules assists a client in the fraudulent avoidance of U.S. federal tax. As that would not be a violation of the laws of the state of admission, would that state be able to sanction the lawyer? As noted above, the commentary to the Model Rules clearly indicates that such sanctions are appropriate. The cases and rulings under the states I've reviewed would all take the same position, and impose sanctions.

What then is the difference if the lawyer's activities assist in the fraudulent avoidance of a foreign country's tax? If the state of admission can sanction for inappropriate activities with respect to another state's taxes, or with respect to federal taxes, is there a difference when it comes to non-U.S. taxes? I cannot construct a rational basis for drawing such a distinction, and I think the lawyer's state of admission has the right to impose sanctions for such behavior.

This position is informed by the outcome of a case in which a lawyer was disbarred for activities that involved foreign law. In *The Matter of Application for the Discipline of Thomas K. Scallen*, 260 N.W. 2d 834 (Minn. 1978). In *Scallen*, Mr. Scallen was a licensed Minnesota lawyer who was appealing his disbarment, which was imposed on the following facts. Mr. Scallen oversaw the production of a prospectus through which his company was going to issue debt in Canada. The prospectus was governed by Canadian securities rules. A court in Canada found Mr. Scallen guilty of knowingly making a false statement in the prospectus.

Although it modified the discipline imposed, from disbarment to indefinite suspension, the Minnesota court upheld the right of the state to impose sanctions. It specifically noted that its disciplinary rule 1-102, which prohibits a lawyer from engaging in conduct involving dishonesty, fraud, deceit or misrepresentation, is not restricted by political or geographic boundaries. Rather, the disciplinary rules regulate the conduct of a Minnesota lawyer anywhere in the world.

Mr. Scallen also argued that because the commission of a foreign crime is not expressly mentioned in the disciplinary rules, he should not be disciplined under the general ethical duties established by disciplinary rule 1-102. The court summarily dispensed with this argument, noting that they were entirely unimpressed with it. Instead, the court pointed out that the ethical rules govern the activities of all lawyers who have chosen to avail

themselves of a Minnesota license, and express an expectation that the lawyer will comport himself or herself in accordance with the principles and aspirations set forth in the rules. It is not necessary to list all of the things one may not do, said the court; it is enough that the action at issue involved conduct that was prohibited under the general rules.

The court's finding in *Scallen* is consistent with the analysis I follow in reaching my conclusion: There is no rational basis for saying that a state may impose sanctions for actions in another state, or for violations that involve federal law, but not allow sanctions to be brought for violations that involve non-U.S. tax law. The clarity (at least to me) of my conclusion notwithstanding, I think it is just the tip of the iceberg. From here the question is, under what circumstances *should* the jurisdiction of admission exercise its right to sanction? Three questions immediately arise:

- What is a lawyer's duty to investigate whether the client's plan would result in a violation of non-U.S. tax law?
- What if the activity would not constitute fraudulent activity under U.S. tax rules, but might still be a technical violation of foreign law? A good example would involve foreign exchange violations, which are not U.S. issues since we have no foreign exchange rules.
- What if under the disciplinary rules applicable to lawyers in the non-U.S. jurisdiction, there is no prohibition against assisting a client in tax avoidance?

A thorough analysis of each one of those questions can easily fill volumes, and I'm about out of space, but I offer the following thoughts to prompt readers' consideration of these questions:

A lawyer must provide competent representation, which requires the legal knowledge reasonably necessary for the representation. But a lawyer is allowed to limit the scope of representation if the limitation is reasonable

and the client gives informed consent. At least under the Model Rules, a lawyer must know or reasonably should know that a client expects assistance in a fraudulent action before the lawyer can be sanctioned. So, if the client agrees that non-U.S. tax advice is beyond the scope of the U.S. tax lawyer's responsibility, may the lawyer proceed, with the proverbial blinders on? What does "reasonably should know" mean? What if the lawyer is sufficiently experienced to know there is a problem, but is advised by the client that it's not within the scope of the representation?

In the disciplinary proceeding in *Scallen*, the judge at the trial level noted that the facts leading to the conviction in Canada for filing a false prospectus would support a similar result under Minnesota law. Does this mean that if the facts and legal conclusions had been different, the lawyer could not be sanctioned? That seems contrary to the goals of the Model Rules, at least in this type of circumstance, and would dramatically complicate my conclusion.

