

Introduction to Tax Practice and Ethics

Learning Objectives

Chapter Outline

Elements of Tax Practice

Tax Compliance
Tax Planning
Tax Litigation
Tax Research

Rules and Ethics in Tax Practice

Circular 230 (Complete Text in Appendix C)
Who May Practice [Circular 230 §10.3]
Limited Practice without Enrollment [Circular 230 §10.7]
Tax Return Preparers [Circular 230 §10.7]
Practice Before the IRS [Circular 230 Subpart B]
Due Diligence [Circular 230 §10.22]
Contingent and Unconscionable Fees [Circular 230 §10.27]
Solicitation and Advertising [Circular 230 §10.30]
Best Practices [Circular 230 §10.33]
Tax Return Positions [Circular 230 §10.34]
Covered Opinions [Circular 230 §10.35]
Other Written Advice [Circular 230 §10.37]

AICPA Code of Professional Conduct

Rule 101: Independence
Rule 102: Integrity and Objectivity
Rule 201: General Standards
Rule 202: Compliance with Standards
Rule 203: Accounting Principles
Rule 301: Confidential Client Information
Rule 302: Contingent Fees
Rule 501: Acts Discreditable
Rule 502: Advertising and Other Forms of Solicitation
Rule 503: Commissions and Referral Fees
Rule 505: Form of Organization and Name

Statements on Standards for Tax Services

SSTS No. 1: Tax Return Positions
SSTS No. 2: Answers to Questions on Returns
SSTS No. 3: Certain Procedural Aspects of Preparing Returns
SSTS No. 4: Use of Estimates
SSTS No. 5: Departure from a Position Previously Concluded in an Administrative Proceeding or Court Decision
SSTS No. 6: Knowledge of Error: Return Preparation
SSTS No. 7: Knowledge of Error: Administrative Proceedings
SSTS No. 8: Form and Content of Advice to Taxpayers

Sarbanes-Oxley and Taxation

- Describe the elements of modern tax practice in the United States.
- Distinguish between open and closed transactions.
- Identify sources of legal and ethical standards that guide those who engage in tax practice.
- Examine in detail the major collections of ethical standards that bear upon tax practitioners today.
- Place tax issues in a broader context of ethics and morality.
- Understand the limitations on tax research by CPAs and other nonattorneys.

Chapter Outline (continued)

ABA Model Code of Professional Responsibility

Nonregulatory Ethical Behavior Models

Ethical Dilemmas

Ethical Reasoning

End-Based Ethical Reasoning

Rule-Based Ethical Reasoning

Care-Based Ethical Reasoning

Ethical Professional Behavior

Morality

Social Responsibility

Business Ethics

Tax Planning Ethics

Other Ethical Standards

Ethics Training and Education

Tax Research by Certified Public Accountants

Historical Developments

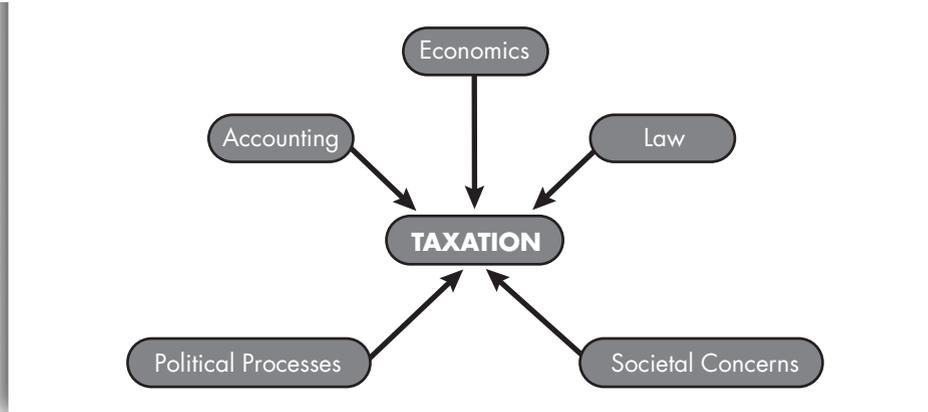
CPAs and Other Nonattorneys

AT THE START OF the twenty-first century, tax practice and **tax research** are continuing to evolve into an electronic and paperless reporting system. For example, 2007 is the first year that over 50 percent of individual taxpayers e-filed their tax returns. In keeping with this transition to an all-electronic tax system, tax research is almost 100 percent computer based. The Uniform CPA Exam recognizes this transition and includes a set of “simulation” questions that require that the candidate demonstrate accounting and tax research skills by completing short computer research cases online. However, before the tax practitioner can complete a tax research project, he or she must understand the tax research process and all its elements, and how each element relates to solving a specific tax problem. The primary purpose of this book is to inform the user on how effectively to obtain tax research results in a timely and efficient manner.

The practice of taxation is the process of applying the tax law, rules, regulations, and judicial rulings to specific transactions to determine the tax consequences to the taxpayer involved. There are many ways to practice tax. One can practice tax directly through jobs such as a CPA, tax attorney, **Enrolled Agent (EA)**, or commercial income tax return preparer. In addition, tax can be practiced indirectly by such individuals as controllers, accountants, CFOs, and others who do tax work as part of their other duties. An understanding of taxation and the tax practice environment is essential to the individual who wants to have a position in the tax area.

Taxation is the process of collecting revenue from citizens to finance government activities. In a modern technological society such as that of the United States, however, taxation comprises an interaction among several disciplines that is far from simple. The tax system is derived from law, accounting, economics, political science, and sociology (Exhibit 1-1). Principles of economics, sociology, and political science provide the environment, while law and accounting precepts are applied in a typical tax practice.

Tax policy questions concerning the effects that a specified tax law change will have on economic growth, the effects of projected inflation on the implementation of the tax law and vice versa, and the effects of the tax law on the United States’ balance of payments are addressed by economists. Political scientists, economists, and sociologists, alternatively, examine issues such as who bears the ultimate burden of a tax, how a tax bill becomes law (including practical effects of the legislative process), the social equity of a tax, and whether a tax is discriminatory. Attorneys interpret (and often create) taxation statutes, and accountants apply the tax laws to current or prospective economic transactions.

Exhibit 1-1: Elements of Taxation

ELEMENTS OF TAX PRACTICE

The tax laws of a democratic country such as the United States are created by a political process. In recent years, the result of this political process has been a law that levies taxes on income, sales, estates, gifts, and other items that usually are reflected by the accounting process. Thus, tax practice can be described as the application of tax legislation to specific accounting situations. The elements of modern tax practice can be separated into three categories: compliance, planning, and litigation, which are all supported by tax research. How these elements of tax practice fit together is illustrated in Exhibit 1-2.

Tax Compliance

In general, **tax compliance** consists of the gathering of pertinent information, evaluation and classification of such information, and the filing of necessary tax returns. Tax compliance also includes other functions necessary to satisfy government requirements, such as representation at a client's Internal Revenue Service (IRS) audit. Commercial tax preparers, EAs, attorneys, and CPAs all perform tax compliance to some extent. Noncomplex individual, partnership, and corporate tax returns often are completed by commercial tax preparers. EAs, attorneys, and CPAs usually are involved in the preparation of more complex tax returns; in addition, they provide tax-planning services and represent their clients before the IRS. The elements of tax compliance and administration are examined in more detail in later chapters.

Tax Planning

Tax planning is the process of arranging one's financial affairs to optimize (i.e., usually to minimize current tax payments, but not always) tax liabilities. However, whereas **tax avoidance** is the legitimate object of much of modern tax practice, **tax evasion** constitutes the illegal nonpayment of a tax and cannot be condoned. Fraudulent acts of this sort are unrelated to the professional practice of tax planning.

Tax planning can be divided into two major categories: **open transactions** and **closed transactions**. In an open transaction, the tax practitioner maintains some degree of control over the attendant tax liability because the transaction is not yet completed; for example, the title to an asset has not yet passed. If desired, some modifications to an incomplete transaction can be made to receive more favorable

Exhibit 1-2: Elements of Tax Practice

tax treatment. In a closed transaction, however, all of the pertinent actions have been completed; therefore, tax planning may be limited to the presentation of the facts to the government in the most favorable, legally acceptable manner possible.



SPOTLIGHT ON TAXATION

Case Quotation

There is nothing inherently illegal or immoral in the avoidance of taxation (i.e., Tax Planning) according to the tax system's rules. The eminent judge Learned Hand best expressed this doctrine in the dissenting opinion of *Commissioner v. Newman*, 159 F.2d 848 (CA-2, 1947):

Over and over again, courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced extractions, not voluntary contributions.

Tax Litigation

A specialized area within the practice of law is the concentration on **tax litigation**. Litigation is the process of settling a dispute with another party (here, usually the IRS) in a court of law (here, a federal court). Typically, a tax attorney handles tax litigation that progresses beyond the initial appeal of an IRS audit result. Accountants and other financial advisers can also serve in a support capacity. Later chapters of this book contain additional discussions of the various opportunities and strategies available in tax litigation.

Tax Research

Tax research is undertaken to answer taxation questions. The tax research process includes the (1) identification of pertinent issues, (2) determination of proper authorities, (3) evaluation of the appropriateness of these authorities, and (4) application of these authorities to specific facts. Tax research techniques are examined in Chapters 2 through 10 of this text.

RULES AND ETHICS IN TAX PRACTICE

A person who prepares tax returns for monetary or other compensation, or who is licensed to practice in the tax-related professions, is subject to various statutes, rules, and codes of professional conduct. All tax practitioners are regulated by **Circular 230**, Regulations Governing the Practice of Attorneys, CPAs, EAs, Enrolled Actuaries, and Appraisers before the IRS. The ethical conduct of an attorney is also governed by the laws of the state(s) in which he or she is licensed to practice. Most states have adopted, often with some modification, guidelines that are based on the **American Bar Association (ABA) Model Code of Professional Responsibility** or the newer **ABA Model Rules of Professional Conduct**.

CPAs who are members of the **American Institute of Certified Public Accountants (AICPA)** must follow its Code of Professional Conduct and any other rules generated by the state board(s) of accountancy. The AICPA has also produced a series of Statements on Standards for Tax Services (SSTS), which contain advisory guidelines for CPAs who prepare tax returns.

Although CPAs who are not members of the AICPA are not bound by the Code of Professional Conduct and the SSTS, those rules and standards are a useful source of guidance for all members of the profession. Statutory tax law also specifies certain penalties and other rules of conduct that apply to everyone (e.g., attorneys, CPAs, and EAs) in addition to their respective professional standards, and also to commercial tax preparers who are not attorneys, CPAs, or EAs. Chapter 13 addresses these rules. The basic overlapping sources of rules and ethics for tax practitioners are illustrated in Exhibit 1-3.

Circular 230 (Complete Text in Appendix C)

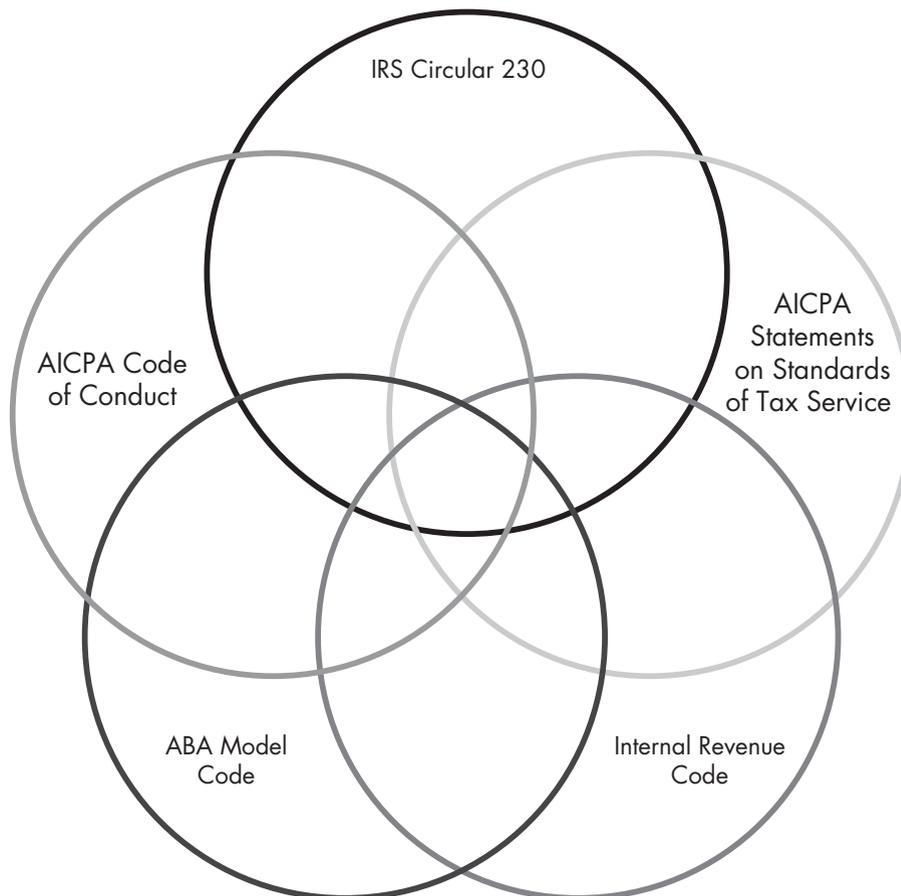
Circular 230, which constitutes Part 31 of the Treasury Department Regulations, is designed to provide protection to taxpayers and the IRS by requiring tax preparers to be technically competent and to adhere to **ethical standards**. *Circular 230* contains the following definition of **practice before the IRS** in Section 10.2 of Subpart A.

