Ethics for Tax Professionals in an Age of Hashtags and Heightened Transparency

2018 U.S. Cross-Border Tax Conference

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Notices

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.
Agenda

01  Transparency, Morality, and the Importance of Ethics in the Tax Practice

02  The Ethical Landscape: Social Science Research
    • Surveys by Ethics & Compliance Initiative
    • The Importance of Environment
    • Cultural and Demographic Differences

03  An Analytical Framework for Tax Professionals

04  Professional Standards: AICPA, ABA, and Circular 230; Penalties; Foreign Corrupt Practices Act

05  Appendices: AICPA Code of Professional Conduct, Whistleblower Rules, and State False Claims Acts
## Today’s presenters

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It’s simple even if it isn’t easy …

#Ethics-in-the-headlines
Objectives

Following a review of recent behavioral and other social science research relating to ethics, this session will focus on changes effected by recent changes to the IRS’s Circular 230 and then discuss the application of Circular 230, as well as applicable ABA and AICPA rules, in a number of real-world examples, including situations involving the Foreign Corrupt Practices Act and Subpart F.

Participants will be able to:

— Appreciate the trends identified in recent behavioral and other social science research about the significance of certain demographic attributes (including age and gender) to ethical conduct.

— Recognize applicable ABA Model Rules and AICPA Code of Professional Conduct and Statements on Standards for Tax Services relating to in-house tax practice.

— Understand the relevance to in-house professionals of the ethical standards of the Internal Revenue Service contained in Circular 230.

— Apply specific ABA and AICPA rules, as well as Circular 230, to specific examples of permitted and prohibited conduct.
It’s simple even if it isn’t easy …

Is the challenge knowing what’s right and wrong…

… or knowing how to act on your values?
It’s simple even if it isn’t easy …

Is it an ethical violation to …

… hand a presenter the wrong envelope during an awards ceremony?

… buy fake social media followers?

… sneak outside food into a movie theater?

… take files from your old government job to your new private sector job?

… assert a position at odds with controlling Supreme Court precedent?

… insert a fictive number in yours financials to lower your company’s effective tax rate?

… allow your client to make a misleading statement to an auditor? a judge? the public?
Transparency, morality, and the importance of ethics in the tax practice
Importance of ethics in tax practice


— Employees see the need for and have positive views of ethics and compliance (E&C) training, but stress the need for training to be applicable and informative.

  - Employees say E&C training tends to focus on compliance, regulation, and standards, rather than on changing behavior and preventing future misconduct.

— Surveys identified the critical importance of senior leadership’s visible participation. Interaction with leadership reinforces the importance of culture and changes behavior.

— Case studies, role play, and learning how to solve ethical dilemmas are all associated with improved results. Of these, learning how to solve dilemmas seems to be the single most effective activity.


— As important as identifying what the ideal solution is, knowing does not necessarily translate into acting on one’s values.

— Importance of creating an environment where employees feel empowered to speak up — to raise their hands.

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Importance of ethics in tax practice

Global trends in transparency, including BEPS (e.g., release of Country-by-Country Reports, via governmental action, or data breaches)

People we know and work with — people like us — are finding themselves on the wrong side of the ethical (or legal) line:

— Internal Revenue Service or Revenue Department employees
— Tax Court judges
— Tax executives
— Practitioners (and financial statement auditors)
— Companies
— Rise of Tax Whistleblowers, Qui Tam, NGOs, Tax-Related Leaks (e.g., LuxLeaks, Panama Papers, Paradise Papers)
Example: Discovery of a clear error

Example 1

You’re reviewing a proposed settlement agreement which the IRS case manager has already signed.

A. You notice an arithmetic error in your favor.
B. You notice that the agreement does not include a taxpayer concession that the case manager had previously insisted would be included.

What do you do in these situations?

What if you do not discover the error or omission until you get back to your office?
Hypothesis: Do Unethical People Self-Select into the Tax Profession?


- Examination of the moral reasoning of tax practitioners in social and tax contexts.
- Focus on internal and external variables that affect behavior.
- Among the questions raised by the article:
  — Does the need to be aware of the intricate details of regulations lead people to focus more in terms of following the letter of the law (and only that) rather than the spirit?
  — Does the culture in the organizations in which tax practitioners work promote certain ways of viewing a situation?
Ethical reasoning process of tax practitioners

Conclusions

— Tax practitioners use “lower levels of ethical reasoning” at work than in a social context; *i.e.*, they are more likely to follow the letter rather than the spirit of the law.
  - No support in the results for proposition that tax practitioners have a generally lower level of moral reasoning than the population as a whole.
  - Individuals whose reasoning is less principled than the norm are not self-selecting into the tax profession.
— This appears to be as a result of training and socialization.
— May be a result of having a predominantly law-and-order (*i.e.*, hypertechnical) orientation of tax practitioners.
— No difference found between law firms and accounting firms.
— Results did not reveal any significant difference in moral reasoning between the sexes.
  - Prior research suggests that, where differences exist based on sex, women are likely to achieve higher moral reasoning scores than men.
— Results better for government tax professionals.
  - Results for government practitioners are closer to those for non-specialists than other practitioners, suggesting that there is something in the private sector tax practice environment that drives the difference in tax and social context moral reasoning.
Example: Error on prior year’s return

Example 2
While gathering information to prepare the company’s current tax return, you discover an error on a prior tax return that would result in $10 million in additional income. The IRS reviewed the prior tax return and did not catch the error.

Can you ignore the error?
Example: Error on prior year’s return

Treasury Regulation § 1.451-1(a): “If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should if within the period of limitation file claim or credit for refund of any overpayment of tax arising therefrom.”

Treasury Regulation § 1.461-1(a)(3): “Effect in current taxable year of improperly accounting for a liability in a prior taxable year. …If a taxpayer ascertains that a liability was improperly taken into account in a prior taxable year, the taxpayer should, if within the period of limitation, file an amended return and pay any additional tax due. However, except as provided in section 905(c) and the regulations thereunder, if a liability is properly taken into account in an amount based on a computation made with reasonable accuracy and the exact amount of the liability is subsequently determined in a later taxable year, the difference, if any, between such amount shall be taken into account for the later taxable year.”
Example: Error on prior year’s return

*Badaracco v. Commissioner*, 464 U.S. 386 (1984). Supreme Court specifically noted that the regulations referring to amended returns do not require the filing of such returns.

*Broadhead v. Commissioner*, T.C. Memo. 1955-328, *aff’d on other issues*, 254 F.2d 169 (5th Cir. 1958). The Tax Court held that taxpayer was not obligated by statute to file an amended return, and was acting legally when it refused to do so, even though an amended return had been prepared by the accountant who discovered the error.
Example: Error on prior year’s return

Disclosure by Tax Professional of Error.

— There is general agreement that a lawyer must disclose the existence of the error to the client. See, e.g., Circular 230, § 10.21 (lawyer “must advise the client promptly of the fact”).

— Similar standards govern accountants. See AICPA Statement on Standards for Tax Services, No. 6, stating that the accountant “should” inform the client of the existence of the error.

Requirement to Advise that Amended Return Be Filed.

— Circular 230 does not provide that a professional should or must recommend the filing of an amended return to the client. See Circular 230, § 10.21.

— Similarly, the AICPA Statement on Standards for Tax Services, No. 6, does not specifically require that the accountant must recommend the filing of an amended return, although the Statement provides that a CPA “should” recommend “appropriate measures” to correct the error.
Example: Error on prior year’s return

Lawyers May Not Disclose Error

— Lawyer may not disclose the error, absent the consent of the client. ABA Model Rule 1.6 provides, for example, that a lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except in limited circumstances (i.e., a lawyer may reveal information to the extent that the lawyer reasonably believes necessary to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm).

— Similarly, accountants may not inform the IRS of the error “except where required by law.” AICPA Statement on Standards for Tax Services, No. 6.

Lawyer May Not Be Associated With Future Filings

— ABA Model Rule 4.1(a) and 8.4 provide that a lawyer may not make a false statement of a material fact or law or a fraudulent statement. Thus, lawyer may not be involved or associated with the filing of a future tax return, or future filing of a tax document, that incorporates or continues the previous error.
Example: Error on prior year’s return

Accountants May Not Be Associated With Future Filings.

— CPAs are required to take reasonable steps to ensure the error is not repeated in preparing future tax returns. Thus, they face difficulty in preparing tax returns that incorporate an error made in a previous return. See AICPA Statement on Standards for Tax Services, No. 6.

Circular 230, § 10.51(d) prohibits giving false or misleading information to the IRS, as well as participating in any way in the giving of false or misleading information.

Under AICPA Statement on Standards for Tax Services No. 7, a CPA representing a client before the IRS where the CPA is aware of an error in the return being audited, should consider withdrawing from representing the taxpayer if the client refuses to inform the IRS of the error. This language likely means that the CPA should withdraw unless the withdrawal itself could breach the client’s confidentiality.
The ethical landscape: Social science research

Global Business Ethics Survey
The Importance of Culture and Environment
Cultural and Demographic Differences
The Ethical landscape

Global Business Ethics Survey (2018)*

— Rates of observed misconduct are on the decline, close to a historic low.

— Survey of workers in 18 countries found a median of 33% of employees observed misconduct within the prior 12 months. Misconduct rates ranged from low of 15% in Japan to a high of 48% in Indonesia. In the U.S., 30% of workers observed rule violations; in Russia, the figure was 45%.

— A median of 22% of employees felt pressured to compromise organizational standards, policy, or law — from a high of 47% in Brazil to a low of 10% in Spain; in the U.S., the number was 22%. (As pressure to compromise rises, misconduct increases.)

— A median of 36% of respondents experienced retaliation, with the highest percentage (74%) being reported in India, and the lowest percentage (29%) being reported in China. In the U.S., 53% of respondents reported that they experienced retaliation.
  - Rate of retaliation for reporting misconduct has doubled since 2013.
  - 72% of employees who experienced retaliation said it occurred within three weeks.
  - Highest rates of retaliation for reporting: accepting gifts or kickbacks or bribing public officials (83%), improper political contributions (62%), and retaliation against a reporter (56%).

— In half of the countries, 25% (or more) employees do not hear managers voicing support for workplace integrity.


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Global Business Ethics Survey (2018) (continued)

— Most observed types of misconduct
  - Observed lying to employees and external stakeholders (26%)
  - Observed abusive behavior (21%)
  - Observed conflicts of interest (15%)
  - Observed Internet abuse (15%)

— Leading types of misconduct
  - Misuse of confidential information (79%)
  - Giving/accepting bribes/kickbacks (76%)
  - Stealing (74%)
  - Failed inspections (73%)
  - Sexual harassment (70%)

— Why don’t those observing misconduct report it?
  - Report would not be confidential (74%)
  - Corrective action would not be taken (69%)
  - Could not report anonymously (64%)
  - They would be labelled a snitch (63%)
The Ethical landscape

Global Business Ethics Survey (2018) (continued)

— Culture: Shared understanding of what really matters in an organization, and the way things get done.

— Compared with employees in strong cultures, employees in weak cultures are:
  - Three times more likely to say they experienced pressure to compromise standards
  - Three times more likely to say they observed misconduct
  - 41% less likely to report observed misconduct
  - 27% more likely to say they experienced retaliation after reporting misconduct.

