Ethics for Tax Professionals

Tax Executives Institute
New England Chapter
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Dwight Mersereau
(202) 624-2856
dmersereau@crowell.com

Jeremy Abrams
(202) 624-2926
jabrams@crowell.com

Teresa M. Abney
(202) 624-2667
tabney@crowell.com
This Presentation . . .

. . . contains general information only and the speakers are not rendering accounting, business, legal, tax, or other professional advice, other than their own feeble attempts at education and entertainment.
Agenda

• Sources of Ethical Guidance
• Federal Privileges
• Tax Returns
• Audits
• Case Study
Sources of Guidance

• Professional Organizations
• Government-Imposed Rules
• Rules Imposed on Revenue Departments
• Corporate Policies
• Personal Convictions
Purpose and Function of Ethics Codes

• Reflect organizational values
• Articulate principles and standards
• Advise members of accepted conduct – and conduct that is not acceptable
• Aspiration to members and, through enforcement measures, protects integrity of the organization
• Assist members in identifying ethical issues and provide framework for resolution
An Ethical Analytical Framework

Organizational Considerations
- Relationship with IRS or State Revenue Officials
- Effect on future years
- Potential future benefit
- Good corporate citizen
- Culture or climate of employer

Legal Considerations
- ABA Model Rules
- AICPA SSTS
- State Standards of Conduct
- TEI Standards of Conduct
- Treasury Circular 230

*Note: If the proposed act passes muster under listed item, actor must proceed to consider next item; only after all items are considered can the actor decide whether to proceed with the proposed act.

Personal Considerations
- Individual religious, philosophical or moral standards
- WSJ Test=practical way to apply your own individual moral standard

Special thanks to Don Griswold, formerly of Crowell & Moring LLP, who developed this analytical framework.
Rules of Professional Organizations

- American Bar Association
- Professional Oaths
  - e.g., Massachusetts Attorney’s Oath (https://malegislature.gov/Laws/GeneralLaws/PartIII/TitleI/Chapter221/Section38)
- American Institute of CPAs
  - http://www.aicpa.org/Research/Standards/Tax/Pages/default.aspx
- Tax Administrator Associations
  - e.g., Louisiana Association of Tax Administrators
    http://www.laota.com/documents/CodeofEthics.doc
- Tax Executives Institute
  - http://www.tei.org/membership/Pages/StandardsofConduct.aspx
- Institute for Professionals in Taxation
Government-Imposed Rules

- Sarbanes-Oxley

- Circular 230

- State-specific rules of professional conduct
  - e.g., Rhode Island Rules of Professional Conduct
    - [https://www.courts.ri.gov/PublicResources/disciplinaryboard/PDF/Article5.pdf](https://www.courts.ri.gov/PublicResources/disciplinaryboard/PDF/Article5.pdf)
  - e.g., Massachusetts Rules of Professional Conduct

- Rules within tax laws
Rules Imposed on Revenue Departments

- Taxpayer bills of rights
- Codes of conduct
Corporate Policies

• Company’s own ethics policies or codes
• Association of Corporate Counsel
  – http://www.ethicsxchange.com/topic/35529-code-of-conduct
• Court-appointed monitoring
Personal Convictions

- Individual Moral Code
  - Often the first level of scrutiny of a potential action
- Individual Character
  - Internal moral barometers
  - Only the starting point; must navigate the whole framework

“If you tell the truth, you don’t have to remember anything.” – Mark Twain
Other Considerations

• Disincentive of Public Disclosure
  – “What-would-your-mother-say” test
  – “Wall Street Journal” Test
  – “The Red Face Test”
  – “What do you do when no one is watching?”
New Pressures – New Issues

• Have economic and societal pressures created new ethical issues?
  – Strains on company resources – How accurate are the numbers on tax returns?
  – Market Tension – Is there pressure to reach a certain “level of authority” in order to recognize a tax benefit?
  – Managing risk – What impacts annual goals?
Issues for CPAs

- The handling of tax returns
- Reporting false information
- Withholding tax information
- Unwarranted protests or appeals
- Qualifications
- Hiring practices
Issues for Attorneys

- Conflicts of interest
- Revealing confidential information
- Unwarranted appeals
- False or misleading advertising
- Fee issues
Potential Consequences of Ethical Failures

• Corporate
  – Reputational risk
  – Shareholder suits
  – Penalties
  – Other?