...matters connected with presentation to the Internal Revenue Service or any of its officers or employees relating to a client's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include the preparation and filing of necessary documents, correspondence with and communications to the Internal Revenue Service, and the representation of a client at conferences, hearings and meetings.

Under this definition, practice before the IRS consists primarily of the representation of clients during audit procedures, such as a meeting with a revenue agent on behalf of a client to establish the correctness of a taxpayer's return. The preparation of tax returns or the furnishing of information to the IRS in response to a request for such information is not considered practice before the IRS. (Tax return preparation rules are addressed by various statutes discussed in Chapter 13.) *Circular 230* also states who may conduct such a practice and sets forth the disciplinary procedures that apply. In addition, CPAs, lawyers, and tax return preparers are (or may be) regulated by the states. As a result, there can be additional statutes, regulations, and requirements that must be met by individuals who practice in certain states.

Who May Practice [Circular 230 §10.3] Under Section 10.3, Subpart A, of *Circular 230*, the following individuals may practice before the IRS.

1. Attorneys
2. CPAs

Exhibit 1-3: Sources of Rules and Ethics for Tax Practitioners

3. Enrolled agents
4. Enrolled actuaries

To qualify under this rule, an attorney must be a member in good standing of the bar of the highest court in any state, possession, territory, commonwealth, or the District of Columbia. Likewise, CPAs and Enrolled actuaries must be qualified to practice in any state, possession, territory, commonwealth, or the District of Columbia. No further substantive examination is required.

Enrolled Agents (EAs) [Circular 230 §§10.4, 10.5, and 10.6] Individuals who are not attorneys or CPAs can qualify to practice before the IRS by becoming an EA. An EA is someone who has either passed a special IRS examination (currently given once a year, in October) or worked for the IRS for five years. The procedures for becoming an EA are detailed in *Circular 230*, Subpart A, §§10.4, 10.5, and 10.6. EAs have the same rights as attorneys and CPAs to represent clients before the IRS. Under *Circular 230*, an EA must renew his or her enrollment card on a three-year cycle.

For each enrollment cycle, EAs, like attorneys and CPAs, must meet certain continuing education requirements as defined in Subpart A, §10.6. For an EA's

enrollment card to be renewed, he or she must complete seventy-two hours (i.e., an average of twenty-four hours per year) of qualifying continuing education for each three-year enrollment period. In addition, a minimum of sixteen hours of continuing education credit must be completed during each year of an enrollment cycle. Subpart A, §10.6(f) defines what qualifies as continuing education for EAs.

Circular 230 allows an individual to be an attorney or CPA and an EA simultaneously. Being both an EA and an attorney or CPA might be useful to certain tax practitioners who practice across state lines. For example, a CPA in Texas who is also an EA can practice in any state. The EA's card is effectively a national license to practice before the IRS anywhere in the United States (including territories). In addition, most state taxing agencies grant an EA the right to practice before that state agency.

For more information on EAs, see the following two web sites. The first site is EA information on the IRS's web page and the second is the web site of the National Association of Enrolled Agents (NAEA).

<http://www.irs.gov/taxpros/agents/>

<http://www.naea.org/>

Limited Practice without Enrollment [Circular 230 §10.7] In *Circular 230*, the IRS has authorized certain individuals to practice without being an attorney, CPA, or EA. Individuals (with proper identification) can represent themselves under §10.7(a) and participate in IRS rule making as provided for under §10.7(b). In addition, under §10.7(c), individuals (with proper identification and authorization, IRS Form 2848) are allowed to represent taxpayers in the following special situations.

1. An individual may represent a member of his or her immediate family.
2. A regular full-time employee of an individual employer may represent the employer.
3. A general partner or regular full-time employee of a partnership may represent the partnership.
4. A bona fide officer or regular full-time employee of a corporation (including a parent, subsidiary, or other affiliated corporation), an association, or organized group may represent the corporation, association, or organized group.
5. A trustee, receiver, guardian, personal representative, administrator, executor, or regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate.
6. An officer or regular employee of a governmental unit, agency, or authority may represent the governmental unit, agency, or authority in the course of his or her official duties.
7. An individual may represent any individual or entity before personnel of the IRS who are outside the United States.

Tax Return Preparers [Circular 230 §10.7] Any person who signs a tax return as having prepared it for a taxpayer is authorized to conduct "limited practice" before the IRS (with proper taxpayer authorization) under §10.7(c)(viii). *Circular 230* requires that such person must not be disbarred or suspended from practice before the IRS or his or her profession. A tax return preparer can make an appearance as the taxpayer's representative only before the Examination Division of the IRS. A tax return preparer may not represent a taxpayer before any other IRS division,

including the Appeals and Collection Divisions [IRS Publication 947]. In addition, the following actions are outside the authority of an unenrolled preparer [*Rev. Proc.* 81-38, 1981-1 C.B. 386].

1. Executing a claim for refund for the taxpayer
2. Receiving checks in payment of any refund of taxes, penalties, or interest for the taxpayer
3. Agreeing to later assessment or collection of taxes than is provided for by the applicable statute of limitations
4. Executing closing agreements with respect to tax liability or other specific matters for the taxpayer
5. Executing waivers of restriction on assessment or collection of a tax deficiency

Practice Before the IRS [Circular 230 Subpart B] Subpart B of *Circular 230* provides a set of rules of conduct for those individuals authorized to practice before the IRS. Attorneys, CPAs, and EAs must observe the following rules of conduct (among others) when practicing before the IRS.

1. A tax practitioner must furnish information, on request, to any authorized agent of the IRS, unless the practitioner has reason to believe that the request is of doubtful legality or the information is privileged [§10.20(a)].
2. A tax practitioner must provide the Director of Practice of the IRS, on request, any information concerning the violation of any regulation pertaining to practice before the IRS. The tax practitioner must testify in a disbarment or suspension proceeding, unless there is reason to doubt the legality of the request or the information is privileged [§10.20(b)].
3. A tax practitioner who knows of client noncompliance, error, or omission with regard to the tax laws must advise the client of that noncompliance, error, or omission [§10.21].
4. Practitioners must not unreasonably delay matters before the IRS [§10.23].
5. Practitioners must not accept assistance from or employ a disbarred or suspended person or a former IRS employee disqualified from practice under another rule or U.S. law [§10.24].
6. Partners of government employees cannot represent anyone for which the government employee-partner has (or has had) official responsibility [§10.25]. For example, a CPA firm with an IRS agent as a partner cannot represent any taxpayer that is (or was in the past) assigned to the IRS agent/partner.
7. No former government employee shall, subsequent to his or her government employment, represent anyone in any matter administered by the IRS if such representation would violate other U.S. laws [§10.25].
8. No tax practitioner may act as a notary public for his or her clients [§10.26].
9. Fees for tax work must not be contingent or unconscionable [§10.27], and a practitioner must not negotiate a taxpayer's refund check [§10.31].
10. No tax practitioner can represent conflicting interests before the IRS unless he or she has the express consent of the directly interested parties [§10.29].
11. In general, a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with his

or her Federal tax obligations. The practitioner may retain copies of the records returned to a client [§10.28].

Due Diligence [Circular 230 §10.22] Section 10.22 of *Circular 230* requires tax practitioners to use due diligence in preparing tax returns and in their practice before the IRS. Due diligence is not defined in *Circular 230*. However, the Second Circuit in *Harary v. Blumenthal*, 555 F.2d 1113 (CA-2, 1977) has held that due diligence requires that the tax practitioner be honest with his or her client in connection with all IRS-related matters. In the view of the IRS, the failure to exercise due diligence involves conduct that is more than a simple error, but less than willful and reckless misconduct (*Coursebook Training 994-102*, IRS, December 1992). In determining if a practitioner has exercised due diligence, the IRS uses several factors, including the nature of the error, the explanation of the error, and other standards that apply (e.g., the AICPA SSTS that are discussed later in this chapter). In essence, due diligence means a tax practitioner should use reasonable effort to comply with the tax laws.

Example 1-1 Judy is a CPA who fails to include rental income on a tax return she completed for a client. The omitted rental income was from a new rental property purchased by the client this year and therefore had not been reported on prior years' tax returns. The taxpayer did not mention the new rental property to Judy in any communications with her. Under these circumstances, Judy has exercised due diligence in preparing the tax return. However, if Judy also kept the rental income records for the new rental property and still omitted the income from the tax return, she would not be exercising due diligence.

Contingent and Unconscionable Fees [Circular 230 §10.27] Tax practitioners are prohibited from charging **contingent fees** on an original tax return by §10.27(b) of *Circular 230*. Examples of contingent fees include a fee that is based on a percentage of the refund on a tax return or a fee that is a percentage of tax "saved." Although contingent fees are prohibited for the preparation of an original return, a practitioner may charge a contingent fee for an amended return or a claim for refund (other than a claim for refund made on an original return). The tax practitioner must reasonably anticipate, at the time of the fee arrangement, that the amended return will receive a substantive review by the IRS.

Example 1-2 Oak Corporation has been audited by the IRS for its tax return filed two years ago. The controller of the company completed the original return. The IRS is asserting that Oak underpaid its taxes by \$100,000. Oak contacted Joe, a CPA, and engaged him to handle the appeals process with the IRS. In this situation, Joe can use a contingent fee arrangement. (For instance, Joe's fee could be 30 percent of any amount by which he could get the IRS to reduce the assessment.)

Section 10.27(a) also prohibits a tax practitioner from charging an unconscionable fee. This term is not defined in *Circular 230*. If a tax practitioner charges a fee that is out of line with some measure of the value of the service provided to a client, then the fee would be unconscionable. For example, a CPA could not charge a fee of \$10,000 to an unsophisticated taxpayer (such as an elderly person) for simple tax work that most CPAs would complete for less than \$500.

Solicitation and Advertising [Circular 230 §10.30] An attorney, CPA, or EA may use public communication to obtain clients under §10.30 of Subpart B. Types of public communication allowed by this provision include billboards, telephone

books, and advertisements in newspapers, on radio, and on television. However, such public communications must not contain false, fraudulent, unduly influencing, coercive, or unfair statements or claims. If done in a dignified manner, examples of items that a practitioner may communicate to the public include (1) his or her name, address, and telephone number, (2) names of individuals associated with the practitioner, (3) a factual description of services offered, (4) credit cards accepted, (5) foreign language ability, (6) membership in professional organizations, (7) professional licenses held, and (8) a statement of practice limitations. Attorneys, CPAs, and EAs also must observe any applicable standards of ethical conduct adopted by the ABA, the AICPA, and the NAEA.

Best Practices [Circular 230 §10.33] Section 10.33 of *Circular 230* states that tax advisors should provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice. According to *Circular 230*, the best practices rules are aspirational. Thus, a practitioner who fails to comply with best practices will not be subject to discipline by the IRS. Still, tax professionals are expected to observe them to preserve public confidence in the tax system.

Best practices to be observed by all tax advisors include:

1. Communicating clearly with the client regarding the terms of the engagement. For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.
2. Establishing the facts, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at a conclusion supported by the law and the facts.
3. Advising the client regarding the importance of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the *Internal Revenue Code* if a taxpayer acts in reliance on the advice.
4. Acting fairly and with integrity in practice before the IRS.

According to *Circular 230*, these procedures are to help to ensure best practices for tax advisors. In addition, tax practitioners with responsibility for overseeing a firm's practice of providing tax advice or of preparing tax returns should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees follow "best practices procedures."

Tax Return Positions [Circular 230 §10.34] Tax practitioners under *Circular 230* must meet certain standards with respect to advice given to clients on tax return positions. Under §10.34, a practitioner must not sign a tax return if he or she determines that the return contains a position that does not have a **more-likely-than-not** chance of being sustained on its merits if challenged by the IRS.¹ The more-likely-than-not standard is met if analysis of the tax return position by a reasonable and well-informed person knowledgeable in the tax law(s) would lead such person to conclude that the position has a greater than 50 percent likelihood of being sustained on its merits [§10.34(a)(4)].

¹In May 2007, Congress amended the Code and changed the "realistic possibility" (33%) threshold of Section 6694 to a "more-likely-than-not" (over 50%) standard. We assume that related documents such as *Circular 230* and SSTS No. 1 will adopt this standard after the publication date of this text. The "realistic possibility" standard still applies to all tax returns filed before the enactment date of this change.

A practitioner may recommend a position on a tax return that does not meet the more-likely-than-not standard if the position is not frivolous and the position is disclosed on the tax return. A frivolous position is one that is patently improper under the tax law. When analyzing the merits of a tax return position, the authorities applicable under IRC §6662 and Reg. §1.6662 should be used to decide if the more-likely-than-not standard has been met. See Chapter 14 for further discussion of pertinent restrictions on tax return positions.