— In 2017, 40% of employees believed that their company has a weak or weak-leaning ethical culture, a figure that has not notably changed since 2000.
The Ethical landscape

Global Business Ethics Survey (2016)*

— Survey of workers in 13 countries found a median of 33% of employees observed misconduct within the prior 12 months. Misconduct rates ranged from low of 15% in Japan to a high of 45% in Russia. In the U.S., 30% of workers observed rule violations.

— A median of 22% of employees felt pressured to compromise organizational standards, policy, or law.

— Employees in supplier companies (those primarily providing goods and services to other companies) were more likely to witness misconduct, including retaliation, than those at non-suppliers that sell primarily to consumers.

— Employees in multinational corporations observed more misconduct and experienced significantly more pressure to compromise standards than workers at businesses and other organizations that operate within a single country.

— Organizational change, especially merger and acquisition activity, heightens the risk of wrongdoing and adds to the number of employees who feel pressure to violate standards. The more change, the more risk. Why? Big changes may distract leaders from focusing on integrity issues and shift their attention to managing change.

The Ethical landscape

**THE WALLET EXPERIMENT**

Reader’s Digest wanted to know how honest world cities were, so they “lost” 192 wallets in 16 cities — that’s 12 wallets in each city — to see how many would be returned. Each wallet contained $50 equivalent of the local currency, as well as a name, phone number, family photo, coupons and business cards. Here’s what happened:

**Most honest cities**
- Helsinki, Finland
- Mumbai, India

**Least honest city**
- Lisbon, Portugal (only 1 of 12 wallets returned, and that one was returned by a Dutch couple)

**Conclusions**
- 90/192 wallets returned (47%)
- Age, gender, and comparative wealth seemed no guaranty of honesty

The Ethical landscape

National Ethics Survey (2013)*
— Good news: Workplace misconduct at historic low.
— 41% of U.S. workers observed misconduct** (compared with 45% in 2011).
— 63% of those who witnessed wrongdoing reported misconduct (compared with 65% in 2011).
— 9% perceived pressure to compromise standards in order to do jobs (compared with 13% in 2011).
— Still, the results are sobering: “a relatively high percentage of misconduct is committed by managers — the very people who are supposed to set a good example.”
  - 60% of misconduct involved someone with managerial authority.
  - 24% of observed misdeeds involved senior managers.

**Top three types of reported misconduct were abusive behavior, lying to employees, and discrimination.
The Ethical landscape

National Ethics Survey (2013)

— Percentage of companies providing ethics training increased from 74% in 2011 to 81% in 2013.
— 67% of companies included ethical conduct as a performance measure in employee evaluations, up from 60% in 2011.
— 66% of companies now have positive ethics culture.*
— When companies undergo change (mergers, acquisitions, or restructurings), the prevalence of misconduct increases.
  - On average, observed misconduct increased by about 21.5% in companies undergoing some type of organizational change (e.g., merger, acquisition, etc.).
  - Effects of change can be noticeably felt for up to 6 months as employees settle into new organizational structure and working relationships.

* “[E]thics culture drives employee conduct. When companies value ethical performance and build strong culture, misconduct is substantially lower. In 2013, one in five workers (20 percent) reported seeing misconduct in companies where culture are ‘strong’ compared to 88 percent who witnessed wrongdoing in companies with the weakest cultures.”
Example: “Reasonable basis” opinions

Example 3
Your CFO has just informed you that your company is doing a tax structured transaction that is “aggressive but legal.” He tells you not to worry, because he “got an opinion.” The opinion states that there is a “reasonable basis” for the claimed tax benefits, but warns that if the taxpayer is audited, the claims will likely be challenged and under existing law you will probably lose.

What do you do?
Example: “Reasonable basis” opinions


AICPA Statement on Standards for Tax Services: (1) Reasonable basis plus disclosure, or (2) realistic possibility of success.

I.R.C. § 6694: (1) Substantial authority, or (2) reasonable basis with disclosure, and (3) for tax shelters and reportable transactions, reasonable belief that it is more likely than not the position will be sustained on the merits.

Circular 230: Standard under section 6694.

ASC 740: More likely than not.
Definitions & general comments

Ethics in Everyday Life*
(Line Drawing 101)

— Instances of ethical transgressions abound — from politics and business to education, sports, and religion.
— It’s a matter of expectation … but whose expectation?
— Shampoo from Hotel Room … versus Towels or the Bathrobe.** What about the Gideon bible? Why is there a sign on the robe but not the hair dryer?
— Variety of “ethical frameworks” … IS there a line? WHERE is it?
  - Do explicit rules help or hinder? Is it better to have (a few) general principles or (many) specific rules?
  - If something is not expressly prohibited, is it allowed? Why do some rules have to be written down, but others don’t?


** According to hotel.com, 35 percent of global travellers filch amenities (towels, linens, magazine, books, even furnishings); toiletries excepted from survey because “everyone takes those.” But see Chuck Klosterman, Rinse & Repeat (The Ethicist), New York Times, at MM20 (Magazine) (Oct. 14, 2012).
Personal & societal considerations

Ethics in Everyday Life
(Line Drawing 101)

— Difference between Morality and Ethics (Social Mores vs. Professional Standards)
  - Morality is understanding the difference between right and wrong. It is influenced by society, culture, and religion.
    — Morals are fundamental principles of right and wrong.
      - Utilitarianism (or consequentialism): “The greatest good for the greatest number.”
      - Deontology: Absolute truths or duties.
        — Albert Einstein: “Relativity applies to physics, not ethics.”
      - Virtue-based ethics: Moral character.
  - Ethics is the philosophy of how morality guides individual or group behavior. Rules of morality are the foundation of ethics, but ethics are influenced by and tailored to particular profession, field, and organization.
  — Ethical rules are promulgated by government or other governing body, often to address particular profession (e.g., law or accounting).
  — Ethic of Reciprocity (i.e., Golden Rule).
  — Wall Street Journal Test.

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Personal & societal considerations

Ethics in Everyday Life
(Line Drawing 101)

— Specific requirements for lawyers and accountants vary from jurisdiction to jurisdiction, but a recurring theme is that professionalism is conduct consistent with the tenets of the legal or accounting profession as demonstrated by the professional’s courtesy and civility, honesty, integrity, character, fairness, competence, ethical conduct, public service, and respect for the rule of law, adjudicatory bodies, clients, opposing parties, witnesses, and others who work within the profession.

— A profession’s or jurisdiction’s Code of Professional Conduct establish minimal standards. The difference between Ethics and Professionalism has been expressed this way by one state’s Continuing Legal Education agency:

- “[P]ersons are not ‘ethical’ simply because they act lawfully or even within the bounds of an official code of ethics. People can be dishonest, unprincipled, untrustworthy, unfair, and uncaring without breaking the law or the Code. Truly ethical people measure their conduct not by rules but by basic moral principles such as honesty, integrity and fairness.”

- “… [T]he letter of the law is only a minimal threshold describing what is legally possible, while professionalism is meant to address the aspirations of the profession….”
Personal & societal considerations

Ethics in Everyday Life
(Line Drawing 101)

— In the tax world, are concepts of “morality” and “ethics” coextensive? Should they be? Is something that is “legal” necessarily “right”? Should in-house professionals, seeking to “maximize shareholder value,” pursue strategies (or engage in conduct) that, while “lawful,” are “awful”? Does that distinction have any place in the workplace?

- For example, might a legally permissible corporate inversion (or an international structure that successfully navigates “discontinuities” in different countries’ tax laws) nevertheless be “immoral” (or “unpatriotic”)?

- Can tax professionals ethically defend (say, on audit or litigation) a particular transaction or structure that they wouldn’t recommend as a planning matter (or lobby for)?

- Tension between duty to client (or shareholders) and duty to the system (or society).
Example: Document management

Example 4
The IRS seeks production of a document that existed at some point, but has since been lost.

What are your options?
Example: Document management

A practitioner cannot:
— Create new documents and indicate that they are contemporaneous materials.

A practitioner can:
— Identify materials that have been lost and create new materials that attempt to memorialize what the relevant parties recall the missing documents said, as long as the new document clearly indicates that this is what was done and does not masquerade as the original.

A practitioner cannot:
— Redact a document without disclosing it was redacted.
— Change a document and produce the changed document, without disclosure.
— Falsely state that a requested document does not exist.
— Describe a document as something it is not.
— Assert that all responsive documents have been produced when they have not.
— Adopt an unreasonable reading of a request and reply on that basis.
— Present a new document as an existing piece of evidence.
Example: Document management

A practitioner can:
— Redact documents to protect privileged material, with disclosure.
  - Practitioner may not withhold (or redact) documents by falsely asserting privilege, or falsely describe documents on a privilege log to mislead the IRS.
— Adopt a reasonable reading of a request and reply on that basis, with an explanation of the reading.
— Create a document in response to a request for information, as long as the nature of the document is disclosed.
— Produce fewer than all documents with disclosure that the production is a subset believed to be adequate.

In considering an information request, a practitioner should be:
— Reasonable.
— Respectful.
— Responsive.
— Timely.
Example: Document management

Example 5

The IRS seeks production of a document. Upon review, you see that the document has handwritten notes in the margins.

Can you erase the notes? What are your options?
Example: Document management

When the IRS seeks production of relevant materials, the taxpayer must produce that material as it then exists.
— The original document must be produced, unless it is subject to an evidentiary privilege.
— Any copy of an original document that differs in any way from the original is a distinct document.
— Excessive delay can be an ethical violation under Circular 230.

A practitioner cannot:
— Alter documents from the form in which they exist and produce the altered documents as the originals.

A practitioner can:
— Redact handwritten words added to a copy of a document that do not constitute part of the requested document, keep the original with the handwritten notes, inform the recipient that handwritten comments have been redacted, and produce the document as it was originally prepared.

The IRS may require the unredacted version to be produced unless the notes are protected.
Personal & societal considerations

Social Science Research

— Early research based on “standard deterrence theory.”*
  - Increased penalties = increased compliance.
— More recent research shows importance of ethical values.**
  - Ethics “frame” decisions; influence of “nudges.”