• Personal
  – Disbarment
  – Loss of CPA License
  – Get fired
  – Other?
Let’s Talk Hypotheticals

Remember the ethical analytical framework!
Is it ethical:

... to claim 4 hours of ethics training today if you step out for a 30 minute call from your boss?

1. Yes
2. Possibly
3. Probably Not
4. No
Is it ethical:

... to knowingly omit material facts from a formal opinion?

1. Yes
2. Possibly
3. Probably Not
4. No
2. Formal Opinions

- **AICPA SSTS No.7.** Taxpayers should be informed that (a) the advice reflects professional judgment based upon the member’s understanding of the facts, and the law existing as of the date the advice is rendered.
Is it ethical:

... to ignore nexus questionnaires or phone calls from auditors until you receive formal requests or correspondence?

1. Yes
2. Possibly
3. Probably Not
4. No
4. Political Pressure

Is it ethical:

... to apply political pressure to the taxing authority via government contacts in an attempt to achieve a favorable settlement?

1. Yes
2. Possibly
3. Probably Not
4. No
Is it ethical:

... to sign a settlement agreement which you know contains an error in favor of your company?

1. Yes
2. Possibly
3. Probably Not
4. No
5. Mistake of Fact

- Model Rule 3.3(a)(1). Prohibits an attorney from knowingly making a false statement of fact or law to a tribunal, or failing to correct a false statement of material fact or law previously made.
- Model Rule 3.3(b). Attorneys have a duty of candor to the tribunal.
- Model Rule 4.1. An attorney “shall not knowingly: (a) make a false statement of material fact or law to a third person; or (b) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.”
- AICPA SSTS No. 6. A CPA is not obligated to inform a taxing authority, nor may a CPA do so w/o client’s permission.
- Circ. 230, 10.21. A practitioner who knows that the client has not complied with the revenue laws or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the U.S., must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the IRC and regulations of such noncompliance, error or omission.
- Circ. 230, 10.22. Addresses practitioners’ duty to exercise due diligence.
6. Collecting Too Much

Is it ethical:

... to sign a settlement agreement that results in the most amount of tax collected even if you know the agreement does not reflect the “right” answer?

1. Yes
2. Possibly
3. Probably Not
4. No
Is it ethical:

... to enter into a settlement agreement without raising dispositive authority that the tax administrator failed to address?

1. Yes
2. Possibly
3. Probably Not
4. No
7. Mistake of Law

- **AICPA SSTS No. 6.** A CPA is not obligated to inform taxing authority, nor may CPA do so w/o client’s permission.

- **Model Rule 3.3(a)(2).** An attorney shall not knowingly “fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel . . . .”
Is it ethical:

... in settlement negotiations or mediation, to understate the actual amount of your settlement authority or limits?

1. Yes
2. Possibly
3. Probably Not
4. No
8. Settlement Negotiations

- **ABA Model Rule 4.1, Comment.** “A lawyer is required to be truthful when dealing with others on a client’s behalf, but generally has no affirmative duty to inform an opposing party of relevant facts.”
Is it ethical:

. . . in settlement negotiations or mediation, to omit facts or legal precedents that might be adverse to your settlement position?

1. Yes
2. Possibly
3. Probably Not
4. No
9. Settlement Negotiations

- **Model Rule 3.1.** “A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law.”

- **Model Rule 4.1, Comment.** “A lawyer is required to be truthful when dealing with others on a client’s behalf, but generally has no affirmative duty to inform an opposing party of relevant facts.”
Is it ethical:

... to enforce a tax law that is clearly unconstitutional?

1. Yes
2. Possibly
3. Probably Not
4. No
Is it ethical:

... to sign a tax return that you know is based on an estimate of the amount of tax owed instead of on actual amounts?