The third question—What if a lawyer in a non-U.S. jurisdiction would *not* be subject to disciplinary sanctions in that jurisdiction, should the lawyer's U.S. state of admission sanction?—raises the full panoply of similar issues that are being considered as we move to multijurisdictional practice in the United States. Consider the 2003 version of Model Rule 8.5. In choosing which ethical rules to apply, other than in litigation, should the rules of the jurisdiction in which the attorney's conduct occurred govern, or should it be the rules of the jurisdiction in which the predominant effect of the conduct is realized that apply? Under this provision, if the predominant effect of the conduct is in country X, and country X would not impose sanctions on its lawyers for assisting in the work, then the lawyer's state of admission would also not be allowed to impose sanctions. According to the commentary, this choice of law provision applies to lawyers in transnational practices unless

international law, trustees, or other agreements between competent regulatory authorities in the affected jurisdiction provide otherwise.

Finally, I would add that my comments are restricted to the ethical sanction that may be imposed by a lawyer's jurisdiction of admission. All tax lawyers are also subject to discipline under Circular 230, which contains Treasury's standards for practice. I do not find anything in Circular 230 that addresses whether the Service may sanction a practitioner for activities that assist in the fraudulent avoidance of non-U.S. tax. I find that a bit curious, as U.S. tax rules have never shied away from addressing U.S. taxpayer behavior in non-U.S. jurisdictions (what immediately comes to mind is the foreign tax credit disallowance related to violations of the Foreign Corrupt Practices Act, and on a more subtle note the branch rule in foreign base company sales income in Subpart F). In my informal (i.e., non-attributed and non-binding) conversations with personnel in the Service's Office of Practice, I confirmed that the focus in Circular 230 is practice before the Service and before U.S. courts; Circular 230 is not intended to provide sanctions for non-U.S. activities.

COUNTERPOINT: U.S. ETHICAL STANDARDS SHOULD NOT DEPEND ON FOREIGN LAW

by *H. David Rosenbloom,*
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The growing cross-border nature of legal practice has confronted the practitioner with difficult problems that only a short time ago would have been seen as rare and exotic. It is not at all rare these days to be called upon to deal with issues arising under, and directly pertaining to, foreign law. What (the practitioner may be asked to say or advise) are the applicable standards when the question is whether to observe or not observe, perhaps even actively attempt to circumvent,

a foreign legal mandate? An important subset of that question would be whether the answer is subject to any ethical constraints.

It is easy to confuse the question with others: whether the course of action facing client and practitioner raises pragmatic issues, such as potential harm of one sort or another in the foreign jurisdiction, or outside the foreign jurisdiction but stemming from the foreign legal mandate; whether that course presents moral questions subsumed in, but independent of, the foreign law; whether U.S. law is somehow implicated, for reasons of reciprocity or otherwise, by the foreign law. These are important questions in many situations, and the attorney facing an issue of foreign law would be best advised to keep them in mind. But they are different from the question that concerns us here: whether there are ethical requirements placed upon an attorney licensed to practice in the United States by the mere fact of a foreign law mandate.

The inquiry could, of course, be further refined. The law may have a criminal aspect or it may only sound in civil jurisdiction; the foreign country may be a close ally of the United States, or it may be a foe; it may have a legal or political system resembling our own, or it may not; the foreign law may or may not have an analogue in U.S. jurisprudence; the case may involve mere disregard of a foreign requirement or active planning to violate the requirement; the role of the attorney may range from affirmative advice to simply paying no heed; there may be special local practices of which the attorney is or is not aware. The common question here is whether a member of a bar in the United States, because he or she is a member of the bar, has an ethical obligation to obey a foreign law, because it is a law.

I am inclined to favor the negative side of that question. An attorney may have many and varied reasons for paying close attention to foreign law, but there is no solid basis for ethical considerations to rank among those reasons.

Persons licensed to practice law in the United States are rightly held accountable for adhering to U.S. laws simply because they are U.S. laws. We are members of a profession integral to the U.S. legal system and legitimately required to observe a variety of rules and requirements for the practice of that profession. It is entirely proper to include among those rules and requirements a respect for, or at least the absence of an active disrespect for, the laws that form the core of the legal system. Moreover, although regulation of the bar generally occurs at the level of the several states, the intertwining of state and federal laws and the overarching importance of a single Constitution and a single nation fairly call for an attorney's compliance, on ethical grounds, with all U.S. laws, state and federal, regardless of the geographical or subject-matter orientation of a particular legal assignment or practice.