Personal & societal considerations

Sources of Guidance

— Individual Religious, Philosophical, or Moral Standards; Cultural Mores.
  - Morals: Fundamental Principles of Right and Wrong.
  - Ethics: Externally Sourced; e.g., Tailored to Particular Profession.
— Ethic of Reciprocity (i.e., Golden Rule).
— Wall Street Journal Test.
— “Relativity applies to physics, not ethics.” — Albert Einstein
— “Knowing what’s right doesn’t mean much unless you do what’s right.” — Theodore Roosevelt
Personal & societal considerations

Social Science Research
— Like it or not, most people cheat a little bit.
  - Rationalization.
  - How many people remit the use tax on Internet purchases?
— Perspective is everything (business vs. ethical frame).
— We lie because we care about others.
  - Evidence from emissions tests.
  - Unable to fully assess the harm.
Personal & societal considerations

Social Science Research
— Slippery slope — People who wear counterfeit sunglasses are more likely to cheat.
— We are more likely to cheat if people like us cheat.
— Behavioral economics
  - Dan Ariely, *The (Honest) Truth about Dishonesty; Predictably Irrational.*
  - Daniel Kahneman, *Thinking, Fast and Slow*
  - Michael Lewis, *The Undoing Project* (on the work of Daniel Kahneman and Amos Tversky)
— Consider how your actions affect others.
  - Contagion: Tax shelter marketing in the 1990s.
  - Milgram Experiment (Yale 1963): Obedience to Authority.
  - “Boiling a frog.”
Personal & societal considerations

Social Science Research
— If we all cheat a little, and do it (seemingly) without thinking, how do we minimize it?
  - “Honesty” reminders (“nudges”).
    — Witness oaths; mandatory ethics training or reaffirmation of Code of Conduct.
  - Adequate systems to avoid conflict of interest or otherwise encourage good (or discourage bad) behavior
    — E.g., automatic enrollment in 401k plans.
  - Best practices.
  - Would moving the jurat to the beginning of a tax return spur higher compliance?
### Personal & societal considerations

**Survey of American and German MBA Students’ Views on Tax Evasion***

— Most students in both countries thought tax evasion was unethical.
  - Note: In 2014, 11% of Americans expressed tolerance for some cheating on their taxes.**

— Reasons some gave in support of tax evasion:
  - Tax money used for unacceptable purposes.
  - Can’t afford to pay.
  - System is unfair; government discriminates against me.

**IRS Oversight Board, 2014 Taxpayer Attitude Survey.
Survey of American and German MBA Students’ Views on Tax Evasion

— Female students less accepting of tax evasion than males.
  - Christine Lagarde of the IMF has quipped that if the name of the firm had been Lehman Sisters, rather than Lehman Brothers, the “economic crisis clearly would look quite different.”

— Opposition to tax evasion increases with age.
  - Several studies show that people tend to become more ethical as they get older, but some types of cheating defy this trend; e.g., older students had fewer qualms about pirating software than young students.

— Opposition to tax evasion increases with education level in the U.S.
  - This was consistent with the results of studies involving six Latin American countries, but inconsistent with studies involving Australia and New Zealand.
Personal & societal considerations
What’s the matter with kids today?

Ethics and the Next Generation*
— 35% of teens use their cell phones to cheat.
— 25% believe texting answers to a friend is not cheating.
— 1/3 of students have copied from the Internet and
  turned in the work as their own.

*Survey, Hi-Tech Cheating: Cell Phones and Cheating in Schools, A National Poll, Common Sense Media, Inc.,
available at www.commonsensemedia.org/hi-tech-cheating (survey conducted in 2009).
Personal & societal considerations

What’s the matter with kids today?

Ethics and the Next Generation*

— Percentage of Millennials who consider the following behaviors to be ethical:
  - Using social networking to find out about the company's competitors — 37%.
  - "Friending" a client or customer on a social network — 36%.
  - Uploading personal photos on a company network — 26%.
  - Keeping copies of confidential documents — 22%.
  - Working less to compensate for cuts in benefits or pay — 18%.
  - Buying personal items using a company credit card — 15%.
  - Blogging or tweeting negatively about a company — 14%.
  - Taking a copy of work software home for personal use — 13%.


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Personal & societal considerations

What’s the matter with kids today?

Ethics and the Next Generation

— But perspective is important:

- Granville Stanley Hall, *The Psychology of Adolescence* (1904): "Never has youth been exposed to such dangers of both perversion and arrest as in our own land and day. Increasing urban life with its temptations, prematurities, sedentary occupations, and passive stimuli just when an active life is most needed, early emancipation and a lessening sense for both duty and discipline, the haste to know and do all befitting man’s estate before its time, the mad rush for sudden wealth and the reckless fashions set by its gilded youth — all these lack some of the regulatives they still have in older lands with more conservative conditions."

- In a January 1950 essay in *Life* magazine, cartoonist Bill Maudlin defended returning World War II veterans, who by end of the century earned the moniker the "Greatest Generation," against attacks for "lacking some of the good old American gambling spirit and enterprise," with an accompanying cartoon captioned "Every Generation Has Its Doubts about the Younger Generation."

- Joel Stein, "Every Every Every Generation Has Been the Me Me Me Generation," *The Atlantic* (May 9, 2013): "Basically, it’s not that people born after 1980 are narcissists, it’s that young people are narcissists, and they get over themselves as they get older."
Ethical reasoning of tax practitioners

Elaine Boyle, Jane Fredenall Hughes & Barbara Summer,

— Examination of the moral reasoning of tax practitioners in a social and tax context.
— Focus on internal and external variables that affect behavior.
— Among the questions raised by the article:
  - Does the need to be aware of the intricate details of regulations lead people to think more in terms of following the letter of the law rather than the spirit?
  - Does the culture in the organizations in which tax practitioners work promote certain ways of viewing a situation?
Ethical reasoning of tax practitioners

Conclusions

— Tax practitioners use lower levels of ethical reasoning at work than in a social context.
  - No support in the results for proposition that tax practitioners have a generally lower level of moral reasoning than the population as a whole.
  - Individuals whose reasoning is less principled than the norm are not self-selecting into the tax profession.
— This appears to be as a result of training and socialization.
— May be a result of having a predominantly law-and-order (i.e., hypertechnical) orientation of tax practitioners.
— No difference found between law and accounting firms.
— Results did not reveal any significant difference in moral reasoning between the sexes.
  - Prior research suggests that, where differences exist based on sex, women are likely to achieve higher moral reasoning scores than men.
— Results better for government tax professionals.
  - Results for government practitioners are closer to those for non-specialists than other practitioners, suggesting that there is something in the private sector tax practice environment that drives the difference in tax and social context moral reasoning.
Example 6
You discover that you made an error in your favor on your return and now you want to file an amended return for an unrelated purpose.

Can you ignore the error?
Examples: Discovery of error — amended return related to other items

I.R.C. § 6065(a)

— "[A]ny return, declaration, statement, or other documents required to be made under any provision of the internal revenue laws or regulation shall contain or be verified by a written declaration that is made under the penalties of perjury."

— No cherry-picking: Failure to file complete and accurate return may result in civil tax penalties and even criminal prosecution if errors were made willfully.

— For example, I.R.C. § 6663(a) levies a penalty equal to 75% of any tax underpayment attributable to fraud, which the IRS must prove by clear and convincing evidence.
An analytical framework for tax professionals
An analytical framework for tax professionals

Legal and Regulatory Considerations
— Statutes and Rules.
— Professional Practice Standards.
— Company Policy.

Organizational Considerations
— Relationship with Tax Authorities, Reputational Risk.
— Effect on Future Years.
— Potential Future Benefit.
— Good Corporate Citizenship.
— Corporate Culture or Climate.

Personal Considerations
— Individual religious, philosophical, or moral standards.
An analytical framework for tax professionals

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

A special thanks to Donald M. Griswold, formerly of KPMG LLP, who developed this analytical framework.

*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.

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

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

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Professional standards: AICPA, ABA, and Circular 230; penalties
Professional standards

Complementary but not always Consistent or Coextensive Standards
(highest applicable standard applies)

— Statutory Rules (e.g., for Licensed CPAs).
— Professional Rules
  - AICPA Code of Professional Conduct and Statements on Tax Services (and Related, but Perhaps Not Identical, Rules of State CPA Societies).
  - ABA Model Rules (and Related, but Perhaps Not Identical, Rules of State Bar Associations).
  - TEI Standards of Conduct.
— Treasury Circular 230.
— Plus …
  - Penalties (e.g., I.R.C. §§ 6662, 6694).
Professional standards

Complementary but not Always Consistent Standards

— AICPA SSTS 1: (1) Reasonable basis with disclosure, or (2) realistic possibility of success.*
— ABA Formal Opinion 85-352: Realistic possibility of success.*
— I.R.C. 6694: (1) Substantial authority, or (2) reasonable basis with disclosure, and (3) for tax shelters and reportable transactions, reasonable belief that it is more likely than not the position will be sustained on the merits.
— ASC 740: More likely than not.

*Practitioner should discuss potential penalties with client.
AICPA Code of Professional Conduct

  - One set of rules for members in public practice.
  - Another set for members in business.
  - A third set for retired or transitioning members.
— Adoption of a "threats and safeguards" approach to help members identify, evaluate, and eliminate (or mitigate to acceptable levels) threats arising from a specific relationship or circumstance.
— See Appendix A.
Professional standards

AICPA Code of Professional Conduct

Exhibit 2 Steps of the Conceptual Framework

Step 1: Identify Threats
- No Threats–Proceed
- Threats Not Significant–Proceed

Step 2: Evaluate Threats
- Threats Not at Acceptable Level–Stop
- Threats at Acceptable Level–Proceed

Step 3: Identify Safeguards
- Existing
- New

Step 4: Evaluate Safeguards
- Threats Not at Acceptable Level–Stop
- Threats at Acceptable Level–Proceed

Source: AICPA website.
Professional standards

AICPA Code of Professional Conduct
— Preface: Applicable to All Members
- Sets forth Principles of Professional Conduct. (0.300)
  — Responsibilities Principle.
  — Public Institute Principle.
  — Integrity Principle.
  — Objectivity and Independence Principle.
  — Due Care Principle.
  — Scope and Nature of Services Principle.
- Definitions. (0.400)
Professional standards

Process for In-House Professionals to Identify Risks to Compliance and Apply Safeguards

— Members should identify threats to compliance with the rules and evaluate the significance of those threats. (AICPA Code 2.000.06)

- Identify threats. The existence of a threat does not mean that the member is in violation of the rules, but only the significance of the threat should be evaluated.

- Evaluate the significance of the threat to determine whether it is at an acceptable level.

- Identify and apply safeguards to eliminate the threat or reduce it to an acceptable level.

- There may be some circumstances where no safeguards can reduce a threat to an acceptable level. In such circumstances, the members should determine whether to decline or discontinue the professional services or resign from the employing organization.
Professional standards

Process for In-House Professionals to Identify

Risks to Compliance and Apply Safeguards

— Types of threats: adverse interest, advocacy, familiarity, self-interest, self-review, and undue influence. (AICPA Code 2.000.07)

— Subordination of Judgment (AICPA Code 2.130.020)

  - Integrity and Objectivity Rule prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services for an employer.