Covered Opinions [Circular 230 §10.35] *Circular 230* imposes strict standards on “covered opinions.” This term includes written advice (including electronic communications such as e-mail) concerning one or more federal tax issue(s) arising from:

1. A transaction that is the same as or substantially similar to a transaction that, at the time the advice is rendered, the IRS has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction under 26 CFR 1.6011-4(b)(2);
2. Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, the principal purpose of which is the avoidance or evasion of any tax imposed by the *Internal Revenue Code*; or
3. Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of any tax imposed by the *Internal Revenue Code*, if the written advice:
 - a. *Is a reliance opinion.* A reliance opinion is written advice that concludes at a confidence level of a greater than 50 percent likelihood that one or more significant Federal tax issues would be resolved in the taxpayer’s favor;
 - b. *Is a marketed opinion.* A marketed opinion is written advice that the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner’s firm) in promoting, marketing, or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayers;
 - c. *Is subject to conditions of confidentiality;* or
 - d. *Is subject to contractual protection.*

In addition, §10.36 requires a practitioner who has principal authority and responsibility for overseeing a firm’s practice of providing advice concerning Federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect to ensure compliance with §10.35. Any such practitioner can be subject to discipline for failing to comply with the requirements of §10.36.



SPOTLIGHT ON TAXATION

E-mail Disclaimer

As a result of *Circular 230* covered opinions rules, most CPAs and other tax advisors include some form of blanket disclaimer in the tag line of all their e-mail sent to clients. An example of such a disclaimer would be:

continued

continued

I am required by IRS Circular 230 to inform you that, unless otherwise expressly indicated, any Federal tax advice contained in this communication, including attachments and enclosures, is not intended or written to be used, and may not be used, for the purpose of (1) avoiding tax-related penalties under the Internal Revenue Code or (2) promoting, marketing, or recommending to another party any tax-related matters addressed herein.

Other Written Advice [Circular 230 §10.37] A practitioner must not give written advice (including electronic communications) concerning one or more Federal tax issues if the practitioner:

1. bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events),
2. unreasonably relies upon representations, statements, findings, or agreements of the taxpayer or any other person,
3. does not consider all relevant facts that the practitioner knows or should know, or
4. in evaluating a Federal tax issue, takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.

When applying the provision, all facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client, will be considered in determining whether a practitioner has failed to comply with this section.

Circular 230 can be found on the IRS's web site at <http://www.irs.gov/pub/irs-pdf/pcir230.pdf>

AICPA Code of Professional Conduct

Members of the AICPA are subject to the Institute's Code of Professional Conduct. The Code is relevant to all of the professional services performed by CPAs, including those services provided in the practice of public accounting, private industry, government, or education. It was previously referred to as the AICPA Code of Ethics. Changes adopted in 1988 were believed necessary to reflect the significant changes in the profession and the environment in which CPAs practice, although the basic tenets of ethical and professional conduct remained the same. One of the most significant changes was the expansion of the rules to apply to all members in all fields of practice, except where the wording of the rule limits the application to a specified field of practice. Under the prior Code of Ethics, only members engaged in the practice of public accounting were required to observe all of the rules. Other members, such as those in the fields of education, government, and industry, were subject only to the rules requiring integrity and objectivity and the rule prohibiting members from performing acts discreditable to the profession.

In addition, the rule prohibiting a CPA in public practice from engaging in a business or an occupation concurrently with the practice of public accounting, which would create a conflict of interest in rendering professional services, was deleted from the Code of Professional Conduct. The members of the Institute felt

that such conflicts of interest are effectively prohibited under new Rule 102, Integrity and Objectivity.

The Code of Professional Conduct was designed to provide its members with the following.

1. A comprehensive code of ethical and professional conduct
2. A guide for all members in answering complex questions
3. Assurance to the public concerning the obligations and responsibilities of the accounting profession.

The AICPA Code of Professional Conduct consists of two integral sections: the principles and the rules. The principles provide a foundation on which the rules are based. The principles suggest that a CPA should strive for behavior above the minimal level of acceptable conduct required by law and regulations. In addition to expressing the basic tenets of ethical and professional conduct, the principles are intended to provide a framework for the CPA's responsibilities to the public, clients, and colleagues. Included are guidelines concerning the member's responsibility to perform professional services with integrity, objectivity, and **independence**.

The rules consist of a set of enforceable ethical standards that have been approved by a majority of the members of the AICPA. These rules are broad in nature and apply to all of the professional services that a CPA performs, whether in the practice of public accounting or in the fields of education, industry, or government. The only exceptions to the rules occur when their wording indicates that their application is limited to a specified field of practice only, or with respect to certain activities of those who are practicing in another country. In the latter case, however, the CPA must adhere to the ethical standards of the foreign country.

Any failure to follow the rules under the Code of Professional Conduct may result in the offender receiving admonishment, suspension, or expulsion from membership in the AICPA. The rules apply not only to the CPA, but also to those employees who are under his or her supervision, partners or shareholders in the practice of the CPA, and any others who act on the CPA's behalf (even if they are not compensated for their activities). As previously discussed, the Code of Professional Conduct is applicable to all of the professional services performed by a CPA, including services rendered in the fields of public accounting, such as tax and management advisory services, education, industry, and government.

In addition to the principles and rules, the Code of Professional Conduct provides for three additional promulgations. These are interpretations of rules, ethics rulings, and "ethics features." Interpretations of Rules are issued by the Division of Professional Ethics of the AICPA. They provide additional detailed guidelines for the scope and application of the rules. These guidelines are enforceable, and the CPA must be prepared to justify any departure from them.

The Division of Professional Ethics of the AICPA also issues ethics rulings to further explain the application and interpretation of the rules of conduct and to provide interpretations of the rules in specific circumstances. A member who, in similar circumstances, departs from the findings of these ethics rulings must be prepared to justify such departure. In addition, the Division of Professional Ethics publishes a column in the *Journal of Accountancy* dealing with issues of professional ethics. These informal articles are intended to address issues raised in questions submitted by members of the AICPA. The questions and answers contained in the articles are not considered formal rulings by the AICPA.

Rule 101: Independence Under Rule 101, a CPA (or CPA firm) in public practice must be independent of the enterprise for which professional services are being provided. Independence is required not only for opinions on financial statements, but also for certain other reports and services where a body of the AICPA has promulgated standards requiring independence. A CPA is not independent if one or more financial relationships exist with a client during the period of professional engagement or at the issuing of the opinion. Thus, independence is impaired if a CPA:

1. has any direct or material indirect financial interest in the client's enterprise;
2. has any jointly held material investment with the client or with its officers, directors, or principal stockholders;
3. has any loan to or from the client, an officer of the client, or any principal stockholder of the client, except for loans, such as home mortgages, that were obtained under normal lending procedures;
4. is an officer, director, employee, or underwriter of the client during the period that is covered by the financial statements, during the period of the professional engagement, or at the time of expressing an opinion; or,
5. is related as a trustee, executor, or administrator of any estate that holds a direct or material indirect financial interest in the client.

These independence standards also apply to a CPA who is restricted to doing tax work in a partnership with other CPAs who are examining related financial statements. For instance, a tax partner in a CPA firm should not own stock in a client whose financial statements are audited by her partners in the firm, even though she may have nothing to do with the audit of that client's statements.

Rule 102: Integrity and Objectivity All professional services by a CPA should be rendered with objectivity and integrity, avoiding any conflict of interest. A CPA should not knowingly misrepresent facts or subordinate his or her judgment to that of others in rendering any professional services. For example, in a tax practice, the CPA may be requested to follow blindly the guidelines of a government agency or the demands of an audit client. Rule 102 prohibits such blind obedience. Prior to the most recent revision of Rule 102, a CPA in tax practice could resolve doubt in favor of the client. This phrase was omitted in the revised language because resolving doubt in favor of a client in an advocacy engagement is not considered as impairing integrity or objectivity and thus need not be specifically "allowed."

Rule 201: General Standards The CPA must comply with the following general standards, as well as any interpretations of such standards, of the AICPA Code of Professional Conduct.

1. The CPA must be able to complete all professional services with professional competence.
2. The CPA must exercise due professional care in the performance of all professional services.
3. The CPA shall adequately plan and supervise the performance of all professional services.
4. The CPA must obtain sufficient relevant data to afford a reasonable basis for any conclusion or recommendation in connection with the performance of any professional services.

The standard requiring “professional competence” recognizes the need for members of the profession to commit to a program of professional development, learning, and improvement. Such a program of professional continuing education is also recognized in the standard of “due professional care.”

Rule 202: Compliance with Standards A CPA, whether providing tax, management advisory, audit, review, compilation, or other professional services, must comply with all standards promulgated by bodies designated by the AICPA Council.

Rule 203: Accounting Principles A CPA is prohibited from expressing an opinion that financial data of an entity conform with Generally Accepted Accounting Principles if those statements or other financial data contain any material departure from the profession’s technical standards. In some cases where a departure is present but the financial statement or other financial data would have been misleading without that departure, a member may be able to comply with this rule by describing the departure, the effect of the departure, and the justification for it.

Rule 301: Confidential Client Information A CPA in the practice of public accounting must not disclose confidential client data without the specific consent of the client. Rule 301 does not, however, apply:

1. If there is a conflict with Rules 202 (Compliance with Standards) and 203 (Accounting Principles) as set forth by the AICPA Code of Professional Conduct;
2. If the CPA is served with an enforceable subpoena or summons, or must comply with applicable laws and government regulations;
3. If there is a review of a CPA’s practice under AICPA or state society authorization; or
4. If the CPA is responding to an inquiry of an investigative or disciplinary body of a recognized society, or where the CPA is initiating a complaint with a disciplinary body.

In connection with this rule, members of the investigative bodies who may be exposed to confidential client information are precluded from disclosing such information.



SPOTLIGHT ON TAXATION

Confidentiality

A Texas District Court held that the identities of taxpayers who hired the accounting firm of KPMG to participate in a tax shelter later identified as potentially abusive by the IRS were not protected from disclosure under the §7525 confidentiality privilege for communications between taxpayers and federally authorized tax practitioners. Disclosing taxpayers’ identities to the IRS would only reveal their participation in these shelters, and it would not reveal any confidential communications made regarding these tax shelters. *John Doe 1 and John Doe 2 v. KPMG*, 93 AFTR 2d 2004-1759 (DC N. Tex.).

Rule 302: Contingent Fees A CPA in public practice cannot charge or receive a contingent fee for any professional services from a client for whom the CPA or the CPA's firm performs audit, review, or compilation work. For example, a fee schedule of \$5,000 for a qualified audit opinion and \$35,000 for an unqualified opinion would not be allowed. Rule 302 also prohibits a CPA from preparing an original or amended tax return, or claim for a tax refund for a contingent fee.

A contingent fee is defined here as a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent on the finding or result of such service. Solely for purposes of this rule, fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

Rule 501: Acts Discreditable A CPA must not commit an act that is discreditable to the profession. This rule is not specific as to what constitutes a discreditable act; however, violations have been found when the CPA committed a felony, failed to return client records after a client requested them, signed a false tax return, or issued a misleading audit opinion.

Rule 502: Advertising and Other Forms of Solicitation A CPA in public practice cannot seek clients through false, misleading, or deceptive advertising or other forms of solicitation. In addition, solicitation by the use of coercion, overreaching, or harassing conduct is not allowed. The Institute has placed no restrictions as to the type, media, or frequency of a CPA's advertisements, or on the artwork that is associated with them. Under Rule 502, an activity would be prohibited:

1. If it created false or unjustified expectations of favorable results;
2. If it implied the ability to influence any court, tribunal, regulatory agency, or similar body or official;
3. If it contains a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee, or fee range when it was likely, at the time of the representation, that such fees would be substantially increased and the prospective client was not advised of that likelihood; or
4. If it contains any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

For example, a radio spot that states a CPA firm "can beat the IRS every time" would be in violation of Rule 502.

Rule 503: Commissions and Referral Fees A CPA in public practice cannot charge or receive a commission or referral fee from a client for whom the CPA or the CPA's firm performs audit, review, or compilation work. Thus, under Rule 503, a CPA who does only tax or other nonaudit work for a client may accept or pay a commission. The CPA must, however, disclose the commission to the client or other party in the transaction. In addition, a member who accepts or pays a referral fee for recommending or referring any service of a CPA must disclose that fact.

Rule 505: Form of Organization and Name CPAs may practice public accounting only in the form of organization permitted by state law or regulation whose

characteristics conform to resolutions of the AICPA Council. Under Rule 505, a CPA cannot practice under a firm name that is misleading. The names of one or more past owners may be included in the firm name of a successor organization. In addition, all partners or members of a firm must be members of the AICPA if a firm is to designate itself as “Members of the AICPA.”

Statements on Standards for Tax Services

To assist CPAs, the AICPA has issued a series of statements as to what constitutes appropriate standards for tax practice. These SSTS delineate a CPA’s responsibilities to his or her clients, the public, the government, and the profession. The SSTS is a set of enforceable standards. They are intended to specifically address the problems inherent in the tax practitioner’s dual role in serving the client and the public. The statements are intended to supplement, rather than replace, the AICPA Code of Professional Conduct and *Circular 230*. They are designed to address the development of tax practice as an integral part of a CPA’s practice and the changing environment in which tax practitioners must operate, including the rapidly changing tax laws.