It is quite a different matter, however, when the laws of a foreign jurisdiction are at issue. That jurisdiction, by definition, has nothing to do with the license to practice law in the United States, and I cannot see any reason why fitness to practice in this country should be influenced by foreign laws simply because they are laws. Globalization has not reached that level—yet. A contrary conclusion could place the attorney in the difficult position of advising or acting against the client's interests in circumstances that have not passed the filter of the U.S. democratic process.

It would be easy to justify the position I espouse on the ground that, as we all know, there are some foreign laws that would be wholly unacceptable to every U.S. lawmaking body. Singapore, for instance, harshly punishes what appear to U.S. eyes to be, at most, petty offenses. Transfer pricing issues in Italy can easily give rise to criminal charges. It is criminal in India to harm a cow, even inadvertently. And there are numerous other situations where foreign laws are either inexplicable to our sensibilities

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or outright repugnant. It would probably be possible to deal with repugnant laws—the passbook laws of apartheid-era South Africa or whatever passed for laws in Taliban-period Afghanistan—or laws that otherwise do not measure up to U.S. standards, by holding the U.S. member of the bar to observance of foreign legal requirements while allowing exception for requirements that shock the conscience, violate accepted U.S. moral precepts, or some other such asterisk.

That approach does not satisfy me, however. The problem lies in the underlying suggestion (regardless of any exceptions to it) that foreign laws, because they are laws, are per se entitled to deference on ethical grounds. It will not do just to exempt the foreign law that the attorney finds immoral, for two reasons. First, that hypothetical ethical standard would carry a presumption favoring the observance of foreign law, subject to exceptions and excuses in particular cases. Such a standard would place bar members in the position of justifying exceptions on the basis of case-by-case moral judgments that are bound to be subjective, individual, and in some instances idiosyncratic. Second, and more fundamentally, the suggestion that foreign laws are presumptively entitled to deference fails to take account of what laws are—expressions of a community’s accepted code of conduct. The fact that the expressions bear the label “law” does not, I think, necessarily endow them with any greater status for an attorney in

the United States than local custom, practice, or belief, especially since the process by which the expressions entered into “law” was, in no sense, ours. It is not necessary to invoke abhorrent regimes or extreme situations to conjure up examples where differences in community standards and cultural circumstances should be sufficient to deprive foreign laws of a claim to ethical deference in the United States.

The issue arises in the workaday world of planning business transactions for tax efficiency. As noted, Italy sees criminal conduct in certain transfer pricing issues, and many countries have a variety of strict laws on their books relating to foreign currency transactions. Shari’a law in the Moslem world prohibits the earning of interest on money lent, yet some fairly obvious circumventions of that prohibition are in common use and broadly tolerated. Is a member of the bar supposed to take the law at face value and, as a matter of ethics, accept it? If the attorney does so, the client may fail to receive the assistance that is its due. Better, by far, I think, for the attorney (on pragmatic grounds) to steer the client to local expertise that can interpret the foreign requirement, what it means in practice, and what its realistic contours are. Needless to add, there are many foreign laws, just as there are many U.S. laws, that are honored in nonobvious ways or even in the breach.

This is not, of course, to say that an attorney should disregard require-

ments of foreign law. A client may need to understand, and heed, foreign legal requirements at the peril of civil or even criminal jeopardy in foreign courts. And there are going to be circumstances in which foreign laws mesh precisely with moral imperatives: committing fraud in France is still committing fraud, and there should not be any problem with finding ethical fault in the case of an attorney who abets such conduct, regardless of whether there is an anti-fraud rule in French jurisprudence. The governing standard here is something that should be familiar and acceptable to all bar members, not because they are bar members but because they are human beings. The fact that the standard is embodied in foreign law is quite irrelevant.

With the wonders of the internet and the ability to communicate readily with persons in other countries who, increasingly, speak English, the modern world has tended to confirm a seemingly instinctive American belief that everyone else really is (or wants to be), at bottom, just like us. Not so. Differences still run deep among countries and peoples, and those differences find expression in the laws they adopt. It is difficult enough trying to define, refine, and ensure compliance with our own laws; finding ethical requirements in laws enacted by others is an exercise in ethnocentrism that we would be well advised to avoid. ■