  - Self-interest, familiarity, and undue influence threats may exist when a member and others in his or her organization have a difference of opinion relating to the application of accounting principles, auditing standards, or other relevant professional standards (including standards applicable to tax and consulting services).
Professional standards

Process for In-House Professionals to Identify Risks to Compliance and Apply Safeguards

— Types of safeguards. (AICPA Code 2.000.15)
  - Created by the profession, legislation, or regulation (excerpts from AICPA Code):
    — Education and training requirements on ethics and professional responsibilities.
    — Continuing education requirements on ethics.
    — Legislation establishing prohibitions or requirements for entities and employees.
    — Competency and experience requirements for professional licensure.
    — Professional resources, such as hotlines, for consultation on ethical issues.
  - Implemented by the employing organization regulation (excerpts from Code):
    — Tone at the top.
    — Policies and procedures addressing ethical conduct and compliance with the laws, rules, and regulations.
Professional standards

Process for In-House Professionals to Identify Risks to Compliance and Apply Safeguards

- Types of safeguards. (AICPA Code 2.000.15)
  - Implemented by the employing organization regulation (excerpts from AICPA Code):
    - Audit committee charter.
    - Internal policies and procedures requiring disclosures of identified interests or relationships.
    - Dissemination of corporate ethical compliance policies and procedures, including whistleblower hotlines, to promote compliance.
    - Human resources policies and procedures stressing the hiring and retention of technically competent employees.
    - Assigning sufficient staff with the necessary competencies to projects and other tasks.
    - Staff training on applicable laws, rules, and regulations.
    - Regular monitoring of internal policies and procedures
Professional standards

Process for In-House Professionals to Identify Risks to Compliance and Apply Safeguards

— Types of safeguards. (AICPA Code 2.000.15)
  - Implemented by the employing organization regulation (excerpts from AICPA Code):
    — Regular monitoring of internal policies and procedures.
    — Policies for promotion, rewards, and enforcement of a culture of high ethics and integrity.
    — Use of third-party resources for consultation as needed.
Example 7

It is September 14, 2018. You had a $100 million capital loss that expired December 31, 2017. The head of the real estate department has just sent you a copy of the transaction documents relating to the sale of some land. The documents are dated “as of” December 30, 2016, and show that you sold the land for a $100 million capital gain.

Can you report the sale as a 2017 sale (and use the expiring capital loss)?
Example: Propriety of “as of” dating

A rose by any other name … “temporal modification.”
— Conduct ranging from blatant fraud to executing a document sometime after the event evidenced by the document occurs.

What is the taxpayer’s purpose?
— To document something that has already occurred?
— To memorialize an (oral) agreement?
— To ratify an action already taken?
— To reflect the economics of a business arrangement?
— To clarify an ambiguity? Correct a mistake?
— To mislead or fabricate?

Care should be taken to avoid any suggestion or inference that the document was prepared on the stated date.
— Disclosure: Identifying the date the document was executed.
— Utilizing “as of” dating.
Example: Propriety of “as of” dating

Business vs. Tax.

— “In a business context, where both parties to a transaction are agreed, the custom of backdating documents or dating them ‘as of’ a prior date may be acceptable.” Pittsburgh Realty Investment Trust v. Commissioner, 67 T.C. 260 (1976).

— “But in the present context where the liquidation itself triggers the recapture taxes and may determine who is liable for the tax, the actual date of liquidation must be determined and we cannot accept predating of events which have a bearing on when the liquidation was accomplished.”

Credibility: “The ‘effective as of’ dating and backdating of relevant documents impede our review of the substance of the transactions involving the foreign trusts . . . and lead us to conclude that the chronology reflected by those documents is not credible.” Melnik v. Commissioner, T.C. Memo. 2006-25.
Professional standards

AICPA’s Statements on Standards of Tax Services
These AICPA rules delineate the members’ responsibilities to taxpayers, the public, the government, and the accounting profession (www.aicpa.org — Professional Ethics area).
— Aid members in fulfilling their ethical responsibilities.
— Apply to all members providing tax services regardless of jurisdiction.
— Complement other standards of tax practice, including Circular 230, the penalty provisions of Internal Revenue Code, and state boards of accountancy rules.
— Provide for appropriate range of behavior.
— Not likely to change substantively in light of revised AICPA Code of Professional Conduct.
Professional standards

AICPA’s Statements on Standards of Tax Services
— SSTS No.1, Tax Return Positions
— SSTS No. 2, Answers to Questions on Returns
— SSTS No. 3, Certain Procedural Aspects of Preparing Tax 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 and Administrative Proceedings
— SSTS No. 7, Form and Content of Advice to Taxpayers
Professional standards

AICPA SSTS No. 1: Tax Return Positions

— Member should determine and comply with the standards, if any, imposed by the applicable taxing authority with respect to recommending a tax return position, or preparing or signing a tax return.

— If the applicable taxing authority has no written standards (or lower standards):
  - Member must have good-faith belief that position has at least a realistic possibility of being sustained on its merits if challenged; or
  - Member concludes there is a reasonable basis for the position with appropriate disclosure.
Professional standards

AICPA SSTS No. 2: Answers to Questions on Return

— Member should make a reasonable effort to obtain from taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer.

— Reasons for required diligence:
  - Omission may detract from quality of the return.
  - Disclosure may be necessary for a complete return or to avoid penalty.
  - Penalty of perjury statement — i.e., affirmation that return is “true, correct, and complete.”
AICPA SSTS No. 3: Certain Procedural Aspects of Preparing Returns

— In preparing or signing a return, member may in good faith rely, without verification, on information furnished by taxpayer or by third parties.

- Should not ignore implications of information furnished.
- Should make reasonable inquiries if appears to be incorrect, incomplete, or inconsistent (on its face or with other known facts).
- Should refer to one or more prior returns whenever feasible.
Professional standards

AICPA SSTS No. 4: Use of Estimates

Unless prohibited by statute or by rule, member may use taxpayer’s estimates in the preparation of a tax return if it is not practical to obtain exact data and if member determines that the estimates are reasonable based on the facts and circumstances known to member.

- Taxpayer’s estimates should be presented in a manner that does not imply greater accuracy than exists.
AICPA SSTS No. 5: Departure from a Position Previously Concluded in an Administrative Proceeding or Court Decision

— Tax return position with respect to an item as determined in an administrative proceeding or court proceeding does not restrict member from recommending a different tax position in a later year’s return, unless taxpayer is bound to a specified treatment in the later year, such as a formal closing agreement [or where a judicial doctrine such as res judicata or collateral estoppel applies].
Professional standards

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

— Member may recommend a tax return position or prepare or sign a tax return that departs from treatment of an item as concluded in an administrative proceeding or court decision with respect to a prior return of taxpayer as long as the requirements of SSTS No.1, Tax Return Positions, are satisfied.

— Determination in earlier administrative proceeding or existence of unfavorable court decision are factors that member should consider in evaluating whether standards in SSTS No. 1 are met.
Professional standards

AICPA SSTS No. 6: Knowledge of Error: Return Preparation and Administrative Proceedings

- Member should inform taxpayer promptly upon becoming aware of error in previously filed return, error in return that is the subject of administrative proceeding, or taxpayer’s failure to file required return.
  - Should also advise of potential consequences of error and recommend corrective measures.
  - Member is not allowed to inform taxing authority without taxpayer’s permission, except when required by law.
Professional standards

AICPA SSTS No. 6: Knowledge of Error: Return Preparation and Administrative Proceedings

— If taxpayer has not taken appropriate action to correct error, member should consider whether to continue professional or employment relationship.
   - If member does prepare current year’s return, member should take reasonable steps to ensure that error is not repeated.
   - If member is representing taxpayer in administrative proceeding, member should consider withdrawing unless taxpayer agrees to disclosure of the error to taxing authority.
Professional standards

AICPA SSTS No. 7: Form and Content of Advice to Taxpayers

— Member should consider: return reporting and disclosure standards; potential penalties; and SSTS No. 1, *Tax Return Positions*.

— Member has no obligation to communicate subsequent developments to taxpayer, except while assisting taxpayer in implementing procedures or plans associated with advice provided (or when member undertakes this obligation by specific agreement).
AICPA SSTs No. 7: Form and Content of Advice to Taxpayers

- Member should use professional judgment to ensure that tax advice provided to taxpayer reflects competence and appropriately serves taxpayer’s needs.
  - When communicating tax advice to taxpayer in writing, member should comply with relevant taxing authority standards, if any.
  - Member should use professional judgment about need to document oral advice.
  - Member is not required to follow standard format.
Example: Error on submitted IDR

Example 8
You discover that a response you provided to an IDR was not accurate. The audit is not yet complete.

Must you correct the mistake?
Example: Error on submitted IDR

**ABA Model Rule 3.3 Candor Toward the Tribunal**
— A lawyer shall not knowingly make a false statement of material fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer.
— IRS is not a tribunal.

**ABA Model Rule 4.1: Truthfulness in Statements to Others**
— In the course of representing a client, a lawyer shall not knowingly make a false statement of material fact or law to a third person.

**ABA Model Rule 8.4: Misconduct**
— It is professional misconduct for a lawyer to engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.

**Circular 230**
— § 10.22 states that practitioner must exercise due diligence in preparing or assisting the preparation or determining the correctness of an oral or written representation made to the IRS.
— § 10.51 states that a practitioner may be punished for “giving false or misleading information to the IRS… in connection with any matter pending before the IRS.”
Example: Receipt of privileged documents

Example 9

You ask for a copy of your administrative file. When the IRS gives it to you, you find a memorandum from IRS Chief Counsel to the international agent marked “privileged and confidential” that discusses the hazards of the position the agent wants to take.

Can you read the document? Can you keep the document? Must you inform the IRS?
Example: Receipt of privileged documents

Waiver of privilege through inadvertent disclosure

— Whether inadvertent production of a privileged document will result in a waiver is usually decided on a case-by-case basis. See Alldread v. Grenada, 988 F.2d 1425 (5th Cir. 1993); American Casualty Co. v. Healthcare Indemnity, Inc., 2002 U.S. Dist. LEXIS 9713 (D. Kan. 2002).

— Courts generally follow one of three approaches to determining whether inadvertent disclosure of a privileged document will result in a waiver. Gray v. Bicknell, 86 F.3d 1472 (8th Cir. 1996); Bank Brussels Lambert v. Credit Lyonnais (Suisse) S.A., 160 F.R.D. 437 (S.D.N.Y. 1995).
  - Lenient Approach: Only waived intentionally and knowingly.
  - Middle Approach: Must analyze whether the client and the lawyer took reasonable steps to prevent inadvertent disclosure and whether there was “good cause.”
  - Strict Test: Intentional or unintentional production of any privileged document waives the privilege, except possibly in circumstances where the party disclosing the privileged communication has taken all precautions.
  - 2008 Amendments to Federal Rule of Evidence 502 to limit inadvertent waivers.
Example: Receipt of privileged documents

Waiver of privilege through inadvertent disclosure

— ABA Model Rule 4.4(b): When lawyer receives inadvertently sent document, lawyer's duty is to promptly notify sender.
  - Rule does not prohibit reading and using the document.
  - But Comment [2] states that whether additional steps are required, such as returning the document, is a matter of law beyond the scope of the ethical rules, as is the question of whether privilege has been waived.
  - ABA Formal Opinion 05-437 is co-extensive with Model Rule 4.4(b) (prior opinion prohibiting lawyer from examining the document withdrawn).
  - Rules in individual states may differ.

— Risks of Use of Privileged Information.
  - Knowingly using other side's privileged material may be a violation of Model Rule 8.4(c) (engaging in conduct that is deceptive or dishonest).
  - Could result in disqualification; could render evidence inadmissible.
Professional standards

ABA Rules for Professional Conduct
Most states have enacted a version of the American Bar Association’s Model Rules (www.abanet.org/cpr).
Special Challenges of In-House Tax Professionals

AICPA Code of Professional Conduct’s revised structure recognizes that in-house professionals (“Members in Business”) “often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances... Regardless of their service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.”

— Although members not in public practice cannot maintain the appearance of independence, they have the responsibility to maintain objectivity in rendering professional services.

— Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice.
Special Challenges of In-House Tax Professionals

— Tax Executives Institute adopted its own Standards of Conduct in 1962 in recognition of the dual role of in-house tax professionals, *i.e.*, that they are not only advisers but frequently “doers”; they have final responsibility for deciding what the company does.
Example: Existence of adverse authority

Example 10

You are involved in litigation and there is at least one lower-level court decision in your jurisdiction (e.g., state trial court or tax court or federal district court) addressing the substantive issue involved in your case and holding against your position. The government’s brief does not cite to this case.

Are you obligated to bring the adverse case to the government’s attention? Are you obligated to bring the case to the court’s attention? What do you do?
ABA Model Rule 3.3, Candor Toward the Tribunal, provides that a lawyer shall not knowingly:
— (2) 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...

ABA Rule is stricter than the general federal court rules.

What if you’re in Appeals and not court?
— Although disclosure to Appeals may not be required, failure to disclose adverse authority would not preclude Appeals from discovering adverse authority on its own and could deny tax adviser the opportunity to argue why the authority is wrong or distinguishable.
Circular 230

Framework
— Issued under 31 U.S.C. § 330 (enacted in 1884), Circular 230 contains “standards of practice” to promote ethical practice before the IRS. (First promulgated as Circular 230 in 1921.)
— Imposes affirmative duties.
— Prohibits certain types of conduct.
— Establishes a legal process for disciplining tax professionals for violation.
— Disciplinary action includes censure, suspension, disbarment, fines, and injunctive relief.
— Final regulations promulgated June 12, 2014.
Circular 230

Principal Changes to Circular 230

— Single standard for all written advice; “covered opinion” rules rescinded.
  - No more disclaimers or legends.
— General competency standard in new § 10.35.
— **Reasonableness** standard in new § 10.37.
  - For written tax advice (e.g., factual and legal assumptions).
  - For reliance on other professionals.
Principal Changes to Circular 230

— Migration from “rules-based” guidance to “principles-based” guidance.
— Expanded definition of “federal tax matters.”
— Guidance on how firms should ensure compliance.
Circular 230

“Fitness to Practice”
— Good character.
— Good reputation.
— Necessary qualifications to enable the representative to provide valuable service to the client.
— Competency to advise and assist persons in presenting their cases.
Caveat: Loving, Ridgely, and Sexton

— In Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2014), the IRS’s authority to regulate return preparers was challenged on the ground that return preparers do not “practice before the IRS.” Mandatory CPE requirement invalidated.

— In Ridgely v. Lew, No. 1:12-cv-00565, 2014 U.S. Dist. LEXIS 96447 (D.D.C. July 17, 2014), the court invoked Loving to overturn Circular 230’s prohibition of contingent fees in connection with “ordinary refund claims.” If preparing a claim for refund does not constitute “practice before the IRS,” could it be argued that neither does preparing an opinion about a possible return position? (Note: The IRS did not appeal Ridgely.)

— Sexton v. Hawkins, No. 2:13-cv-00893 (D. Nev. Mar. 17, 2017), further restricted the IRS’s authority to regulate return preparers and givers of tax advice, even when individual has been disbarred for misconduct and suspended from practice before the IRS.
Guidance on Need for Forms 2848 for In-House Employees

— On September 9, 2014, the IRS Office of Professional Responsibility confirmed that providing or accepting information to, or from, the IRS, does not constitute a “representation” activity or “practice before the IRS.” When the employee advocates, negotiates, disputes, or does anything beyond mere delivery of facts, general explanation, or acceptance of materials, the employee is engaged in representation activities (“practicing”) before the agency and the Form 4764 is not sufficient.
Guidance on Need for Forms 2848 for In-House Employees

— IRS Form 4764, Communications Agreement, allows a corporate taxpayer to designate one or more employees to discuss tax matters, provide and receive information, or receive and discuss adjustments.

— The form operates as an authorization to receive tax information, similar to Form 8821, Tax Information Authorization, but is not a substitute for Form 2848, Power of Attorney and Declaration of Representative.

— If the corporation wants an employee to advocate, negotiate, or dispute issues on its behalf, a Form 2848, Power of Attorney, must be signed by a duly elected officer or director of the corporation as identified in the corporate articles or by-laws (typically, the same officer who signs the corporation’s tax returns and consents to extend the time for assessment of tax).

- Form 2848 has been revised to acknowledge application of Circular 230 to authorized representatives.
Civil penalties

I.R.C. § 6694(a): Tax return preparer penalty
— If a tax return preparer prepares a return or claim for refund:
  - Containing an “unreasonable position” that results in an understatement of liability; and
  - The preparer knew or should have known of the position, then:
— The preparer is subject to a penalty equal to the greater of $1,000 or 50% of the income derived by the tax return preparer with respect to the return.
  - If the tax return preparer’s conduct is willful or reckless, the penalty increases to the greater of $5,000 or 50% of the income derived by the tax return preparer with respect to the return. I.R.C. § 6694(b).
Civil penalties

I.R.C. § 6694(a): Tax return preparer penalty
— Unreasonable positions do not include:
  - A position for which there is **substantial authority**;
  - A disclosed position that is neither a tax shelter nor a reportable transaction and for which there is a **reasonable basis**; or
  - A position with respect to a tax shelter or a reportable transaction and for which it is reasonable to believe that the position would more likely than not be sustained on its merits.
— No penalty shall be imposed if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.
Civil penalties

I.R.C. § 6664(c): Reasonable Cause Exception

— Treas. Reg. § 1.6664-4 — Relief from penalty where taxpayer (in connection with section 6662 penalty) or preparer (in connection with section 6694 penalty) acts with reasonable cause and in good faith in respect of the position.

— Taxpayer cannot rely (for purposes of avoiding the section 6662 penalty) on opinion of a “disqualified tax advisor,” i.e., a material adviser under section 6111 — an adviser who materially aids, assists, or advises in connection with organizing, managing, promoting, or selling the transaction.

— Section 6694 and 6662 apply to signing and non-signing preparers, tax attorneys, and tax accountants.
Civil penalties

Factors Affecting Availability of Reasonable Cause Relief

— Nature of error
— Frequency of error
— Materiality of error
— Normal office practices
— Reliance on another person
— Good faith and consistency with generally accepted administrative practices
Foreign Corrupt Practices Act
Global Expansion of Anti-Bribery and Corruption Laws and Investigations — Overview

— In 2013, the World Bank estimated that the amount of bribes worldwide totalled $1 trillion annually.

— Aggressive global enforcement of anti-bribery and corruption (ABC) laws has increased frequency of cases, size of fines and penalties, and effort required by multinational companies to stay compliant with the U.S. Foreign Corrupt Practices Act (FCPA), the Organisation for Economic Co-operation and Development’s (OECD’s) Anti-Bribery Convention, and similar statutes. Governmental authorities are increasingly focusing not only on companies but also on officers and high-ranking directors.

— Ongoing efforts by non-governmental entities and transparency advocates — resulting in broad-scale disclosures such as LuxLeaks, the Panama Papers, and Paradise Papers — have heightened the likelihood that violations will be disclosed and the attendant legal and reputational risks.

— Compliance risks are more acute in an era of intense merger & acquisition activity, in which the time to conduct robust due diligence reviews of potential acquisition targets or merger partners (and their agents and other third parties) may be constrained.

— FCPA and ABC compliance activities tend to be managed by corporate legal departments, but efficient management of risk and remediation of problems will likely require an integrated response, including resources and expertise from the finance and tax functions (as well as human resources, sales, and procurement).
Background: Expansion of Anti-Bribery and Corruption Laws

— Enacted in 1977, the U.S. Foreign Corrupt Practices Act bans many, but not all, payments made to a foreign government official or employee for the purpose of influencing that person’s acts or decisions. There are exceptions for certain facilitation or expediting payments (e.g., for the issuance of permits or visas). The FCPA, which applies to employees, agents, and other entities acting with or on behalf of a company, also imposes substantial requirements relating to internal controls and the maintenance of books and records.

— I.R.C. § 162(c) denies a deduction for payments made to an official or employee of a foreign government that are unlawful under the FCPA. In addition, bribes and other illegal payments made by or on behalf a controlled foreign corporation generally constitute Subpart F income (§ 954(a)(4)) and do not reduce earnings and profits (§ 964(a)).

— The United States is no longer an outlier in adopting anti-bribery and corruption (ABC) laws.
  - In 1989, the OECD began a project that culminated a decade later with the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.
  - Most U.S. trading partners have now adopted national ABC legislation, including the United Kingdom (whose Bribery Act 2010 is considered the strictest anti-bribery legislation in the world), and most EU Member States, China, Russia, and India.
Foreign Corrupt Practices Act

Substantial Penalties for Noncompliance

— Under U.S. anti-bribery provisions, corporations face criminal fines of up to $2 million per violation; for individuals, the maximum fine is $100,000 per violation and up to 5 years in prison. (Additional civil fines of up to $10,000 may be imposed.)

— Under accounting and recordkeeping provisions, corporations may be criminally fined up to $2 million per violation; for individuals, the maximum penalty is up to $100,000 (and a maximum imprisonment of 5 years) for each violation. (Additional civil fines of up to $10,000 may be imposed.)

— Maximum penalties for willful violations are $25 million for corporations and $5 million (and up to 20 years imprisonment) for individuals.

— Other adverse consequences
  - Possible debarment or suspension from federal contracts.
  - Treble damages under the Racketeer Influenced and Corrupt Organization Act (RICO) or actions under other federal or state laws.
  - Derivative actions by shareholders.

— Taxpayers that improperly deduct bribes and other illegal payments are potentially liable for accuracy-related penalties, as well as civil or criminal fraudulent filing penalties.
Recent U.S. Enforcement Activity

— The U.S. Department of Justice and Securities and Exchange Commission are the two agencies responsible for FCPA enforcement.

— In April 2016, DOJ announced a pilot program to reward companies that voluntarily self-report FCPA violations. The “declinations and disgorgement” program was revised and indefinitely extended in November 2017, and DOJ’s heightened scrutiny does not seem to have diminished with the change of Administration. In 2017, there were —
  - 24 individuals charged, of whom 18 pleaded guilty and 3 were convicted at trial.
  - 7 corporate criminal enforcement actions brought, resulting in $822 million in corporate U.S. criminal fines, penalties, and forfeiture, and total enforcement action amounts payable to U.S. and foreign authorities of $2.5 billion.
  - 2 declinations under the former FCPA Pilot Program in which the companies agreed to disgorge illicit profits totaling more than $15.2 million to either DOJ or the SEC.
Foreign Corrupt Practices Act

Recent U.S. Enforcement Activity

— Under the DOJ program, three conditions are required to secure full benefits (prosecutorial declination) of program:

- **Voluntary self-disclosure**… “within a reasonably prompt time after becoming aware of offense” and “prior to an imminent threat of disclosure or government investigation.”

- **Full cooperation**… timely disclosure of all facts relevant to the wrongdoing, including all facts gathered during an independent investigation, and timely preservation of all relevant documents.

- **Timely and appropriate remediation**… including implementation of an effective compliance and ethics program.
Foreign Corrupt Practices Act

Recent U.S. Enforcement Activity — What’s Tax Have to Do with It?