SSTS No. 1: Tax Return Positions In providing professional services that involve tax return positions, a member should have a good-faith belief that a recommended position has a more-likely-than-not chance of being sustained if challenged; otherwise, such a position should not be recommended by the member.² A member may reach a conclusion that a position is warranted based on existing law and regulations, as well as on other sources such as well-reasoned articles by tax specialists, treatises, IRS General Counsel Memoranda and written determinations, and explanations of revenue acts as prepared by the Joint Committee on Taxation.

In this statement the members of the AICPA have adopted a standard that is similar to the substantial authority standard of IRC §6662; however, the statement specifically states that the member may reach a conclusion based on authority as specified in the statement without regard to whether such sources are treated as “authority” under IRC §6662. Thus, a member who is in compliance with SSTS No. 1 may still lack substantial authority for taking a position under §6662. In cases where a taxpayer insists on a specific position, a member may sign the return even though the position does not meet the above standard, provided that (1) the position is adequately disclosed on the return by the taxpayer, and (2) the position is not “frivolous.” Under no circumstances should a member recommend a tax return position that is exploitative or frivolous.

In cases where the member believes that the taxpayer may have some exposure to a penalty, the statement suggests that the member advise the taxpayer of such risk. Where disclosure of a position on the tax return may mitigate the possibility of a taxpayer penalty under the *Internal Revenue Code*, the member should consider recommending that the taxpayer disclose the position on the return.

SSTS No. 2: Answers to Questions on Returns Before signing a return as the preparer, a member should make a reasonable effort to obtain from the taxpayer appropriate answers to all questions on the taxpayer’s tax return. Where the taxpayer

²As stated previously, in May 2007, Congress amended the Code and changed the “realistic possibility” (33%) threshold of Section 6694 to a “more-likely-than not” (over 50%) standard. We are assuming the related documents such as *Circular 230* and SSTS No. 1 will adapt this new standard after the publication date of this text. The “realistic possibility” standard still applies to all tax returns filed before the enactment date of this change.

leaves a question on the return unanswered and reasonable grounds exist for not answering the question, the member need not provide an explanation for the omission. The possibility that an answer to a question may prove disadvantageous to the taxpayer, however, does not justify omitting the answer.

Reasonable grounds may exist for omitting an answer to a question on a return. For example, such an omission is acceptable where:

1. The pertinent data are not readily available and are not significant to the determination of taxable income (or loss) or the tax liability;
2. The taxpayer and member are genuinely uncertain as to the meaning of the question on the return; or
3. An answer to a question is voluminous (however, assurance should be given on the return that the data can be supplied upon examination). In this regard, a notation on Form 1120 and related schedules that information will be provided on request is not considered acceptable (*IRS Brooklyn District Newsletter* No. 47, 10/89).

SSTS No. 3: Certain Procedural Aspects of Preparing Returns In preparing or signing a return, the member ordinarily may rely without verification on information that the taxpayer or a third party has provided, unless such information appears to be incorrect, incomplete, or inconsistent. A more formal audit-like review of documents or supporting evidence is generally not required for a member to sign the tax return. Where material provided by the taxpayer appears to be incorrect or incomplete, however, the member should obtain additional information from the taxpayer. In situations where the statutes require that specific conditions be met, the member should determine, by inquiry, whether the conditions have been met. For example, the Code and Regulations impose substantiation requirements for the deduction of certain expenditures. In such a case, the member has an obligation to make appropriate inquiries.

Although members are not required to examine supporting documents, they should encourage the taxpayer to provide such documents when deemed appropriate; for example, in the case of deductions or income from a pass-through entity, such as a partnership, the entity's documents might be useful in preparing the owner's tax returns.

The member should make proper use of the prior year's tax return when feasible to gather information about the taxpayer and to help avoid omissions and errors with respect to income, deductions, and credit computations.

SSTS No. 4: Use of Estimates A member may prepare tax returns that involve the use of the taxpayer's estimates if it is impractical to obtain exact data and if the estimated amounts appear reasonable to the member. In all cases, the estimated information must be supplied by the taxpayer; however, the member may provide advice in connection with the estimate. When the taxpayer's estimates are used, they should be presented in such a manner as to avoid the implication of greater accuracy than exists. Situations where the use of estimates may be appropriate include cases where the keeping of precise records for numerous items of small amounts is difficult to achieve, where data are not available at the time of filing the tax return, or when certain records are missing.

The use of estimates in making pertinent accounting judgments where such use is not in conflict with the *Internal Revenue Code* is not prohibited under this statement; such judgments are acceptable and expected. For example, the income

tax regulations permit the use of a reasonable estimate for accruals if exact amounts are not known.

Although in most cases the use of estimates does not necessitate that the item be specifically disclosed on the taxpayer's return, disclosure should be made where failure to do so would result in misleading the IRS about the accuracy of the return. For example, disclosure may be necessary where the taxpayer's records have been destroyed in a fire or where the taxpayer has not received a Schedule K-1 from a pass-through entity at the time the return is filed. Tax practitioners should make their taxpayers aware that the tax law does not allow estimates of certain income and expenditure items, and that more restrictive substantiation requirements apply in cases of certain expenditures, such as travel and entertainment expenses.

SSTS No. 5: Departure from a Position Previously Concluded in an Administrative Proceeding or Court Decision

The recommendation by a member as to the treatment of an item on a tax return should be based on the facts and the law as they are evaluated at the time during which the return is prepared or signed by the member. Unless the taxpayer is bound by the IRS to the treatment of an item in later years, such as by a closing agreement, the disposition of an item in a prior year's audit, or as part of a prior year's court decision, the member is not prevented from recommending a different treatment of a similar item in a later year's return. Thus, a member may sign a return that contains a departure from a treatment required by the IRS in a prior year, provided that the member adheres to the standards in SSTS No. 1.

In most cases, a member's recommendation as to the treatment of an item on a tax return will be consistent with the treatment of a similar item consented to in a prior year's **administrative proceeding** or as a result of the prior year's court decision. In deciding whether a recommendation contrary to the prior treatment is warranted, the member should consider the following.

1. Neither the IRS nor the taxpayer is bound to act consistently with respect to the treatment of an item in a prior proceeding; however, the IRS tends to act consistently in similar situations.
2. The standards under SSTS No. 1, Tax Return Positions, must be followed. In determining whether such standards can be met, the member must consider the existence of an unfavorable court decision and the taxpayer's consent in an earlier administrative proceeding.
3. In some cases, the taxpayer's consent to the treatment of an item in a prior administrative or judicial proceeding may have been due to a desire to settle the issue or a lack of supporting data, whereas in the current year these factors no longer exist.
4. The tax climate may have changed for a given issue since the prior court decision was reached or the prior administrative hearing concluded.

SSTS No. 6: Knowledge of Error: Return Preparation The member must advise the taxpayer promptly, regardless of whether the member prepared or signed the return in question, when he or she learns of an error in a previously filed tax return or becomes aware that a required return was not filed. Such advice should include a recommendation for appropriate measures the taxpayer should take. However, the member is neither obligated to inform the IRS of the situation, nor may he or she do so without the taxpayer's permission, except as provided by law.

If the member is requested to prepare the current year's return, and the taxpayer has not taken action to correct an error in a prior year's return, the member

should consider whether to proceed with the preparation of the current year's return. If the current year's return is prepared, the member should take reasonable steps to ensure that the error is not repeated.

A member may advise a taxpayer, either orally or in writing, as to the correction of errors in the prior year's return. In a case where there is a possibility that the taxpayer may be charged with fraud, the taxpayer should be referred to an attorney. If a member discovers the error during an audit or other nontax engagement, he or she should refer the taxpayer to the tax return preparer. If the item in question has an insignificant effect on the taxpayer's tax liability, the item should not be considered an "error" under this statement. In addition, the term "error" does not include a situation where the taxpayer's position satisfied the standards under SSTS No. 1 at the time the return was filed.

SSTS No. 7: Knowledge of Error: Administrative Proceedings When a member represents a taxpayer in an administrative proceeding (such as an audit), and the member is aware of an error other than one that has an insignificant effect on the taxpayer's tax liability, the member should request the taxpayer's agreement to disclose the error to the IRS. Lacking such an agreement with the taxpayer, the member may be under a duty to withdraw from the engagement and may consider terminating the professional relationship with the taxpayer. Disclosure, once agreed on, should be made in a timely manner to avoid misleading the IRS.

SSTS No. 8: Form and Content of Advice to Taxpayers In providing tax advice to taxpayers, the member must use judgment that reflects professional competence and serves the taxpayer's needs. The member must assume that any advice given will be used to determine the manner of reporting items on the taxpayer's tax return; therefore, the member should ensure that the standards under SSTS No. 1 are satisfied. When providing advice that will be relied on by third parties, the member's responsibilities may differ. Neither a standard format nor guidelines have been issued or established that would cover all situations and circumstances involving written or oral advice from a member. When giving such advice to taxpayers, in addition to exercising professional judgment, the member should consider each of the following.

1. The importance of the transaction and the amounts involved
2. The specific or general nature of the taxpayer's inquiry
3. The time available to develop and submit the advice
4. The technical complications that are presented
5. The existence of authority and precedents
6. The tax sophistication of the taxpayer
7. The possibility of seeking legal advice

Written communication is recommended in important, unusual, or complicated transactions, while oral advice is acceptable in more typical situations. In the communication, the member should advise the taxpayer that the advice reflects his or her professional judgment based on the current situation and that subsequent developments may affect previous advice, such as stating that the position of authorities is subject to change (see Chapter 11).

When subsequent developments affect the advice that a member has previously communicated to a taxpayer, the member is under no obligation to initiate

Exhibit 1-4: Summary of AICPA Statements on Standards for Tax Service

Statement	Summary of Contents
1	Specifies the standards for professional services that involve tax positions
2	Explains how a member should handle answering questions on a tax return
3	Describes the procedural aspects of preparing a tax return
4	Defines when a member can use an estimate in preparing a tax return
5	Explains what a member should do about items on a current return when similar items were audited on a prior year's return or were the subject of a judicial hearing
6	States what a member should do upon learning about an error in a prior year's tax return
7	Gives the procedure to follow if an error is discovered during an audit
8	Establishes standards for the giving of tax advice to taxpayers

further communication of such developments to the taxpayer unless a specific agreement has been reached with the taxpayer, or the member is assisting in the application of a procedure or plan relative to such advice.

Exhibit 1-4 summarizes the main topic of each of the AICPA SSTs. The complete text of the SSTs can be found on the AICPA web site at: <http://www.aicpa.org/download/tax/SSTfinal.pdf>

Sarbanes-Oxley and Taxation

In 2002, Congress passed the Sarbanes-Oxley Act, which addressed the corporate management abuses that took place during the 1990s and early 2000s in publicly traded American corporations. These corporate governance breakdowns culminated in spectacular business failures such as with Enron, WorldCom, Global Crossing, Waste-Management, Sunbeam, and others, and led to the eventual failure of the Big Five CPA firm of Arthur Andersen.

The Sarbanes-Oxley Act made it “unlawful” for an auditor to provide any of the nonaudit services listed in the Act. In addition, the Act provided that a registered public accounting firm “may engage in any nonaudit service, including tax services, that is not described [in the list of nine specifically prohibited services] for an audit client only if the activity is approved in advance by the audit committee of the issuer” in accordance with the Act. The prohibited services are:

1. Bookkeeping or other services related to the accounting records or financial statements of the audit client
2. Financial information systems design and implementation
3. Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
4. Actuarial services
5. Internal audit outsourcing services
6. Management functions or human resources

7. Broker or dealer, investment adviser, or investment banking services
8. Legal services and expert services unrelated to the audit
9. Any other service that the Public Company Accounting Oversight Board determines, by regulation, is impermissible.

It should be noted that tax compliance work is not one of the prohibited services. However, tax work is subject to the preapproval process. The audit committee needs to know about the proposed tax-related services in order to preapprove them. Many corporations now take work to CPA firms other than the auditor, rather than seek approval of the audit committee. As a result, many companies divide their audit and tax work between different firms. This appears to be an unintended result of the Sarbanes-Oxley Act.

Investors, on the other hand, would probably prefer that the audit committee be aware of everything that is going on within a company and actually preapprove the work instead of having the work go elsewhere. Currently, the audit committee may not even be aware if someone other than the auditor is being used for non-audit work. Such decision making remains hidden from audit committee review. Tax practitioners will have to wait to see how this contradiction plays out. Perhaps audit committees will get more comfortable with their Sarbanes-Oxley responsibilities and this division of traditional audit and tax work may decline in future years.

In addition to being a response to corporate governance and accounting transparency failures, the Sarbanes-Oxley Act is a response to the general failure of business ethics. For example, the proliferation of abusive tax shelters and super-aggressive tax avoidance strategies (which are discussed shortly) are examples of other business ethical problems.

ABA Model Code of Professional Responsibility

The ABA Model Code of Professional Responsibility includes nine canons, which may be thought of as statements of principles. Canon 6, for instance, requires an attorney to represent a taxpayer competently. Each canon is followed by a series of ethical considerations (ECs), which in turn are supported by disciplinary rules (DRs). The ECs are aspirational in character, setting forth objectives toward which all attorneys are to strive. The DRs set forth minimum standards of conduct. Any failure to abide by the DRs may subject the attorney to disciplinary procedures and punishment.