1. Yes
2. Possibly
3. Probably Not
4. No
11. Signing Tax Returns

• **AICPA SST S No. 4.** A CPA may use the taxpayer’s estimate to prepare return if it is not practical to obtain exact data and the estimates are reasonable.
12. Signing Tax Returns

Is it ethical:

... to sign a tax return that you know is based in whole or in part on a position that is not clearly supported by applicable statutes or rules?

1. Yes
2. Possibly
3. Probably Not
4. No
12. Signing Tax Returns

- AICPA SSTS No. 1 and Interpretation 1-1. A CPA should not recommend that a tax return position be taken with respect to any item unless the CPA has a good faith belief that the position has a “realistic possibility” of being sustained administratively or judicially on its merits if challenged.
13. Statute of Limitations

Brinkmanship

Is it ethical:

. . . to remain silent when a tax administrator asks you to extend the statute of limitations for Co. A when you know the assessment should be against Co. B?

1. Yes
2. Possibly
3. Probably Not
4. No
13. Statute of Limitations Brinkmanship

- **Model Rule 1.6(a)**. Attorney must maintain client confidences.
- **Model Rule 8.4(c)**. Prohibits an attorney from engaging in dishonest acts.
Is it ethical:

... to forego taking a widely accepted industry position because you have personal reservations?

1. Yes
2. Possibly
3. Probably Not
4. No
15. Signing Tax Returns

Is it ethical:

... to take a position that’s aggressive but reasonable knowing that the position is an outlier and may create reputational risk?

1. Yes
2. Possibly
3. Probably Not
4. No
16. Signing Tax Returns

Is it ethical:

... to shop around for an Opinion supporting an overly aggressive position?

1. Yes
2. Possibly
3. Probably Not
4. No
Federal Privileges

- Attorney Client Privilege
- Work Product Doctrine
- Federally Authorized Tax Practitioner Privilege
Federal Privileges

- Privilege issues are fact intensive issues and analyzed on a case by case basis
- Applicable rules vary by jurisdiction
Federal Attorney Client Privilege

• Privilege applies to:
  – A communication
  – between privileged parties
  – made and kept in confidence
  – for purpose of providing or obtaining legal advice
Federal Attorney Client Privilege

• Absolute protection against disclosure
• Protects the advice, not the facts
• Easily waived
  – Kovel arrangements
Federal Attorney Client Privilege – In House Issues

• Attorney client privilege applies to in-house counsel the same as outside counsel

• But just because the person is an attorney doesn’t mean the communication is privileged!
Federal Attorney Client Privilege – In House Issues

• The privilege belongs to the company, not the employees
• But privilege can protect communication with the employees
  – Former employees?
• Give employees an *Upjohn* warning (aka the corporate *Miranda* warning)
Federal Work Product Doctrine

• Protects:
  – documents and tangible things
  – prepared in anticipation of litigation or for trial
  – by a party or that party’s representative
“In anticipation of litigation”

• Circuit split on meaning of “in anticipation of litigation”
  – “Primary motivation purpose” test (5th Circuit)
  – “Because of” test (D.C., 2d, 3d, 4th, 6th, 7th, 8th, 9th Circuits)
  – *Textron’s* variation on the “because of” test (1st Circuit)
Federal Work Product Doctrine

• Does not protect facts concerning the creation of the work product or facts contained within the work product
• Not an absolute protection – privilege can be pierced
• May trigger litigation hold
Federally Authorized Tax Practitioner Privilege

• Codified in 26 U.S.C. § 7525
• Applies to confidential communications between a federally authorized tax practitioner and his client
• Privilege applies only to non-criminal tax matters before the IRS and DOJ
  – Doesn’t apply to other agencies (i.e., SEC) or in private litigation
  – Doesn’t apply to any written communications in connection with promotion of a tax shelter
Protecting Privileges

• Inadvertent disclosures
• Practical measures to protect available privilege claims and avoid waiver
**Hypothetical**