— Are disgorgement payments made to SEC deductible for U.S. tax purposes? In Chief Counsel Advice Memorandum 2016-19-008[1], the IRS concluded that in some cases a deduction may be permitted.

- Because I.R.C. § 162(c) provides that fines and similar penalties may not be deducted, the CCA explained “the tax treatment depends on whether the payment is more punitive or compensatory”; i.e., a deduction is available for payments imposed to encourage prompt compliance or to compensate another party. The case for deductibility could be strengthened by including provisions in agreement with SEC that characterize the payment as compensatory or remedial or that favorably address the deductibility issue.

- 2017 Tax Act amends I.R.C. § 162(f)(1) to provide generally that taxpayers cannot deduct amounts paid or incurred to a government or governmental entity in response to a violation of law or potential violation of law. This amendment effectively limits deductibility to cases in which either (a) a court has ordered amounts be paid as restitution, or (b) defendants and the government agree, in settlement agreement, that the amounts constitute restitution.
Foreign Corrupt Practices Act

Tax Developments

— The IRS has increasingly been involved in FCPA investigations. For example, a 2014 settlement included a seven-figure payment to the IRS, reportedly the first such forfeiture in an FCPA matter. In 2016, the IRS’s Criminal Investigation unit was involved in a case against the Russian affiliate of a Fortune 100 company.

— The IRS has asserted that bribes have been mischaracterized in many ways, including as commissions and royalties, consulting fees, sales and marketing expenses, scientific incentives and studies, travel and entertainment expenses, rebate and discounts, after-sales service fees, free goods, intercompany accounts, supplier/vendor payments, write-offs, customs intervention, miscellaneous expenses, and petty cash withdrawals.

— If a company (or its CFCs or counterparties) pays a bribe or kickback but does not self-disallow its deduction for the illegal payment under I.R.C. § 162(c) (or make the correlative adjustments relating to E&P and the foreign tax credit), it could potentially be subject to civil tax penalties even in cases where the DOJ and SEC cannot establish a violation of FCPA (in part because of the different burdens of proof).
Foreign Corrupt Practices Act

Corporate Executives’ Assessment of Risk Environment
— According to a 2015 KPMG survey of 659 corporate risk leaders —

- Management of third-party risks poses the greatest challenge in successfully implementing ABC compliance programs. (In 2014, the OECD reported that three quarters of 427 reviewed corruption cases involved third parties.)
  — More than one third of respondents do not formally identify high-risk third parties.
  — More than half of those respondents with right-to-audit clauses over third parties have not exercised those rights.
  — Only 42 percent of companies continuously monitor data to spot potential violations.
- ABC considerations are accorded too low a priority by companies preparing to acquire or merge with other corporations across borders
  — It is often difficult to know before an acquisition exactly how a target company does business with governments.
  — Once a company is acquired, differences can make it hard to integrate the target company into the global ABC compliance structure.
Corporate Best Practices

— Tax department can play a significant role in monitoring compliance with (and discovering violations of) ABC rules and regulations and determining whether any payment made to a foreign government official or employee by or on behalf of a CFC is an illegal payment that should be included in Subpart F income.

— Greater vigilance in supervising expenditures (including those of contractors or counterparties, including professional advisers) in foreign operations. The lack of vigilance or failure to promptly follow-through with remediation may vitiate eligibility for relief under DOJ declination and disgorgement program.

— Growing need for close supervision of business practices of foreign subsidiaries, careful selection and monitoring of third parties (including joint-venture partner, customers, vendors, and service providers), and examination of FCPA compliance issues in M&A due diligence review.
  - Emerging markets are generally considered to be a higher risk for bribery and corruption.
  - Data analytics may prove useful to identify risks, remediate problems, and monitor ongoing compliance.
Other examples
Example: Document management

Example 11
Retired VP has decided to clean out his office, his attic, his basement, and his garage. He found 2 boxes of documents from 10 years ago that he thinks “might” contain some “interesting” information about a transaction that is currently at issue in the return before Appeals. He asks if you want the boxes.

What do you say?
Example: Document management

A practitioner (and client) may be under a duty to preserve documents, including documents in possession of employees and former employees. The purpose of the requirement is both fairness (importance of evidence lost) and deterrence (state of mind).

Duty to preserve pertains to unique, relevant evidence that might be useful to an adversary. It must be preserved without significant alteration.

Duty arises when a party reasonably anticipates litigation; party should impose “litigation hold.”

Failure to preserve can lead to significant sanctions, including monetary penalties, adverse inferences, barring of testimony, and even dismissal.
Example: Document management

“Spoliation” is the destruction or significant alteration of evidence or the failure to preserve property for another’s use as evidence in pending or reasonably foreseeable litigation.

— Can lead to sanctions against practitioner or client, including criminal penalties or disciplinary action.

Audit or appeals proceeding does not automatically trigger a duty to preserve, though at some point litigation may become reasonably foreseeable.

— Interplay of concept of “reasonably foreseeable litigation” with work product doctrine, which pertains to documents prepared “in anticipation of litigation.”
Example: Document management

Electronic records
- Electronically stored information (EDI) can create unique challenges for document preservation.
- Understand the company’s IT architecture and practices to ensure that location of potentially relevant documents can be identified.
- Collect EDI before or during the audit and repeat measures once litigation is anticipated.
- Ensure that collected records are kept outside of the automatic record retention and destruction procedures.
- Keep records of document collection process, including rules for instituting (and releasing) a litigation hold.
- Pay special attention to metadata.
Example: Document management

Special EDI Challenges

— Documents can disappear or not be stored on systems subject to retention procedures (e.g., thumb drives).
— Computers and servers can disappear.
— Files, documents, and computers can be corrupted or inaccessible on current IT systems.
— Documents can be changed.
— Privileged documents may be shared more widely.
— Large amounts of data can be lost inadvertently.
— Multiple copies of documents may exist (possibly leading to inadvertent waiver of privilege).
— Metadata must be preserved.
Example: Poorly worded IDR

Example 12

You receive a poorly worded IDR. You can respond to the questions in a technically accurate manner without providing the information that you know the IRS is seeking. If the IRS had asked the questions correctly, it probably would have uncovered a significant audit adjustment.

How do you respond?
Example: Poorly worded IDR

ABA Model Rule 1.6 — Protected Information
— Information relating to the representation is confidential.
— Must get informed consent to disclose.
— The rule does not permit the lawyer to speculate whether particular information might be detrimental.
— No duty to help opposition, but consider practical consequences and what is really in the best interests of the taxpayer.
Example: Inability to remediate problem

Example 13

Your company’s billing software cannot handle its sales tax collection responsibility in a state. Without extensive modification, the company will annually under-collect from customers and under-remit between $50,000 to $100,000 in tax. A vendor has given you a quote of $500,000 to modify, test, and implement the software change. Your CFO has refused to sign off on the expense, saying it would be cheaper to pay the tax, interest, and penalties if the company got assessed.

What should you do?
Example: Settlement agreement

Example 14
The IRS sends you a draft settlement agreement indicating the taxpayer's 100% concession of an issue. You retype the draft, using the identical font, margins, etc., but offer only a 10% taxpayer concession. You submit the offer to the IRS, which accepts it. Only subsequently did the IRS discover the change.

The IRS sues to overturn the settlement agreement on the basis of “fraud, malfeasance, or a misrepresentation of fact.” Who prevails?
Example: Settlement discussions

*H Graphics Access v. Commissioner*, T.C. Memo. 1992-345, 63 TCM (CCH) 3149 (alteration of a document prepared by the IRS was not the product of fraud or malfeasance that voided the resulting agreement; discussion of other cases where taxpayer’s alterations were found to satisfy the statutory test for voiding settlement agreements).

Even if the conduct did not result in voiding of settlement agreement, was attorney’s conduct ethical?

— Immanuel Kant: “Act only according to that maxim whereby you can, at the same time, will that it should become a universal law.”
Appendix A: AICPA code of professional conduct
Appendix A: AICPA code

AICPA Principles

— Responsibilities Principle. (0.300.020)
  - In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.
  - Members have a continuing responsibility to cooperate with one another to improve the art of accounting, maintain the public’s confidence, and carry out the profession’s special responsibilities for self-governance.

— Public Interest Principle. (0.300.030)
  - Member should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate a commitment to professionalism.
  - Distinguishing mark of a profession is acceptance of its responsibility to the public.
  - In discharging their professional responsibility, members may encounter conflicting pressures from clients, employers, governments, investors, the business and financial community, and others. In resolving conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients’ and employers’ interests are best served.
Appendix A: AICPA code

AICPA Principles

— Integrity Principle. (0.300.040)

- To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

- Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

- Integrity requires a member to be honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and honest difference of opinion; it cannot accommodate deceit or subordination of principle.

- Integrity is measured in terms of what is right and just. A member should test decisions and deeds by asking: “Am I doing what a person of integrity would do? Have I retained my integrity?” Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

- Integrity requires a member to observe the principles of objectivity and independence and of due care.
AICPA Principles

— Objectivity and Independence Principle. (0.300.050)

- A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

- Objectivity is a state of mind, a quality that lends value to a member’s services. It is a distinguishing feature of the profession; it imposes an obligation to be impartial, intellectually honest, and free of conflicts.

- Independence precludes a relationship that may appear to impair a member’s objectivity in rendering attestation services.

- Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

- Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services.
Appendix A: AICPA code

AICPA Principles

— Objectivity and Independence Principle. (0.300.050)
  - Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of GAAP and candid in all their dealings with members in public practice.

— Due Care Principle. (0.300.060)
  - A member should observe the profession’s technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member’s ability.
  - Due care requires a member to discharge professional responsibilities with competence and diligence.
  - Competence is derived from the synthesis of education and experience.
  - Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member’s capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member’s firm.
Appendix A: AICPA code

AICPA Principles

— Due Care Principle. (0.300.060)
  - Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

— Scope and Nature of Services Principle. (0.300.070)
  - The public interest aspect of members’ services requires that such services be consistent with acceptable professional behavior for members. Integrity requires that service and public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.
  - The foregoing principles should be considered in determining whether to provide services in individual circumstances. No hard-and-fast rules can be developed to help members in reaching these judgments.
Appendix A: AICPA code

AICPA Principles
— Scope and Nature of Services Principle. (0.300.070)
  - Members should
    — Practice in firms that have in place internal quality control procedures to ensure that services are competently delivered and adequately supervised.
    — Determine whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client.
    — Assess whether an activity is consistent with their role as professionals.
Appendix A: AICPA code

Members in business

— Members may encounter relationships or circumstances that create threats to a member’s compliance with the rules. A member should evaluate whether the relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a threat to the member’s compliance with the rules that is not at an acceptable level. (2.000.01)

— Members should identify threats to compliance with the rules and evaluate the significance of those threats. (2.000.06)
  - Identify threats. The existence of a threat does not mean that the member is in violation of the rules, but only the significance of the threat should be evaluated.
  - Evaluate the significance of the threat to determine whether it is at an acceptable level.
  - Identify and apply safeguards to eliminate the threat or reduce it to an acceptable level.
Appendix A: AICPA code

Members in business

There may be some circumstances where no safeguards can reduce a threat to an acceptable level. In such circumstances, the members should determine whether to decline or discontinue the professional services or resign from the employing organization.
Appendix A: AICPA code

Members in business
— Objectivity and Independence Principle (0.300.050)

- Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members not in public practice serve in financial and management capacities in industry, education, and government. Regardless of their service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

- Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services.

- Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of GAAP and candid in all their dealings with members in public practice.
Appendix A: AICPA code

Members in business

— Types of threats: adverse interest, advocacy, familiarity, self-interest, self-review, and undue influence. (2.000.07)

— Subordination of Judgment (2.130.020)
  - Integrity and Objectivity Rule prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services for an employer.
  - Self-interest, familiarity, and undue influence threats may exist when a member and others in his or her organization have a difference of opinion relating to the application of accounting principles, auditing standards, or other relevant professional standards (including standards applicable to tax and consulting services).
Appendix A: AICPA code

Members in business
— Types of safeguards. (2.000.15)
  - Created by the profession, legislation, or regulation (excerpts from Code):
    — Education and training requirements on ethics and professional responsibilities.
    — Continuing education requirements on ethics.
    — Legislation establishing prohibitions or requirements for entities and employees.
    — Competency and experience requirements for professional licensure.
    — Professional resources, such as hotlines, for consultation on ethical issues.
  - Implemented by the employing organization regulation (excerpts from Code):
    — Tone at the top.
    — Policies and procedures addressing ethical conduct and compliance with the laws, rules, and regulations.
    — Audit committee charter.
    — Internal policies and procedures requiring disclosures of identified interests or relationships.
Appendix A: AICPA code

Members in business
— Types of safeguards. (2.000.15)
  - Implemented by the employing organization regulation (excerpts from Code):
    — Dissemination of corporate ethical compliance policies and procedures, including whistleblower hotlines, to promote compliance.
    — Human resources policies and procedures stressing the hiring and retention of technically competent employees.
    — Assigning sufficient staff with the necessary competencies to projects and other tasks.
    — Staff training on applicable laws, rules, and regulations.
    — Regular monitoring of internal policies and procedures.
    — Policies for promotion, rewards, and enforcement of a culture of high ethics and integrity.
    — Use of third-party resources for consultation as needed.
Appendix A: AICPA code

Members in business
- Competence. (2.300.010)
  - Competence means that the member or member’s staff possesses the appropriate technical qualifications to perform professional services and, as required, supervises and evaluates the quality of work performed. Competence encompasses knowledge of the profession’s standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of professional services.
  - A member’s agreement to perform professional services implies that the member has the necessary competence to complete those services according to professional standards and to apply the member’s knowledge and skill with reasonable care and diligence. The member, however, does not assume responsibility for infallibility of knowledge or judgment.
Appendix A: AICPA code

Members in business

— Competence. (2.300.010)

- A member may have the knowledge required to complete the services in accordance with professional standards. A normal part of providing professional services involves performing additional research or consulting with others to gain sufficient competence.

- If a member is unable to gain sufficient competence, the member should suggest the involvement of a competent person to perform the needed professional service, either independently or as an associate.
Duty of Confidentiality

- Definition of Client Confidential Information. (0.400.09)
  - Any information obtained from the client that is not available to the public.
  - Unless client information is available to the public, it should be considered client confidential information.
  - Federal, state, or local statutes or regulations may be more restrictive than the AICPA rules.
Duty of Confidentiality
— Confidential Information Obtained from Employment or Volunteer Activities. (1.400.070, 2.400.070)

- Member should maintain the confidentiality of his or her employer’s or firm’s confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship.

- Member should be alert to the possibility of inadvertent disclosure, particularly to a close associate, close relative, or immediate family member.

- Member should take reasonable steps to ensure that staff under his or her control or others within the employing organization and persons from whom advice and assistance are obtained are aware of the confidential nature of the information.
Appendix A: AICPA code

Duty of Confidentiality
— Confidential Information Obtained from Employment or Volunteer Activities. (1.400.070, 2.400.070)
  - Special rules for information obtained during course of prior employment. (Distinction between information and experience and expertise.)
  - Member would be considered in violation of the Acts Discreditable Rule (1.400.001) if the member discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization, unless there is a legal or professional responsibility to use or disclose such information.
  - 1.400.70.06 contains several examples of permitted or required disclosure of confidential employer information.
Appendix A: AICPA code

Duty of Confidentiality

— Use of Confidential Information from Non-Client Sources. (1.400.240)
  - Disclosure of confidential information obtained from a prospective client or non-client without consent would violate the Acts Discreditable Rule. (1.400.001)

— Confidential Client Information Rule. (1.700.001)
  - Member in public practice shall not disclose any confidential client information without the specific consent of the client.
  - Interpretations of this rule in situations involving —
    — Client competitors. (1.700.010)
    — Disclosing Information from Previous Engagements. (1.700.020)
Appendix A: AICPA code

Duty of Confidentiality
— Confidential Client Information Rule. (1.700.001)
   - Disclosing Information to Persons or Entities Associated with Clients. (1.700.030)
   - Disclosing Information to Third-Party Provider. (1.700.040)
   - Disclosing Information during Review of the Member’s Practice. (1.700.050)
   - Disclosures to Third Parties (such as Trade Association, Member of the Academia, or Surveying or Benchmarking Organization). (1.700.060)
   - Disclosing Client Information during Litigation. (1.700.070)
   - Disclosing Information in Director Positions. (1.700.080)
   - Disclosing Client Names. (1.700.090)
   - Disclosing Information as a Result of a Subpoena or Summons. (1.700.100)
Appendix B: ABA Model Rules and opinions
Appendix B: ABA Model Rules and opinions

Duty of Confidentiality

ABA Model Rule 1.6

— A lawyer generally may not reveal client confidences without consent.
— Under this general rule, the lawyer would be prohibited from disclosing a prior falsehood.
Appendix B: ABA Model Rules and opinions

Duty of Confidentiality

ABA Model Rule 1.6 provides that before disclosing information, the lawyer must first encourage the client to disclose or ask for permission to disclose himself. If the client declines, the lawyer may consider whether one of these specified exceptions apply:

- To prevent reasonably certain death or substantial bodily harm;
- To prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer’s services;
- To prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client’s commission of a crime or fraud in furtherance of which the client has used the lawyer’s services.
- Will correction prevent a crime or fraud that will result in substantial injury?
Appendix B: ABA Model Rules and opinions

Allocation of Authority Between Client and Lawyer
ABA Model Rule 1.2

— Generally, a lawyer shall abide by a client’s decisions concerning the objectives of the representation and shall consult with the client about the means by which they are to be pursued.
Duty of Confidentiality

— ABA Model Rule 1.6 seemingly precludes disclosing a mere innocent or even negligent (subsequently discovered) error, without consent, unless the failure to disclose works a continuing fraud on the IRS.

— Must the lawyer withdraw:
  - Can he continue to represent the client without perpetuating the error?

Appendix B: ABA Model Rules and opinions

Candor to Third Parties
ABA Model Rule 4.1
— In the course of representing a client, a lawyer shall not knowingly:
  - Make a false statement of material fact or law to a third person; or
  - Fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting
    a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.
ABA Formal Opinion 314 (1965)  
(Reating to Tax Opinions)

— Lawyer owes client “warm zeal,” candor, and fairness.
— Lawyer who is asked to advise his client in the course of the preparation of the client’s tax returns may freely urge the statement of positions most favorable to the client just as long as there is a reasonable basis for this position.
— Lawyer has absolute duty not to make false assertions of fact, but is not required to disclose weaknesses in the client’s case.
— Lawyer is under a duty not to mislead the IRS deliberatively or affirmatively, either by misstatements or silence or by permitting client to mislead.
— “Reasonable basis” standard superseded by ABA Opinion 85-352 (1985). “Warm zeal” standard revised to require lawyer “zealously and loyally to represent the interests of the client within the bounds of the law.”
— Lawyer does not owe as high a duty to IRS as to a court.
ABA Formal Opinion 85-352 (1985)

— “A lawyer may advise reporting a position on a tax return so long as the lawyer believes in good faith that a position is warranted in existing law or can be supported by a good faith argument for an extension, modification or reversal of existing law and there is some realistic possibility of success if the matter is litigated.”

— “The ethical standards governing the conduct of a lawyer in advising a client on positions that can be taken in a tax return are no different from those governing a lawyer’s conduct in advising or taking positions for a client in other civil matters.”
ABA Formal Opinion 85-352 — Caveats

— If a position has a realistic possibility of success, a lawyer can assist in reporting the position, even if:
  - The lawyer believes the position probably will not prevail;
  - There is no substantial authority to support the position; and
  - There is no disclosure on the return.

— But I.R.C. § 6694 may subject the return preparer to a penalty.

— ASC 740 may preclude the taxpayer from recognizing any tax benefit with respect to the position for financial statement purposes. In addition, disclosure of an item on Form UTP may be required.
Appendix B: ABA Model Rules and opinions

Application of Duty of Candor under ABA Rules

— Assume the taxpayer is planning to make a false statement to the IRS in the course of an audit:
  - The practitioner must attempt to persuade the taxpayer not to make such a statement.
  - The practitioner cannot do anything to indicate that she agrees with or countenances the statement.
  - The practitioner may have to withdraw from the representation.
Application of Duty of Candor under ABA Rules

— What happens if the error was made by the IRS?

- There are conflicting authorities.
  
  — Cf. Standards of Tax Practice Statement 1991-1, stating that the tax lawyer should notify the IRS if the mistake is computational, but need not notify the IRS if the mistake is conceptual.
  
  — 1991-1 recognizes that if the client objects to notifying the IRS of a computational mistake, the lawyer must act consistently with the duty of confidentiality under Model Rule 1.6. Therefore, to prevent violation of Model Rule 8.4, which prohibits a lawyer from engaging in dishonest conduct, the lawyer may have to withdraw from the representation.

- In ABA Informal Opinion 86-1518, a lawyer received a contract from opposing counsel that omitted a clause, benefitting the lawyer’s client. The opinion concluded that the lawyer should contact opposing counsel and correct the error, and need not even consult with own client.

- Dallas Bar Association Opinion No. 1984-4 concluded that where an administrative law judge’s decision made an incorrect computation, there was no duty to correct, at least where neither counsel nor client indicated the amount was correct and they did not become aware of the error until after the decision was rendered.
Application of Duty of Candor under ABA Rules

— Example: During audit, the practitioner discovers facts that are favorable to the IRS of which the Service is unaware.

— A practitioner has no affirmative obligation to reveal facts that are favorable to the IRS.

  - But a practitioner may not mislead the IRS through misstatements or silence. If the IRS made a request for information that is not privileged, the practitioner must comply. Circular 230, §10.20.

  - But if no request is made, the practitioner is not required to expose weaknesses in his client’s case. ABA Formal Opinion 314. See also ABA Formal Opinion 93-375.
Appendix B: ABA Model Rules and opinions

Application of Duty of Candor under ABA Rules

— Example: The taxpayer testifies in court in a manner you know to be false.

— Under ABA Model Rule 3.3, a lawyer may not —

  - Knowingly fail to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client.