In nearly all jurisdictions, the ABA Model Code was adopted by the appropriate policy agency, although sometimes modifications were made. In August 1983, the ABA adopted the Model Rules of Professional Conduct, which, in a majority of the states, have substantially replaced the Model Code as the guide for attorney professional conduct.

The ABA has a Standing Committee on Ethics and Professional Responsibility that answers questions concerning ethics and professional conduct. Requests for opinions from the committee should be directed to the American Bar Association Center for Professional Responsibility in Chicago.

Neither the ABA Model Code nor the Model Rules have the force of law. Each was designed to be adopted by the appropriate agencies that govern the practice of law in the states. In many jurisdictions, the state supreme court is charged with policing the practice of law; in other states, the legislature bears this responsibility. Attorneys should consult their own jurisdiction's ethical guidelines to determine whether the provisions of the ABA Model Code or the Model Rules, or some modification of these doctrines, have been adopted.

The current status of the ABA Model Rules can be found on the ABA web site at: http://www.abanet.org/cpr/mrpc/mrpc_toc.html

NONREGULATORY ETHICAL BEHAVIOR MODELS

Since the turn of the twenty-first century, nonregulatory ethical models have become more relevant and applicable to professions such as accountancy and law. Tax practitioners need to be aware there is substantially more to ethical behavior than just following the rules of ethics or conduct of professional organizations such as the AICPA or the ABA. The regulatory rules are generally straightforward. They usually list a defined set of acts that are prohibited by members of the profession. For example, under SSTS No. 6, a CPA cannot disclose an error in a client's tax return to the IRS without the client's permission. On the other hand, nonregulatory ethics involve making choices that are not always clearly spelled out such as disclosure of client tax information.

Ethical Dilemmas

An ethical dilemma occurs when someone is faced with a situation to which there are no clearly defined answers such as, by regulation or law. In other words, there are multiple "right" answers (or put another way, no obviously wrong answers).

Example 1-3 Bill, a CPA, has been requested by his CPA firm employer to join "The Macho Men," a private club. Most of the movers and shakers (i.e., clients and potential clients) in town are members of this club. However, the club does not allow female members. *If you were Bill, what would you do? How do you think Bill's female co-workers would feel about him joining a club that discriminates against women?* There is no "right" answer to these questions because they are ethical dilemmas to which there are several right answers.

As is illustrated in this example, making the choice in an ethical dilemma can be complicated. How then, is a person supposed to deal with a situation such as this? The answer can be assessed through several generally recognized forms of ethical reasoning.



SPOTLIGHT ON TAXATION

Quotation

Ethics is knowing the difference between what you have the right to do and what is the right thing to do

Supreme Court Justice Potter Stewart

Ethical Reasoning

There are several approaches to resolving an ethical dilemma. Len Marrella notes that there are three common lines of reasoning to solve an ethical dilemma.³ These are called End-based reasoning, Rule-based reasoning, and Care-based reasoning.

³*In Search of Ethics: Conversations with Men and Women of Character*, DC Press, 2001.

Each of these approaches attempts to provide a framework in which to resolve an ethical dilemma.

End-Based Ethical Reasoning End-based ethical reasoning was popular in the 1800s. Its main tenet was that an action was right if it produced at least as much net good as any alternative action could have produced. Hence, an ethical decision was the one that did the most good for the largest number of people. In summary, competing ethical solutions are resolved in terms of the “end-result.”

John Stuart Mill was a proponent of this philosophy. He encouraged individuals to examine the consequences of various alternatives and to rely heavily on facts when making ethical choices.⁴ The steps in applying End-based reasoning can be summarized as follows.

1. Identify the courses of action available
2. Identify stakeholders who will be impacted by the various choices of action and what benefit or harm may come to them as the result of a given choice.
3. Choose the action with the greatest benefits and the least amount of harm.⁵

To a CPA this type of decision making is similar to cost-benefit analysis. However, applying cost-benefit analysis to an ethical decision is not as easy as applying it to a financial decision. The real problem is that End-based reasoning does not consider justice, fairness, integrity and similar concepts in arriving at a choice. Ethicists consider this to be one of End-based reasoning’s major failings.

Rule-Based Ethical Reasoning Rule-based reasoning is based on what is referred to as “Kantian ethics,” which were derived from the writing of the German philosopher Immanuel Kant. He held that individual actions should be such that we would accept similar behavior from everyone else. Kant believed rules are made to apply to everyone and there were no exceptions—period. According to Kant, lying and stealing were always unethical, and therefore there is no such thing as a “white lie” to protect someone’s feelings or reputation. This thinking today is usually referred to as “Zero Tolerance” and many times leads to unjust results. For example, what if a six-year-old first grader is expelled from school for bringing a plastic picnic knife to school to eat his lunch, in violation of the no-weapons policy at his school. Is this fair or just?

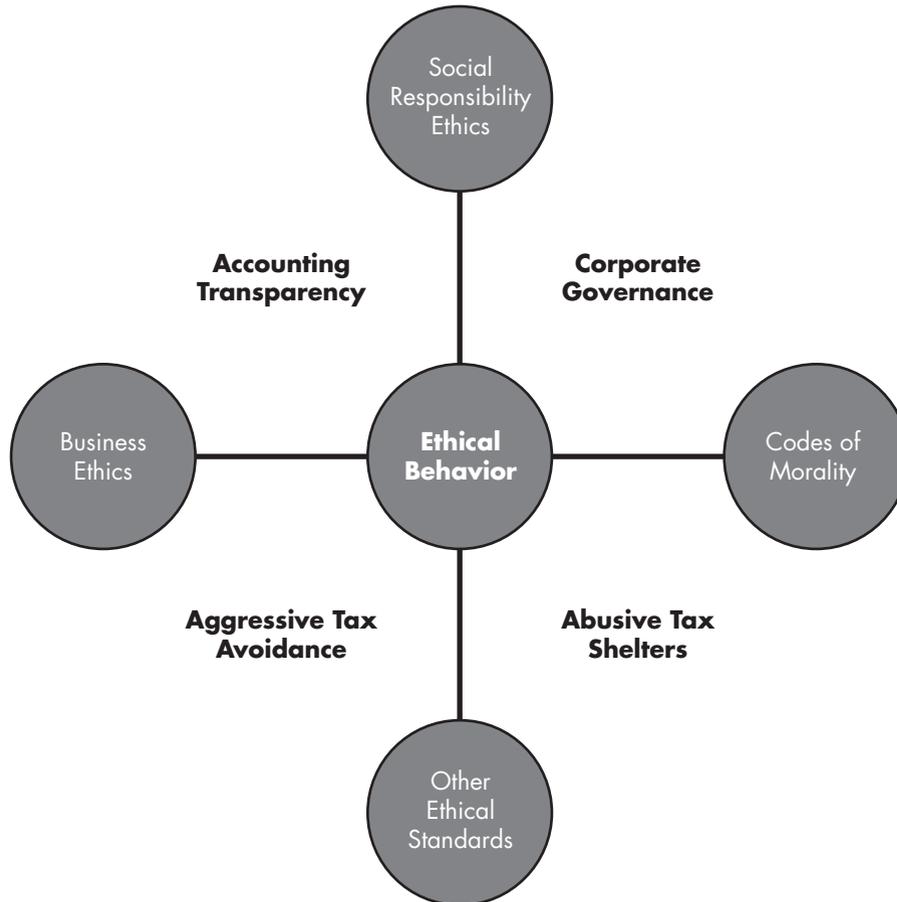
Care-Based Ethical Reasoning Care-based reasoning is found in the moral teachings of almost every culture and religion. In Western culture it is called the “Golden Rule,” which states, “Do unto others as you would have them do unto you.” From an ethical reasoning point of view it says make decisions that would result in the treatment you yourself would like to receive. Care-based reasoning can be described as doing what is “fair and just.”

Ethical Professional Behavior

Professional ethical behavior is the result of the interaction of personal morality, social responsibility, business ethics, and other general ethical standards. Exhibit 1-5 illustrates these ethical standards and shows possible business and accounting areas that could be affected by ethical failures.

⁴Velasquez, M., Andre, C., Shanks, S., and Meyer, M., “Thinking Ethically: A Framework for Moral Decision Making,” *Issues in Ethics*, Vol. 7, No. 1, Winter 1996.

⁵Ibid.

Exhibit 1-5: Sources of Ethical Behavior and Impacts

Morality

The subject of morality fills tens of thousands of books. Publications as diverse as the Bible and popular novels examine morality in one way or another. When something is judged to be morally right or wrong (or good or bad), the underlying standards on which such judgments are based are called moral standards.

According to some people's moral standards, cheating "just a little" in computing a tax liability is morally acceptable. Most people in the United States believe that everyone cheats a little on their taxes. Cheating significantly may be viewed differently, but where is the dividing line between morally "OK" tax cheating and morally wrong tax evasion? Under the self-assessed tax system in the United States, different moral standards provide different answers—from complete honesty to various degrees of dishonesty. The tax practitioner must be ready to work with clients holding various systems of morality and to accept the consequences of the moral choices made, including the possibility of losing a client, paying fines and penalties to the IRS, or even going to jail.

Social Responsibility

The tax practitioner must be aware of social responsibility in areas such as environmental protection, equal opportunity, and occupational safety. Since World War II, society has held the business world increasingly responsible for meeting certain noneconomic standards. In 1970, Milton Friedman, the Nobel Prize-winning economist, said that the “social responsibility” of business is merely to increase profits. But the prevailing sentiment today is that business and the professions should return something to society to make it better, not just to make a profit. For the tax practitioner, this could mean going beyond the minimum legal responsibility to provide equal opportunity in the hiring of employees by making special recruitment efforts, or it could mean volunteering time to help charitable organizations with their tax problems.

Business Ethics

In recent years, one of the major topics in the business world has been the question of business ethics. Many people believe that ethics has application only in one’s personal life, not in the business or professional arena. Like Milton Friedman, they think that the only business of business is to make a profit. This view is popular because (1) people who work in business or professions must concern themselves with producing goods and services to earn a profit, and (2) it is easier to measure profit than it is to make value judgments. People are more comfortable discussing problems in terms of profits, rather than in terms of the ethical impact of the entity and its actions. Few business and professional people are trained in ethical analysis, and, therefore, they usually are not familiar with how to evaluate a problem in terms of ethics.

Example 1-4 Bruce owns a successful small business. The business is operated as a corporation. During the year, Bruce makes numerous personal long-distance phone calls from the office, uses the company credit card to purchase gas for his family’s personal automobiles, sends personal items using the company’s FedEx account, and is reimbursed by the company for meals and entertainment expenditures that are primarily personal in nature. These items are deducted by the corporation on its tax return. *Would you sign this company’s Form 1120 as the tax return preparer? If you also audited this company, what would you do about these transactions?*

That business and professional organizations have ethical responsibilities is readily apparent to anyone who reads the popular press. The lawsuits brought on by the savings and loan failures of the late 1980s and against the large international accounting firms in the last two decades are prime examples of society holding business to a standard of ethical conduct. Most of the big CPA firms have settled lawsuits (both in and out of court) against them for millions of dollars for what was, in part, a business ethics failure.

Tax Planning Ethics

In addition to the previously discussed corporate governance issues addressed in the Sarbanes-Oxley Act, there are many examples of suspect ethics practices in the area of taxation. The following are some “classic” examples of the aggressive tax planning arrangements that have been promoted in recent years by CPAs, lawyers, and others.⁶

⁶For an expanded discussion of tax planning abuse during the 1980s and 1990s, see *Tax Shelter Hustlers*, Forbes (December 14, 1998), p. 198.

Example 1-5 Cerveza Corporation is primarily in the beverage supply business. The taxpayer classified itself as a security dealer and then marks down (and claims a tax deduction for) its accounts receivable based on the contention that they are not marketable and some of the accounts will not be paid. This practice was prohibited by Congress in 1998.

Example 1-6 Sneaky Inc., a United States-based corporation, pays \$600,000 to buy an expiring foreign copyright that has one royalty payment left. The last payment is for \$800,000, less \$240,000 of foreign tax credit (30% of \$800,000). On this deal the buyer has lost \$40,000 (\$600,000 payment less \$560,000 net final royalty), but has purchased a \$240,000 foreign tax credit that can be used to offset \$240,000 of tax on Sneaky's other foreign income.

Example 1-7 Cheater Corporation borrowed \$300,000 and used the proceeds to purchase a \$2,000,000 single premium life insurance policy. The policy is a universal life insurance policy. Like many life insurance policies, this policy pays interest that is tax-free on the cash value of the policy. As a result of this transaction, the corporation receives an interest deduction for the loan and earns tax-free interest on the policy. This type of transaction was stopped by Congress in 1996.



SPOTLIGHT ON TAXATION

Ethics

The taxing authorities of several U.S. states post the names of delinquent taxpayers on their web site. The stated purpose of the postings is to "shame" the taxpayers who have not paid their state taxes into paying them. Although this posting clearly is legal, is it ethical? For example, suppose a family has a child with leukemia and has horrendous medical bills and cannot afford to pay their taxes. Should they be held up to ridicule because they are doing the right thing and taking care of their child, even if it prevents them from paying their taxes?