- Company is doing a business motivated transaction. An outside advisor suggests a structure that, if respected, would significantly minimize tax. One of the steps in the transaction arguably is being done only for tax purposes and has no independent economic substance.
- Your boss, the tax director, sends you an email: “This thing stinks. Fix it.”
- You meet with the business people and the advisor. After conducting extensive research, you prepare a memorandum analyzing the structure and conclude that it is more likely than not to not survive a challenge unless there is a non tax business reason for the questionable step. You provide a copy to your boss, who circulates the memo to the deal team, the advisor, and the company’s auditors.
- The advisor presents the transaction to the Board with a Power Point presentation.
- The Company executes the transaction as recommended by the advisor.
Is it privileged?

Is your memo privileged?
A. Yes, the attorney client privilege
B. Yes, the IRC § 7525 tax practitioner privilege
C. No
D. Maybe
Is it privileged?

• Answer D, Maybe

• If primary purpose of the memo was providing or obtaining legal advice, it may be privileged

• Circulation of the memo matters too – was there waiver?
Is it privileged?

Is the Broad presentation by the advisor privileged?

A. Yes, at the rates we are paying it better be
B. No, there was no expectation of confidentiality
C. Yes, there was an expectation of confidentiality
D. Maybe
Is it privileged?

- Answer D, Maybe
- Presentation to Board not likely privileged, but depends on nature and purpose of presentation
  - For privilege to apply, will need to show that presentation was necessary for the lawyer to provide legal advice
- Communications that enable the lawyer to provide business advice also not privileged
- If a business person could have provided same discussion, would not be privileged
Tax Returns

• Signing the Return
• Penalty Protection
• Tax Opinions
• Circular 230
• Schedule UTP
Signing the Return

• Company’s tax return is now complete, it is 5,000 pages including 3,000 schedules, is about 2 feet of paper. The CEO calls you into his office where the return is stacked in the center of his desk and asks “do you really expect me to sign this?”

• The return includes a tax position that you have been advised has a reasonable basis, but your tax advisor is unable to say is more likely than not to be sustained
What should you do?

What do you tell the CEO?

A. Tell the CEO to sign, he doesn’t need to know any more
B. Tell the CEO to sign, he already certified the tax reserves in the Company’s Financial Statements anyway
C. Tell the CEO to cross out the Jurat (penalties of perjury statement) and sign the return
D. Tell the CEO the return cannot be filed as prepared
E. None of the above
What should you do?

• Answer E, None of the above
The Jurat Conundrum

• Form 1120 Jurat: “Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and believe, it is true, correct, and complete.”
• Section 7206(1): Criminal felony to willfully subscribe a return which signatory does not believe to be true and correct as to every material matter
• Deliberate ignorance is not a defense
Almost Sarbanes-Oxley

- Sarbanes-Oxley requires the CEO and CFO to certify a Company’s Financial Statements, including the provision for taxes
  - Certification to CEO/CFO by subordinates common practice
- SOX stated “sense of the Senate” that CEO should also sign tax return. This proposal has not been adopted as a formal requirement.
- Currently, Section 6062 requires returns to be signed by President, Vice-President, Treasurer, Assistant Treasurer, Chief Accounting Officer, or other Officer duly authorized to so act
Jurat is Required

• Return executed without Jurat does not constitute a return
  – Penalties for failure to file arise
  – Statute of limitations does not run

• Alteration of jurat can give rise to “frivolous” return penalties (arising out of individual “tax shelter/tax protester” arguments)
Tax Return Filing Standards

• Section 6694: No penalty if:
  – “substantial authority” for position (33%-40%) or
  – “reasonable basis” (20%-33%) and disclosed on return
  – Effective May 25, 2007 (previously “Realistic possibility of success on merits”)

• Circular 230 “tax return preparer” standards, now refer to Section 6694
  – Must have reasonable basis and be disclosed or
  – More likely than not (more than 50%) (without disclosure)
Advice from Lawyer

• Many times will be deemed “tax return preparer” if advising on position on return