  - Offer evidence that the lawyer knows to be false. If a lawyer, the lawyer’s client, or a witness called by the lawyer has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.
Appendix B: ABA Model Rules and opinions

False or Frivolous Positions
— A lawyer cannot take steps to defend items he knows to be wrong.
  - ABA 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.
    — A lawyer for the defendant in a criminal proceeding, or the respondent in a proceeding that could result in incarceration, may nevertheless so defend the proceeding as to require that every element of the case be established.
Appendix B: ABA Model Rules and opinions

Duty of Candor vs. Duty of Confidentiality

— Once a false statement has been made:

- The lawyer should advise the client of the lawyer’s duty of candor to the tribunal and seek the client’s cooperation in withdrawing or correcting the false statements or evidence.

- “If withdrawal from the representation is not permitted or will not undo the effect of the false evidence, the advocate must make such disclosure to the tribunal as is reasonably necessary to remedy the situation, even if doing so requires the lawyer to reveal information that otherwise would be protected by Rule 1.6.” ABA Model Rule 3.3, Comment 10.
Withdrawal

— Withdrawal may be necessary

- A lawyer shall withdraw from an ongoing representation if the representation will result in violation of the rules of professional conduct or other law. ABA Model Rule 1.16(a).

- A lawyer may withdraw if the client persists in a course of action involving the lawyer’s services that the lawyer reasonably believes is criminal or fraudulent or the client has used the lawyer’s services to perpetrate a crime or fraud. ABA Model Rule 1.16(b).
Appendix C: Whistleblower rules and state false claims acts
Appendix C: Federal whistleblower rules

Not Just the News, but the Headlines

— Whistleblowers in the News: Not just national security, but taxes.

— Most prominent tax whistleblower is Bradley Birkenfeld. He’s the former UBS employee who secured a $104 million whistleblower award from the U.S. government for telling the IRS about his employer’s involvement in helping UBS clients evade their U.S. tax obligations.
Appendix C: Federal whistleblower rules

Birkenfeld Case Is Special, but not Unique — Other Headlines

— Tax Whistleblower Gets $2 Million IRS Award: Lawyer (Chicago Tribune).
— Tax Informants Are On The Loose (Forbes).
— IRS Gives $4.5 Million Award to Tax Whistle-blower (Associated Press).
— First False Claims Act Recovery in New York, Whistleblower Awarded $1.1 Million (Corporate Crime Reporter).
— Whistleblower Behind Caterpillar’s Tax Headache Could Make $600M (Bloomberg BNA).
Appendix C: Federal whistleblower rules

I.R.C. § 7623(b)
— Awards for provision of information relating to a violation of the internal revenue law.
— When amounts exceed $2 million, statutory award is between 15% and 30% of amount collected (reduced to 10% when information is publicly available).
— IRS has discretionary authority to grant awards for cases less than $2 million under I.R.C. § 7623(a).
— Regulations issued in August 2014.
Appendix C: Federal whistleblower rules

Awards, Even for Those Who Participated in Tax Evasion Scheme

— The Whistleblower Office may reduce an award if informant “planned and initiated” actions leading to the underpayment. I.R.C. § 7623(d)(3).

— Where informant is convicted of criminal conduct related to underpayment, no award may be given at all.

— In September 2012, IRS announced the payment of a $104 million award to Bradley Birkenfeld for information leading to IRS’s $5 billion settlement with UBS Bank, even though he served prison sentence for assisting certain individuals in hiding foreign bank accounts from IRS. ($4,600/hour served.)
A Steady Stream of Whistleblower Claims… and Awards

(FY2017 Whistleblower Office Report to Congress released in January 2018)

— Since 2007, $499 million in tax whistleblower awards have been paid.

— Information provided by whistleblowers since 2007 has resulted in the collection of more than $3.6 billion in tax, interest, and penalties.

— In FY2017, the Whistleblower Office made 242 awards to whistleblowers totaling more than $33.9 million (before sequestration); this included 27 awards under section 7623(b).

— This represents a 50-percent increase in the number of section 7623(b) awards compared with 18 awards paid in FY2016. Total awards and total amounts collected declined, however, by 42 percent and 48 percent, respectively, and award dollars to whistleblowers as a percentage of amounts collected increased to 17.8 percent from 16.6 percent.

— Whistleblower claims assigned in FY2017 were down 13 percent from those submitted in FY2016, and closures decreased by 31.6 percent.

— The IRS rejected 33 percent fewer claims as compared to FY2016 from whistleblowers because the allegations were considered “Not Specific, Credible, or Are Speculative in Nature.”

Appendix C: Federal whistleblower rules
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Federal Whistleblower Rules Liberalized by Bipartisan Budget Act of 2018 (enacted February 9, 2018)

- Whistleblowers are now allowed to deduct attorney fees, court costs, and related expenses “above the line” (i.e., in computing adjusted gross income), so long as the deduction does not exceed the amount of income earned in the whistleblower recovery.

- The term “collected proceeds” in I.R.C. § 7623 (the amount upon which the amount of any whistleblower award is computed) has been expanded to include criminal fines, civil forfeitures, and other fees for violating income reporting requirements.

Supreme Court Decision Limiting Protection for Internal Whistleblowers Could Encourage External Whistleblowers (February 2018)

- In Digital Realty Trust v. Somers, the Supreme Court held that the Dodd-Frank Act’s protections for whistleblowers was not available to employees or others who report wrongdoing internally (i.e., they used the company’s hotline or other procedures); rather, the protections only apply to persons who report wrongdoing to the SEC.

- While the Court’s decision represented a victory for the company (in terms of shielding it from a claim of retaliation against an employee who internally reported wrongdoing), it could have the effect of encouraging employees to bypass internal reporting processes in favor of reporting externally (e.g., to SEC or IRS).
Appendix C: Federal whistleblower rules

Examples Involving Large Companies

— In-house tax professional indicted for participating in filing of false tax return after colleague raised internal concerns about research tax credit claim. The company, a government contractor, conducted internal investigation and subsequently referred matter to Justice Department. After jury trial, tax professional was acquitted of criminal charges under I.R.C. § 7206(2).

— Tax department employee filed federal job-protection suit under SOX claiming retaliation after raising concerns internally about certain international transactions. Suit, which alleged “unlawful scheme to avoid over $2 billion in federal income tax,” was settled without adjudication of underlying tax claims, but IRS and congressional scrutiny continues, and disclosures prompted shareholder suits against company and outside auditor.

— Tax department employee filed wrongful discharge suit under SOX and RICO alleging company misled IRS and hid tax underpayment from outside auditor. (Tax at issue alleged to be $7 million.) Case dismissed and, in separate state case brought by the company, employee was found liable for defamation.
Non-Tax Costs Can Be Substantial

Even assuming whistleblower’s claims do not lead to additional tax liability or penalty, costs to company could be substantial:

— Financial:
  - Legal and other fees incurred in responding to merits of tax claims.
  - Legal costs and possible monetary damages if retaliation (or unlawful discharge) is alleged, either under general employment law principles, Sarbanes-Oxley Act (SOX), or Racketeer Influenced and Corrupt Organization Act (RICO).
  - Consulting fees paid to crisis management, government affairs, or public relations firms relating to claim.
Appendix C: Federal whistleblower rules

Non-Tax Costs Can Be Substantial

Human Resources:
— Decline in employee productivity and morale, both within and outside tax department.

Reputational:
— If whistleblower’s claim becomes public — for example, by leak to media or suit for unlawful retaliation — company could find its name in headlines. Even if claim does not become public, company’s credibility with IRS or other governmental bodies could be impaired.
Appendix C: Federal whistleblower rules

Mitigating Whistleblower Risk

— Don’t Make Matters Worse — Avoid Actual or Perceived Retaliation.
— Confirm Adequacy of Company’s Ethics Hotline and Tax Department Awareness of Procedures.
— Review and Revise Tax Department Procedures and Practices.
  - Demystify Tax.
  - Set Proper Tone at the Top; Listen to Your Team.
  - Train Your Team.
  - Review Performance Standards.
  - Review the Company’s Policy for Making Disclosures to IRS.
Appendix C: State false claims acts

— Federal False Claims Act does not apply to taxes.
— Illinois False Claims Act held in 2007 to extend to claims involving Use Tax (both underpayments and overpayments), leading to numerous suits (e.g., alleging failure to collect sales tax on shipping & handling charges).
— Nevada False Claims Act held in 2007 to permit prosecution of tax cases by private parties.
— Indiana False Claims Act does not apply to income tax.
— In 2010, New York amended false claims statute to cover tax matters. Note: In 2014, a $6.2 million settlement by Massachusetts company led to $1.137 million award to “tax services provider.”
— In March 2014, Kentucky mandated a study whether a tax whistleblower program should be enacted.
Appendix C: State false claims acts

New York (Sales Tax)

— In 2010, New York amended its false claims statute to expressly cover tax matters. From 2013 through 2017, there were more than $70 million in back taxes and penalties collected under the FSA. The largest settlement was for more than $40 million, with the whistleblower’s award exceeding $8.8 million.

— Pending Case involving Spring Nextel Corp.
  - In 2011, a qui tam action was initiated by whistleblower in respect of Sprint Nextel for failing to collect and remit sales tax on mobile phone contracts.
  - In 2012, New York Attorney General took over the case, claiming the company did not collect sales taxes on flat-rate access charges for wireless plans. The trial and appellate courts have declined to dismiss the case. On May 31, 2016, U.S. Supreme Court refused to hear taxpayer’s interlocutory appeal of the state court decision.
  - State alleges that more than $100 million in taxes is involved, which — with penalties and interest — could grow to more than $400 million before the case is resolved.

— Several other states (Arkansas, District of Columbia, Illinois, Michigan, and Pennsylvania) are considering similar legislation.
Appendix C: State false claims acts

**New York (Income Tax)**

— In 2013, former in-house tax lawyer at large mutual fund (Vanguard) filed a whistleblower suit in state court, submitting complementary claims to the IRS, the SEC, and several states.

— Complaint alleged that mutual fund’s pricing practices violate I.R.C. § 482 and the comparable provisions of state law, allowing company to evade more than $35 billion in federal and state taxes over 10-year period.

— New York’s attorney general declined to prosecute case, prompting qui tam action in 2014. In November 2015, New York trial court granted company’s motion to dismiss on the ground the whistleblower had violated legal ethical standards. Collateral litigation in other jurisdictions is pending.

  - In April 2017, Third Circuit held that state court’s rejection of whistleblower’s retaliation claim under state law did not preclude whistleblower’s suit for retaliation under Dodd-Frank Act.

  - In November 2015, Texas paid whistleblower $117,000 for his role as “confidential informant” in the case; claims in other states pending.

— Status of IRS and SEC claims is uncertain.
Appendix C: State false claims acts

Delaware (Unclaimed Property)
— *Qui tam* action filed in 2013 relating to whether unredeemed gift card balances constitute unclaimed property subject to escheat in Delaware (*French v. Card Compliant*).
— Case filed by former executive of gift card service company, naming 27 Delaware-incorporated companies that sold gift cards, arguing that those companies (as opposed to the gift card service company) were the holders of the unclaimed property.
— Case unsealed in March 2014 when Delaware Attorney General intervened.
— Note: Delaware has amended its unclaimed property statute and regulations several times since 2015 in response to judicial and other criticism.
Questions?
Thank you

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