Other Ethical Standards

The study of nonregulatory ethics could be expanded to cover such other issues as public policy, religious beliefs, and cultural values, issues that are beyond the scope of this text. Most of such topics would be addressed in a university course on ethics or business ethics. A tax practitioner can expand his or her understanding of the application of ethics to accounting and business situations by referring to the books on the following reading list.

- Armstrong, Mary Beth, *Ethics and Professionalism for CPAs* (Cincinnati: South-Western Publishing Co., 1993).
- Brooks, Leonard J., *Business and Professional Ethics for Directors, Executives, and Accountants* (Mason: South Western Business & Professional Publishing, 2004).
- Buchholz, Rogene, *Fundamental Concepts and Problems in Business Ethics* (Englewood Cliffs, NJ: Prentice Hall, 1989).

- Collins, Denis, and Thomas O'Rourke, *Ethical Dilemmas in Accounting* (Cincinnati: South-Western Publishing Co., 1994).
- Donaldson, Thomas, *Corporations and Morality* (Englewood Cliffs, NJ: Prentice Hall, 1983).
- Marrella, Len, *In Search of Ethics: Conversations with Men and Women of Character* (Sanford, FL: DC Press, 2001).
- Velasquez, Manuel, *Business Ethics: Concepts and Cases*, 5th ed. (Englewood Cliffs, NJ: Prentice Hall, 2002).
- Velasquez, M., Andre, C., Shanks, S., and Meyer, M., "Thinking Ethically: A Framework for Moral Decision Making," *Issues in Ethics*, Vol. 7, No. 1 (Winter 1996).

The following are examples of nonregulatory ethics dilemmas that could arise in a business, accounting, or tax setting. As shown in these examples, the application of ethics to tax and business situations is not clear-cut. Many times, doing what is "right" may not be possible. The tax practitioner is faced with challenges on how to apply proper business ethics on a daily basis.

Example 1-8 Hilary is a CPA who is a sole practitioner. This year, one of her clients, Gold Corporation, opened a new division in Europe. Gold is a long-time client of Hilary's, and she is anxious to keep it. However, Hilary has no experience in international tax and would not be able to give Gold the kind of tax advice needed for the new division. The ethical question is whether Hilary should inform the client of her lack of knowledge in this area and risk losing the client, or whether she should remain silent and "wing it" on the international tax issues. What should Hilary do in this situation?

Example 1-9 Patrick is a CPA who is a partner in a successful local CPA practice. The state in which Patrick lives has a forty-hour annual continuing professional education (CPE) requirement. If the CPE requirement is not met, a CPA will have his or her license suspended and will not be able to practice. Patrick is approached by the Flight-by-Night CPE Company about signing up for some of their CPE courses. The company representative tells Patrick that they will report that Patrick attended the courses so that he gets the CPE credit, even if he does not attend. Because Patrick is overloaded with work, he considers this a "low hassle" way to get his CPA license renewed. Would it be ethical for Patrick to obtain his CPE credit this way?

Example 1-10 Devona is an auditor in the Boston office of a large international CPA firm. She is sent on an inventory observation for a new client of the Houston office of the firm. The Houston office gives her a six-hour budget for the job. When she arrives at the client's office, Devona discovers that the Houston office has substantially underestimated the size of inventory to be counted. The client has a \$20,000,000 inventory comprised of more than 6,000 different items. The client plans to take twenty hours to complete the count. Devona is up for promotion, and she does not want to have a negative personnel review because she overran the budget on this job. Therefore, she considers spending the budgeted six hours on the observation and signing off in the audit work papers that she completely observed the inventory. Devona thinks this would be OK since she perceives there is only a small risk of a material misstatement of the inventory. Would it be ethical for Devona to do this?

Example 1-11 Last year, one of Andy’s clients, Trout Corporation, had a significant tax problem. Andy needed thirty-five hours of research time to arrive at an answer to Trout’s problem. This year, another of Andy’s clients, Bass Corporation, had the same problem. Because of his experience with Trout, Andy could solve Bass’s tax problem in three hours. The ethical question is whether Andy should bill Bass for three hours or thirty-five hours of professional consulting time. There are two ways to look at this situation. Andy only spent three hours on the job, so he should only bill for three hours of time. Yet, there is “value” in Andy already knowing the approach to take on the Bass matter, so perhaps he should bill for that knowledge and not just for the actual time spent working on the problem. What should Andy do in this situation?

Example 1-12 Betty is negotiating a transaction on behalf of one of her clients, John Carp. During the process, Betty becomes aware that the other party to the transaction does not adequately understand the tax consequences of the proposed transaction, which are highly favorable to Carp. In fact, if the transaction were completed as proposed, the other side would suffer significant negative tax consequences. Ethically, should Betty inform the other party of the potential negative tax consequences of the proposed transaction?



SPOTLIGHT ON TAXATION

Quotation

When morality comes up against profit, it is seldom that profit loses.

Shirley Chisholm

Ethics Training and Education

State Boards of Accountancy are the organizations with the responsibility to license and regulate the practice of public accountancy in each state. Recently, the state boards as a group have increased the ethics training for initial licensing and license renewals in response to highly publicized ethical lapses. A study found that most states had some kind of ethics training requirements for CPA licensing and continuing practice.⁷ His findings can be summarized as follows. All states have some form of ethics training to *become* a CPA, but fewer than half (twenty-three states) have an ethics training requirement to *maintain* a CPA license.

Type of Ethics Training Required	Number of States Requiring
Required Course before Taking CPA Exam	32
Ethics Course Must Be Part of a Degree	15
Ethics Exam Taken at Time of CPA Exam	16
Ethics Exam Taken Separately	22
Ethics Required for CPE	23

Some states have multiple ethics training requirements; therefore, the numbers add up to more than fifty.

⁷Misiewicz, K., “The Normative Impact of CPA Firms, Professional Organizations, and State Boards on Accounting Ethics Education,” *Journal of Business Ethics*, 2006.

TAX RESEARCH BY CERTIFIED PUBLIC ACCOUNTANTS

Over the years, the tax community has addressed the issue of whether the practice of tax law by a CPA or other nonattorney constitutes the **unauthorized practice of law**. The problem stems from the tax law itself, passed in 1913. The provisions of early tax law called for an income tax, but the statute was not specific about the accounting methods to be used in implementing it. In fact, not until 1954 was a formal statutory effort made to address accounting issues in the computation of taxable income. For this reason, many attorneys avoided tax work, allowing CPAs to fill the void and provide taxpayers with most of the professional-quality tax work.

When a CPA resolves an issue in most nonroutine tax situations, he or she is, to some extent, solving a legal problem. The issue is not whether the CPA is rendering legal service but, rather, how much legal service is provided. When does the CPA cross the mythical boundary and begin an unauthorized practice of law? Neither these professions nor the courts have promulgated binding guidelines on this issue. Instead, the Federal agencies seem to have taken the lead in attempting to solve this problem.

Historical Developments

Lowell Bar Association v. Loeb, 315 Mass. 176, S2 N.E.2d 27 (1943), addressed the issue of the unauthorized practice of law by nonattorneys engaged in tax practice. The Lowell Massachusetts Bar Association sued Birdie Loeb, a commercial tax preparer, for her preparation of simple wage-earner tax returns. On appeal, the court held that the preparation of “simple” tax returns did not constitute the unauthorized practice of Massachusetts law because tax return preparation could not be identified as strictly within the legal discipline. Tax practice includes interaction among various disciplines, including law, accounting, economics, political science, and others.

Subsequent courts attempted to adopt the Lowell “wholly within the field of law” test in other jurisdictions, but they found that defining the boundaries of the legal profession was so difficult and the 1943 opinion was so general and vague that the Lowell precedent was of little value in other situations.

Probably the best known case concerning a tax accountant’s unauthorized practice of law is *Bercu*, 299 N.Y. 728, 87 N.E.2d 451 (1949). Bercu was an accountant who consulted with a client concerning whether sales taxes that were accrued, but not yet paid, could be deducted on a tax return. The taxpayer who requested this advice was not one of Bercu’s regular clients. Bercu advised the client that the sales tax could be deducted when it was paid. Bercu presented a bill to the client and, when it was not paid, sued the client to collect the fees.

Ultimately, the State Court of New York held that it was not proper for Bercu to render services in such a situation. The court indicated that Bercu could have provided this type of service and answered the sales tax question had it been incidental to the tax return work he regularly performed for his clients.

This “incidental to accounting practice” test became the chief issue in several subsequent cases concerning the unauthorized practice of law. In a Minnesota case, *Gardner v. Conway*, 234 Minn. 468, 48 N.W.2d 788 (1951), a person who was neither an attorney nor a CPA attempted to answer difficult and substantial questions of law. The court held that the practitioner improperly gave advice to the client and rejected the “incidental to practice” test as an approach to providing guidelines for the definition of tax practice.

In a California case, *Agran v. Shapiro*, 127 Cal. App.2d Supp. 807, 273 P.2d 619 (1954), CPA Agran prepared returns, performed research, and represented his

clients before the IRS. Agran's preparation of Shapiro's return involved extensive research—including more than 100 court cases, Code sections, and Regulations—concerning a question involving the proper treatment of a net operating loss. Upon completion of the work, the CPA presented his bill and, when he was not paid, sued Shapiro to collect. Agran was found by the court to have engaged in the unauthorized practice of law and, therefore, was unable to collect his fees. In its decision, the California Superior Court relied on *Gardner v. Conway* and rejected the “incidental to practice” test that Agran used in his defense. The court did not decide, however, whether the authorization to practice before the IRS preempted the right of the state to regulate tax practice.

In *Sperry v. Florida*, 373 U.S. 379, 83 S.Ct. 1322 (1963), the U.S. Supreme Court held that a Federal statute that admitted nonattorneys to practice before Federal agencies (in this case, the Patent Office) took precedence over state regulation. In late 1965, Congress enacted Public Law 89-332, amending prior law and allowing CPAs to practice before the IRS. Although this law added to the force of the Sperry decision as it applied to CPAs, Sperry still provides for the preemption of Federal regulations and statutes in matters of practice before other Federal agencies.

In 1981, the AICPA and the ABA held a conference for attorneys and CPAs to address some of these definitional questions relative to tax practice and the unauthorized practice of law. The stated purpose of this session was to “promote understanding between the professions in the interests of the client [taxpayers] and the general public.” This National Conference of Lawyers and CPAs issued a statement in November 1981, reaffirming that clients [taxpayers] are best served when attorneys and CPAs work together in tax practice. The text of the statement identifies eight areas related to income taxation and three areas related to estate and gift planning in which such professional cooperation should be encouraged. The statement lacks any form of exclusionary language. Indeed, it asserts the following:⁸

Frequently, the legal and accounting phases (of tax practice) are so intertwined that they are difficult to distinguish. This is particularly true in the field of income taxation where questions of law and accounting are often inextricably intertwined.

CPAs and Other Nonattorneys

Currently, CPAs and other nonattorneys who practice tax law before the IRS are in little danger of entering into the unauthorized practice of law provided they avoid providing general legal services. This can be accomplished if CPAs and other nonattorneys do not themselves engage in the following kinds of general law activities.

- Expressing a legal opinion on any nontax matter
- Drafting wills or trust instruments
- Drafting contracts
- Drafting incorporation papers
- Drafting partnership agreements

⁸For a complete discussion of this conference statement, see the *Journal of Accountancy* (August 1982).

Taxpayers can draft any of these documents themselves without the services of an attorney. If a CPA's client wishes to handle personal legal affairs in this manner, the CPA (exercising caution) can render professional advice without running afoul of the case law concerning the unauthorized practice of law.

As long as CPAs and other nonattorneys stay within the practice of tax, and do not cross over into the practice of general law, the control exercised by *Circular 230* and the AICPA Code should ensure that virtually all tax compliance, planning, and research activities that are provided by adequately trained nonattorney CPAs constitute the "authorized practice of law."

SUMMARY

In addition to the tax return preparation statutes that are discussed in Chapter 13, CPAs, attorneys, EAs, and others who practice before the IRS are faced with various sets of overlapping rules of conduct. *Circular 230* applies to anyone who practices before the IRS. Members of the legal and public accounting professions are subject to additional codes

of ethics and conduct. Similarly, cultural codes of morality and social responsibility form general boundaries relative to acceptable behavior by a taxpayer or tax professional. When engaged in tax practice, one always must be aware of the appropriate rules of conduct and conduct oneself in accordance with those rules.

TAX TUTOR

Reinforce the tax research information covered in this chapter by completing the online tutorials located at the *Federal Tax Research* web site: <http://academic.cengage.com/taxation/raabe>

KEY WORDS

By the time you complete this chapter, you should be comfortable discussing each of the following terms. If you need additional review of any of these items, return to the appropriate material in the chapter or consult the glossary to this text.