• Lawyer may advise of positions most favorable to client if “good faith belief” those positions are “warranted in existing law or can be supported by a good faith argument for extension, modification or reversal of existing law.” Must have “realistic possibility of success if litigated”

• Lawyer must advise that accuracy-related penalty (Section 6694) could apply, but “has no duty to require as a condition of continued representation” that his or her advice be followed
Best Practices

• Need procedures to confirm to CEO and CFO that tax provisions in financial statements are adequate
  – Review of positions in context of UTP and Financial Statements
  – Parallel/supplementary review in context of tax return
• Return signed by corporate officer with most knowledge
Penalty Protection – Accuracy Related Penalty

• 20% penalty on underpayment of tax
Penalty Protection – Reasonable Cause Defense

• No penalty if (1) there was reasonable cause for the understatement and (2) the taxpayer acted in good faith

• BUT special rules for:
  – transactions lacking economic substance
  – Reportable transactions
  – Certain charitable contributions

• Be careful of waiving privilege!
Best Practices for Tax Opinions

- Sophisticated corporate taxpayers are held to a high standard
- Documentation, documentation, documentation
- Facts and assumptions
  - Accuracy is critical
  - Retain records of information supplied
  - Document review
  - Retain comments on drafts
  - Question where facts seem incomplete or sparse
  - Question assumptions
- For full confidence in penalty protection, need independent counsel
Circular 230 Obligations

• Circular 230 sets out standards for the preparation of opinions
• No more covered opinions
• § 10.37 Other Written Advice
Schedule UTP – Who Must File

• Following corporations must file:
  1. Corporation that files Form 1120, 1120-F, 1120-L or 1120-PC and
  2. Assets equal or exceed $10 million and
  3. Issues (or a related party issues) audited financial statements for all or part of tax year and
  4. Has one or more tax positions that must be reported on Schedule UTP
Schedule UTP – Positions that Must Be Reported

- Positions that must be reported:
  - Corporation has taken a position on U.S. federal income tax return for current tax year (or a prior tax year) and
  - Corporation (or a related party) has:
    - Recorded a reserve for the position in audited financial statement or
    - Has not recorded a reserve for the tax position because the corporation expects to litigate the position

- Reserve broadly defined

- Tax position: would result in adjustment to line item on return if not sustained
  - If affect multiple year returns, could be tax position for each year
Schedule UTP – What the Form Requires

• Rank tax positions by size
• Provide a **concise** description of the UTP (usually, just a few sentences)
  – “Available upon request” is not adequate
• Should not include an assessment of the hazards of litigation or analysis of the support for or against the position
Schedule UTP – Consequences?

• The penalties for noncompliance are unclear
• May provide protection from accuracy-related penalties
• Do not need to File Form 8275, Disclosure Statement or Form 8275-R, Regulation Disclosure Statement if position is completely and accurately disclosed on Schedule UTP
• May avoid 6 year statute of limitations
You decide to prepare a Schedule UTP. A manager working for you proposes the following description:

Company participated in a transaction. The issues are whether the company had an independent business purpose for the transaction and whether the transaction economic substance under IRC §7701(o). Company has an opinion from the outside advisor who structured the transaction that the tax treatment reflected on the Form 1120 more likely than not correct. The basis of the opinion is that a transaction of this type need not have an independent business purpose.
What should you do?

What should you do with the draft?

A. It is fine to use
B. Delete the reference to economic substance and business purpose
C. Delete the reference to the tax opinion
D. Fire the manager
What should you do?

• Answer B, C, and D
• Mentioning the opinion (especially the conclusions) could lead to a waiver
• The “concise description” need not (and should not) include a discussion of the support for the taxpayer’s position
• Originally UTP required that taxpayers include a description of the “nature of the uncertainty” or the rationale that might support the IRS’s view. This was withdrawn from the final version of the schedule.
Audit

• First Steps
• Circular 230 obligations
• Document requests
• Summons interviews
First Steps in Audit

• Record retention policy
• Litigation hold
• Notifying potential witnesses and record holders
Circular 230 – IRS Information Request

• § 10.20(a)(1) Information to be furnished
• § 10.20(a)(2) Don’t have the information requested
• § 10.20(b) Duty to cooperate
What Should You Do?

What do you do in response to a documentary summons?

A. Forward it to the General Counsel’s office
B. Assemble the documents and deliver them to the IRS on the response date
C. Issue a litigation hold for documents related to the transaction
D. Ignore it
What should you do?

• Answer A, B, and C
• Do not ignore the summons!
What should you do?

What should you do in anticipation of a summons for your tax accrual workpapers?

A. Burn everything
B. Conduct a privilege review and prepare to protect privileged documents from disclosure
C. Communicate with your auditors and ask them to contact you should they hear from the IRS
D. Issue a hold notice if you haven’t done so already
E. Send a letter to your Senator and Congressman claiming discriminatory targeting
What should you do?

• Answer B, C, and D
• Do not burn anything!
Responses to IRS Summons for Documents

• IRS Summons are not self-enforcing
  – You do not need to file a lawsuit to quash a normal IRS summons
    • John Doe summonses, third-party summonses, and Section 982 formal document requests have different procedures
  – If you fail to comply, the Department of Justice must file suit to compel compliance with the summons

• Privilege review
What should you do?

How do you respond to the request for a written narrative?

A. Crack open the books and write a detailed narrative, explaining all facts and authorities in support of the position
B. Write a nice letter explaining that you are not responding
C. Supply all the documents in support of the position, without the narrative
D. It depends
What should you do?

- Answer A, B, C, or D.
- Cons of Written Narrative
  - Becomes part of the administrative record
  - Potential privilege waiver
  - May reveal issues the examiner has not considered
  - Roadmap for the NOPA
- Pros of Written Narrative
  - May resolve the issue
  - Permits some control over presentation of issue without interviews/testimony
  - Less disruptive to operations
- Alternatives to written narratives
What Should You Do?

What do you do in response to a summons for testimony?

A. Forward it to the General Counsel’s office
B. Consider negotiating a written response to the summons based on the IDR question
C. Prepare the witnesses for testimony on the response date
D. Use it as kindling for the wood stove in your (soon to be former) office
What should you do?

• Answer A, B, and C.
• Do not use the summons for kindling!
Participation in Summons Interviews

• Participation by company
• Representation
• Best practice: seek to have employee invite company attorney
Participation in Summons Interviews

• Attorney representing interviewee has right to object and instruct the witness during interviews
  – IRS may suspend interview and seek to exclude attorney if improperly impeding or obstructing the interview
  – Other persons attending interview have no right to participate in interview

• Interviewee has right to record (but not videotape) the interview with notice to IRS (IRS will also record)
What should you do?

How do you prepare the witness for the summons interview?

A. Do nothing
B. Come up with a script of answers from which the witness is not allowed to deviate
C. Give the witness an *Upjohn* warning and discuss the likely subject matter of the interview
D. Have HR transfer the witness to a location outside United States
What should you do?

• Answer C
• In *Upjohn* (S.Ct. 1981), the Supreme Court held that the attorney-client privilege applies to communications between counsel and employees of the company.
  – The *Upjohn* warning informs the employee that the company, not the employee, is the client and controls the privilege.
• In preparing witnesses, be aware questioner can and will ask about preparation time and character
  – Review IRS Summons Handbook (IRS Part 25, Chapter 5) and DOJ Summons Enforcement Manual prior to interview
Considerations in Witness Preparation

- Questioner can ask about preparation
- Answer witness’s questions first
- Avoid “woodshedding” the witnesses
- Tell the truth, tell the truth, tell the truth
- Note taking during preparation
- Coaching during the interview
- Discussing testimony during breaks
- ABA Model Rule 3.4
Case Study
THANK YOU!

<table>
<thead>
<tr>
<th>Dwight Mersereau</th>
<th>Jeremy Abrams</th>
<th>Teresa M. Abney</th>
</tr>
</thead>
<tbody>
<tr>
<td>(202) 624-2856</td>
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