Administrative Proceeding
 American Bar Association (ABA)
 American Institute of Certified Public Accountants (AICPA)
 Circular 230
 Closed Transaction
 Contingent Fees
 Enrolled Agent (EA)
 Ethical Standards
 Independence

More-likely-than-not
 Open Transactions
 Practice Before the IRS
 Tax Avoidance
 Tax Compliance
 Tax Evasion
 Tax Litigation
 Tax Planning
 Tax Research
 Unauthorized Practice of Law

DISCUSSION QUESTIONS

1. In a modern, industrial society, the tax system is derived from several disciplines. Identify the disciplines that play this role in the United States. Explain how each of them affects the U.S. tax system.
2. The elements of tax practice fall into what major categories in addition to tax research?
3. What is tax compliance as practiced in the United States? Give several examples of activities that can be classified as tax compliance.
4. Several groups of individuals do most of the tax compliance work in the United States. Identify these groups and describe briefly the kind of work that each group does. In this regard, be sure to define the term “Enrolled Agent.”
5. What is tax planning? Explain the difference between tax evasion and tax avoidance, and the role of each in professional tax planning.
6. Tax planning falls into two major categories, the “open” transaction and the “closed” transaction. Discuss each type of transaction, and describe how each affects tax planning.
7. What is tax litigation? What type of tax practitioner typically handles tax litigation on a taxpayer’s behalf?
8. In tax litigation, what is usually the role of a Certified Public Accountant?
9. Define tax research. Briefly describe the tax research process.
10. Who issues *Circular 230*? Which tax practitioners are regulated by it?
11. CPAs must follow the rules of *Circular 230*. In addition, CPAs in tax practice are subject to two other sets of ethical rules. Give the name and the issuer of both of these sets of rules.
12. The term “practice before the IRS” includes the representation of clients in the United States Tax Court for cases being handled under the “small tax case procedure.” True or false? Explain your answer. (IRS adapted)
13. The rules that govern practice before the IRS are found in *Circular 230*. Discuss what entails practice before the IRS, and state which section of *Circular 230* contains the definition.
14. There are two ways to become an EA. Briefly explain what they are and give the Subpart and section references in *Circular 230* where the details of becoming an EA are found.
15. EAs are subject to Continuing Education (CE) requirements. Briefly describe the CE requirements and give the reference to where the details can be found in *Circular 230*.
16. Leigh, who is not an EA, attorney, or CPA, is employed by Rose, a CPA. One of Rose’s clients has been notified that his 2007 income tax return has been selected for audit by the IRS. Rose had prepared the return and signed it as

preparer. Rose has been called out of town on a family emergency and would like for Leigh to represent the client. Leigh cannot represent the client even if she has Rose's written authority to do so and has the client's power of attorney. True or false? Explain your answer. (IRS adapted)

17. Regular full-time employees are allowed to represent certain organizations before the IRS without being an attorney, CPA, or EA. Name the organizations that can be represented by full-time employees, and cite where you found that authority in *Circular 230*.
18. Jane's mother is in a nursing home and cannot travel. There is a problem with her mother's last year's tax return, and the IRS needs to discuss the matter with her at the local IRS office. Is it possible for Jane to handle this matter without having to hire professional tax representation? Reference your answer to the appropriate part of *Circular 230*.
19. A practitioner could be suspended from practice before the IRS if the practitioner employs, accepts assistance from, or shares fees with any person who is under disbarment or suspension from practice before the IRS. True or false? Explain your answer. (IRS adapted)
20. Tax practitioners must not sign a tax return under *Circular 230* if the return takes a position that does not have a "more-likely-than-not" chance of being sustained by the IRS.
 - a. What is a more-likely-than-not chance, as defined by the IRS?
 - b. Is it possible for a tax practitioner to sign a tax return that takes a position that does not meet the more-likely-than-not standard? If so, what must be done to allow the tax practitioner to sign the tax return?
21. Under *Circular 230*, may an attorney, CPA, or EA advertise on television? On the Internet? If so, what standards are applied to the advertisements?
22. Can a tax practitioner who is a CPA form a CPA partnership with an IRS agent who is also a CPA? What limits (if any) would be placed on such a partnership?
23. If a tax practitioner finds an error in a prior year's tax return, what action must he or she take (if any) under *Circular 230*? What subpart and section addresses this situation?
24. Is a tax practitioner required to adhere to the Best Practices standard under *Circular 230* §10.33? Explain.
25. What are the four Best Practices under *Circular 230* §10.33?
26. Explain the difference between a "reliance opinion" and a "marketed opinion" under *Circular 230* §10.35. How does *Circular 230* §10.36 apply the Covered Opinion requirement of §10.35?
27. A practitioner cannot give written advice under *Circular 230* §10.37 in what situations?
28. Practicing CPAs generally are subject to the AICPA Code of Professional Conduct. What is its stated purpose?

29. The rules under the AICPA Code of Professional Conduct are enforceable ethical standards. Broad in nature, they generally apply to all of the services that are performed by a CPA who is an AICPA member. Identify the two situations in which the application of the rules may be limited.
30. In what situation may a CPA under the AICPA Code of Professional Conduct accept a commission?
31. Under Rule 101 (Independence), a CPA (or CPA firm) in public practice must be independent of the enterprise for which professional services are being provided. Discuss situations in which the CPA's independence may be impaired.
32. Under Rule 102 (Integrity and Objectivity), a CPA who is engaged in tax practice may resolve a doubtful area in favor of his or her client. Explain.
33. A CPA must meet certain qualitative standards under Rule 201 (General Standards). Discuss the four general standards of this rule.
34. In each of the following independent situations, state which AICPA Code of Professional Conduct (if any) is violated by a CPA in public practice.
 - a. The CPA opens a tax practice and names the new firm "Jill's Super Tax."
 - b. In return for recommending a certain investment to an audit client, a CPA receives a 5 percent commission from the broker who sells the investments.
 - c. A taxpayer is being assessed by the IRS for an additional \$100,000 of tax. The CPA offers to represent the taxpayer for a fee that is equal to 25 percent of any amount by which he can get the IRS to reduce its assessment.
 - d. A CPA places an advertisement in the local newspaper that states that she is the "Best CPA in the Western World." The advertisement further states that, because of her great skill, the CPA has considerable influence with the IRS and the United States Tax Court.
 - e. A CPA partnership has eight partners, six of whom are members of the AICPA. On its letterhead, the firm designates itself as "Members of the AICPA."
 - f. A CPA who is not in public practice is convicted of helping to run a large illegal drug operation.
35. Under Rule 301 of the AICPA Code of Professional Conduct, a CPA must not disclose confidential client data without the specific consent of the client. Under what conditions might a disclosure of confidential information without the client's consent be appropriate?
36. What are the SSTS? Who issues them? Discuss their principal objectives.
37. What guidelines does SSTS No. 1 provide for a tax practitioner regarding tax return positions?
38. According to SSTS No. 2, a tax return should be signed by a member only after reasonable effort has been made to answer all of the questions on the return that apply to the taxpayer. What are some of the reasonable grounds under which a member may sign a return as the preparer even though some of the pertinent questions remain unanswered?
39. What guidelines are provided by SSTS No. 3 as to the reliance by a member on information supplied by the taxpayer for use in preparing the taxpayer's return?

40. A member may use estimates in completing a tax return according to SSTS No. 4. When might the use of estimates be considered appropriate?
41. Last year a taxpayer was audited by the IRS and an item of deduction on the tax return was disallowed. On this year's tax return, the taxpayer would like to deduct a similar item. Discuss the circumstances under which a member may allow the taxpayer to take the deduction on the current year's return and still be in compliance with SSTS No. 5. Under what conditions must special disclosure be made by the member?
42. When a member learns of an error in a previously filed tax return or learns of an error during an audit, how is he or she to respond and still be in compliance with SSTS No. 6 and No. 7?
43. What situations are addressed by SSTS No. 8?
44. The Sarbanes-Oxley Act prohibits CPA firms from providing certain services to publicly traded corporate audit clients. Is doing tax compliance work for an audit client one of the prohibited transactions? If such tax work is allowed, who must approve it?
45. Differentiate between the ABA Model Code of Professional Responsibility and that organization's Model Rules of Professional Conduct.
46. Who sets ethical rules for attorneys in the various states?
47. What is an Ethical Dilemma?
48. The text discusses three types of ethical reasoning. Identify them and give a short description of each.
49. Ethical professional behavior is the interaction of several standards. Identify these standards and briefly describe each.
50. How does the term "the unauthorized practice of law" apply to CPAs?
51. List several services or products that a CPA or EA purposely should not make a part of a tax practice, so as to minimize exposure to a charge of the unauthorized practice of law.

EXERCISES

52. Summarize what is discussed in each of the following sections of *Circular 230*.
 - a. Subpart A, §10.4(b)
 - b. Subpart B, §10.21
 - c. Subpart B, §10.26
 - d. Subpart B, §10.32
53. Summarize what is discussed in each of the following sections of *Circular 230*.
 - a. Subpart C, §10.51(b)
 - b. Subpart A, §10.6(e)
 - c. Subpart A, §10.2(e)
 - d. Subpart B, §10.27

54. Summarize what is discussed in each of the following sections of *Circular 230*.
 - a. Subpart A, §10.2(e)
 - b. Subpart A, §10.7(c)(viii)
 - c. Subpart B, §10.24
 - d. Subpart B, §10.34
55. Summarize what is discussed in each of the following sections of *Circular 230*.
 - a. Subpart B, §10.33
 - b. Subpart B, §10.35
 - c. Subpart B, §10.36
 - d. Subpart B, §10.37
56. Which subpart and section of *Circular 230* discusses each the following topics?
 - a. Solicitation
 - b. Negotiation of a taxpayer's refund checks
 - c. Depositions
 - d. Authority to disbar or suspend from practice before the IRS
57. Which subpart and section of *Circular 230* discusses each the following topics?
 - a. Conflicting interests
 - b. Tax shelter opinions
 - c. Disreputable conduct
 - d. Assistance from disbarred or suspended persons
58. Which subpart and section of *Circular 230* discusses each of the following topics?
 - a. Practice of law
 - b. Information to be furnished
 - c. Fees
 - d. Who may practice before the IRS?
59. Which subpart and section of *Circular 230* discusses each of the following topics?
 - a. Best Practices
 - b. Covered Opinions
 - c. Tax Return Positions
 - d. Due Diligence
60. Summarize what is discussed in each of the following rules of the AICPA Code of Professional Conduct. Give a simple example of a transaction or an action relevant to each rule.
 - a. Article VI, ¶ para 1
 - b. Rule 201, ¶ .02 201-1
 - c. Rule 502, ¶ .03 502-2
 - d. Rule 504, ¶ .01
61. Summarize what is discussed in each of the following SSTs.
 - a. SSTs No. 1
 - b. SSTs No. 4
 - c. SSTs No. 6
62. What is the precedent-setting value of each of the following cases?
 - a. *Lowell Bar Association v. Loeb*

- b. *Bercu*
 - c. *Sperry v. Florida*
63. Ms. E is an EA who prepared the tax returns for Mr. A and Mr. B (buyer and seller, respectively). Ms. E may not, under any circumstances, represent A and B before the IRS with regard to this buy and sell transaction. True or false? Explain your answer. (IRS adapted)
64. A full-time employee of a sole proprietorship may represent his or her employer in an examination by the IRS without being an EA, attorney, or CPA. True or false? Explain your answer. (IRS adapted)
65. An unenrolled tax preparer who has not prepared the tax return of John Gomez may represent John before an IRS revenue agent in the conduct of an examination, provided that the unenrolled tax preparer has written authorization from John. True or false? Explain your answer. (IRS adapted)
66. EAs, attorneys, and CPAs shall exercise due diligence in preparing or assisting in the preparation of documents and other papers relating to IRS matters. True or false? Explain your answer. (IRS adapted)
67. Which of the following statements may not be used when an EA advertises? Explain your answer. (IRS adapted)
- a. Name, address, and office hours
 - b. Names of associates of the firm
 - c. Claims of quality of service that cannot be verified
 - d. Membership in professional organizations
68. The IRS Director of Practice may take into consideration a petition for reinstatement from any person disbarred from practice before the IRS after a period of how many years? Explain your answer. (IRS adapted)
- a. Never
 - b. 2 years
 - c. 3 years
 - d. 5 years
69. Inclusion of which of the following statements in a CPA's advertisement is unacceptable under the AICPA Code of Professional Conduct? Explain your answer.
- a. Julie Adams, CPA, Fluency in Spanish and French
 - b. Julie Adams, CPA, MBA, Big State University, 2005
 - c. Julie Adams, CPA, Free Initial Consultation
 - d. Julie Adams, CPA, I Always Win IRS Audits
70. Which of the following situations would most likely result in a violation of the practitioner's ethical standards? Explain your answer.
- a. A CPA is controller of a bank and grants permission to the bank to use his "CPA" title in the listing of the bank officers in the bank's publications.
 - b. A CPA who is also a member of the bar represents on her letterhead that she is both an attorney and a CPA.
 - c. A CPA, the sole shareholder in a professional accountancy corporation, uses the term "and company" in his firm's title.
 - d. A CPA who writes a newsletter on financial management topics grants permission to the publisher to solicit subscriptions.

71. Which of the following situations would provide an acceptable case for using a taxpayer's estimated figure in the preparation of a Federal income tax return? Explain your answer.
- The taxpayer has the necessary data available, but is busy with a pressing public offering and has not had the time to look through her records for the information.
 - The data are not available at the time of filing the return, and the estimated amounts appear reasonable to the CPA.
 - The taxpayer has the data available at the time for filing the return but feels that the data do not fairly represent the results of her business operation and therefore desires to use an "estimate."
 - The taxpayer, relying on the income tax regulations that allow the use of reasonable estimates under certain circumstances, desires to use an estimate to determine the amount of his deduction for entertainment expenses.
72. According to the AICPA Code of Professional Conduct, CPAs in tax practice who are representing a taxpayer in a formal controversy with the government are permitted to receive contingent fees because:
- this practice establishes fees that are commensurate with the value of the services rendered.
 - attorneys who are in tax practice customarily set contingent fees.
 - determinations by tax authorities are a matter of judicial proceedings that do not involve third parties.
 - the consequences are based on the findings of judicial proceedings or the findings of a government agency.
- Explain your answer.
73. The AICPA Code of Professional Conduct states that a CPA shall not disclose any confidential information in the course of a professional engagement, except with the consent of the client. This rule should be understood to preclude a CPA from responding to an inquiry that is received from:
- an investigative body of a state CPA society.
 - the Trial Board of the AICPA.
 - a CPA-shareholder of the taxpayer corporation.
 - an AICPA voluntary quality review body.
- Explain your answer.
74. A taxpayer's records are destroyed by fire. A CPA prepares the tax return based on estimates and other indirect information she has obtained. Under the SSTS, she should:
- disclose the use of estimates to the IRS.
 - not disclose the use of estimates to the IRS.
 - charge the taxpayer a double fee.
 - not prepare a return based on estimates.
 - have an attorney prepare the return.
- Explain your answer.
75. With regard to the categories of individuals who may practice before the IRS under *Circular 230*, which of the following statements is correct? Explain your answer. (IRS adapted)
- Only EAs, attorneys, or CPAs may represent trusts and estates before any officer or employee of the IRS.

- b. An individual who is not an EA, attorney, or CPA and who signs a return as having prepared it for the taxpayer may, with proper authorization from the taxpayer, appear as the taxpayer's representative, with or without the taxpayer, at an IRS Appeals Office conference with respect to the tax liability of the taxpayer for the taxable year or period covered by the return.
 - c. Under the limited practice provision in *Circular 230*, only general partners may represent a partnership.
 - d. Under the limited practice provision in *Circular 230*, an individual who is under suspension or disbarment from practice before the IRS may not engage in limited practice before the IRS.
76. If an EA, attorney, or CPA knows that a client has not complied with the revenue laws of the United States with respect to a matter administered by the IRS, the EA, attorney, or CPA is required under *Circular 230* to:
- a. do nothing until advised by the client to take corrective action.
 - b. advise the client of the noncompliance.
 - c. immediately notify the IRS.
 - d. advise the client and notify the IRS.
- Explain your answer. (IRS adapted)
77. Answer each of the following questions.
- a. What is found in Subpart A, §10.7(a) of *Circular 230*?
 - b. In *Circular 230*, where are the rules on tax shelter opinions found?
 - c. Describe the requirements of Rule 301 of the AICPA Code of Conduct.
 - d. Which SSTS discusses the use of estimates in preparing a tax return?
 - e. Under SSTS No. 1, a member must have a good-faith belief that a recommended position has a _____ chance of being sustained if challenged. (Fill in the blank.)
78. Answer each of the following questions.
- a. What is found in Subpart C, §10.51 of *Circular 230*?
 - b. In *Circular 230*, where are the rules on knowledge of client omissions found?
 - c. Describe the requirements of Rule 503 of the AICPA Code of Conduct.
 - d. Which SSTS discusses the requirements for verifying a tax client's information?
 - e. Under SSTS No. 8, a member must use judgment that reflects and serves the taxpayer's needs. (Fill in the blank.)
79. The exam to become an EA has four parts. Go to the IRS web site (<http://www.irs.gov>) and determine what is tested on each part of the exam. Describe the content of each part.
80. Go to the NAEA web site (<http://www.naea.org>). Who is the current president of the NAEA and in what city is the headquarters located?
81. Go to the AICPA web site (<http://www.aicpa.org>). Find SSTS No. 2 and print out the complete statement.
82. Go to the IRS web site (<http://www.irs.gov>). What is the form number of the Application for Enrollment to Practice before the IRS? Print out a copy of the form to hand in.

83. Go to (the IRS web site (<http://www.irs.gov>)). Do a publications search and find the most recent *Circular 230*. Print out the title page of the *Circular 230* you found to hand in.
84. Many states have an ethics education requirement to become a CPA. Determine your home state's ethical education requirements to become a CPA. If your state does not have an ethics requirement, state so.

RESEARCH CASES

85. Professor Andy Accrual works for a big state university. The state has negotiated a set of special airfares with various airlines for state employees to use when traveling on state business. These fares are lower, and they do not have restrictions on changing, cancellation, etc. Andy is aware that the airlines never check to see if he is on state business when he books such a fare. He has decided that he would like to go to Hawaii on short notice for a well-earned mini-vacation. When he checks the web for airfares he discovers that the cheapest fare he can find is \$700 per person. However, the fare for state employees for traveling on business to Hawaii is only \$400. Although he is traveling for personal reasons, in your opinion is it ethical to use the special state employee airfare for his vacation? Would this qualify as an ethical dilemma?
86. Donna Deduction is a staff accountant for Dewey, Cheatham, and Howe, LLP. She and other staff raid the office supply cabinet for office supplies to take home to use. In addition to the standard paper, pens, paper clips, etc., the staff takes home inkjet cartridges and other high-cost supplies. During the year Donna takes home supplies worth over \$500. In your opinion is this ethical behavior? If Donna does a significant amount of work for the firm at home, would your opinion change?
87. You are a CPA in practice who has just obtained a new client. Another CPA did the tax returns for the prior three years. The client has operated his business as an S corporation during the three-year period. After starting work on this year's tax return, you notice that the S corporation has an October 31 fiscal year-end. After examining the file, you discover that three years ago, when the S corporation adopted the fiscal tax year, a §444 election was not made. In addition, the S corporation has not maintained the proper required "minimum deposit account" with the IRS.

The client wants your advice on what to do now. You determine that there are three options: (1) you can do nothing and hope the IRS doesn't find out, (2) you can notify the IRS of the mistake and pay any interest and penalties, or (3) you can elect a calendar year and hope the IRS doesn't notice the current invalid fiscal year. What potential nonregulatory ethical issues do you see in this situation that could influence your decision on any recommendation?
88. You are a CPA in practice and have a long-term client who is involved in a nasty divorce proceeding with her husband. The client has assets she deposited in a bank account in the Grand Cayman Islands. There is U.S.-taxable interest on the deposits. Because she does not want her husband to know about the deposits, she asks you to report the interest on her tax return in such a way that it

will not “tip off” her husband to the existence of the account. You can handle this request by reporting the interest through Schedule C (instead of Schedule B) on her tax return and thus avoid making the source of the income known. What potential nonregulatory ethics issues do you see in this situation?

89. Ahi Corporation is one of your clients in Hawaii. The company had a good year last year and owes the IRS \$100,000,000, due on March 15. There are no penalties or interest due to the IRS. One of Ahi’s employees approaches you with the following plan to benefit from the so-called “float” on the large payment due to the government. First, Ahi Corp. will courier its tax return and payment to the U.S. Virgin Islands. There, the tax return will be mailed to the IRS Service Center in Fresno by certified mail on the return’s due date, March 15. By doing this, the employee thinks it will take at least six days for the tax return to reach the IRS and for them to cash the \$100,000,000 check. Ahi can earn 7 percent after tax on its money, so the interest earned during these six days because of the float is \$19,178 per day [$(\$100,000,000 \times .07/365 \text{ days})$]. Thus, the total interest earned on the float for six days would be \$115,068 ($\$19,178 \times 6 \text{ days}$).
- Would you recommend Ahi complete this transaction?
 - What potential ethics issues do you see in this situation?
90. John Haddock owns 75 percent of Haddock Corporation. The other 25 percent of the stock is held by John’s wife, Marsha. You are a tax manager assigned to prepare the corporate tax return for Haddock. While working on the return, you note that Haddock Corp. pays rent to John for a building he owns with his son, John, Jr. The rent being paid is at least three times the normal rate for rentals of similar property in that area of town. You report this observation to the partner on the engagement. She tells you that it is alright to deduct the payments because Haddock Corp. has been doing it for several years, and the IRS never has objected. Under your firm’s policy, managers sign the tax return for clients.
- Would you sign this tax return?
 - What potential ethics issues do you see in this situation?
91. You are negotiating a transaction for your client, Shark Corporation. Parties on the other side of the deal ask you for information about the structural stability of a building, which is a significant part of the transaction. Coleman, Shark’s tax director, tells you to say “everything is OK,” when, in reality, the building has substantial hidden damage. Coleman tells you to say this because it would be more favorable to Shark’s position in the transaction.
- How would you respond to Coleman’s request?
 - What if you have already told the other side that the building is OK when you learn about the problems?
 - What other potential ethics issues do you see in this situation?
92. Big CPA Firm has many partners in one of its local offices. Two of these partners are Tom, a tax partner, and Alice, an audit partner. Because of the size of the office, Tom and Alice do not know each other very well. Tom has a tax client, Anchovy Corporation, that is in severe financial trouble and may have to file for bankruptcy. Anchovy is a customer of Sardine Corporation, one of Alice’s audit clients. Accounts receivable on Sardine’s books from Anchovy are significant. If Anchovy goes bankrupt, it could cause serious

- problems for Sardine. Alice is unaware of the bad financial condition of Anchovy.
- Can Tom disclose to Alice the problems at Anchovy?
 - What if Anchovy goes under and takes Sardine with it?
 - What potential ethics issues do you see in this situation?
93. You are the tax manager in a CPA office. One of your clients, Snapper Corporation, is also an audit client of the firm. The CFO of Snapper invites you and the audit manager for a one-week deep-sea fishing trip to Mexico, all expenses to be paid by Snapper. The audit manager says that you both should go and just not tell your supervisor at the CPA firm any details (like who paid the expenses) about the trip.
- Would you go on the trip?
 - Would you tell your supervisors at the CPA firm if the audit manager went on the trip without you?
 - What other potential ethics issues do you see in this situation?
94. Clara comes to an attorney's office in need of assistance with her husband's estate. Her husband, Phil, a factory worker, had been a saver all his life and owned approximately \$1,500,000 in stocks and bonds. Clara is relatively unsophisticated in financial matters, so the attorney agrees to handle the estate for 17 percent of the value of the estate. The normal charge for such work is 3–5 percent of the estate. The widow agrees to the 17 percent arrangement. The attorney then hires CPA Charles for \$10,000 to compute Phil's estate tax on Form 706 and to prepare other appropriate documents.
- Does Charles have any responsibility to inform the widow that she is being significantly overcharged by the attorney?
 - What potential ethics issues do you see in this situation?
95. Darlene works for Big CPA Firm. When she was being interviewed, Darlene was told by a partner in the firm that she was not to underreport her time spent on various engagements. However, after working for a few months, she discovers that everyone in her office "eats time." Because she is not eating time like everyone else, Darlene is always over budget. She is beginning to get a reputation as a "budget buster." As a result, none of the senior tax staff wants her on their engagements. She is getting the worst clients and bad reviews from the people for whom she works. It appears that unless she starts eating time, Darlene's future with the firm is limited.
- What would you recommend Darlene do?
 - What potential ethics issues do you see in this situation?
96. Freya is an accountant working on the tax return of a high-tech client. After reviewing the work papers, she discovers that there is a pattern of double billing the U.S. Navy for various projects done by the tax client. She brings this to the attention of her manager on the job, and he tells her that it is not the CPA firm's business what the client does since this is not an audit engagement.
- What would you recommend Freya do at this point?
 - What potential ethics issues do you see in this situation?
97. Jenny is an accountant for an international energy corporation. She oversees the accounting for certain associated offshore entities. The amount of funds involved in the entities is substantial. At the end of the year she notices that the

accounting information from the offshore entities is not included in the consolidated financial statements of the corporation, but is reported on the consolidated tax return. She inquires about this and she is told that the corporation does not report the financial information from the offshore entities since it would lower the earnings of the main corporation. Jenny is sure that this is not the proper accounting and tax treatment for the entities.

- a. What would you recommend Jenny do at this point?
 - b. What potential ethics issues do you see in this situation?
98. Eric is a tax manager for a national CPA firm that audits Penny-Pinching Bank (PPB). Eric and his staff prepare and review the tax return for PPB. One day, at an alumni football tailgate party, he meets another alumnus who Eric discovers is on the Audit Committee of PPB. The Audit Committee member/alumni was unaware that Eric's CPA firm is doing PPC's tax return.
- a. What would you recommend Eric do at this point?
 - b. What potential ethical and practice issues do you see in this situation?
99. Dodger Corporation has been in the manufacturing business in the United States for over 100 years. A tax consultant has proposed that Dodger use a "corporate inversion" to nominally move its headquarters to an island in the Atlantic Ocean. The operating headquarters will remain in the United States, along with all of its employees, its plant and equipment, and most of its customers. By undertaking this corporate inversion and technically moving its headquarters offshore, Dodger can defer or avoid paying U.S. corporate income tax. However, for all practical purposes, it remains a U.S.-based company.
- a. What would you recommend Dodger do about the proposed corporate inversion?
 - b. What potential ethics issues do you see in this situation?