Nuts & Bolts: Introduction to Ethical Considerations for Young Attorneys

- **Panelists:**
  - Honorable Ronald L. Buch, US Tax Court, Washington DC
  - Joshua Wu, Deputy Assistant Attorney General (Policy and Planning), Department of Justice, Tax Division, Washington, DC
  - Brianne DeSellier, Crowe LLP, Fort Lauderdale, FL
  - James Steele, Morgan, Lewis & Bockius LLP, Washington, DC

- **Moderator:**
  - Annie Wurtzebach, DLA Piper, New York, NY
Ethical & Penalty Standards for Tax Practitioners

Virtually all difficult ethical problems arise from conflicts between a tax practitioner’s responsibilities:

- to clients,
- to the tax system, and
- to the practitioner’s own interest in remaining a compliant professional
Duties to the Taxpayer and to the Tax System

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

Comm’r v. Newman, 159 F2d 848, 850-51 (2nd Cir. 1947), (Learned Hand dissenting)
ETHICAL STANDARDS
Standards Applicable to Attorneys

- ABA Model Rules of Professional Conduct
- Court rules of professional conduct (FRCP 11; Tax Court Rule 201)
- ABA and state ethics opinions
Standards Applicable to Accountants

- AICPA Code of Professional Conduct
- AICPA Statements on Standards for Tax Services (SSTS)
- State Board of Accountancy Rules
Standards Applicable to Return Preparers

- “Tax return preparer” means any person who prepares for compensation, or employs one or more people to prepare for compensation, any return of tax. IRC 7701(a)(36).

- “Return preparer” does not include individuals who prepare a return or claim for refund of a taxpayer, by whom the individual is regularly and continuously employed or compensated, or an officer, a general partner, member, shareholder, or employee of a taxpayer.

- So the “return preparer” standards largely do not apply to in-house tax professionals working in the tax department (the audience).

- Beware that civil penalties (with unique professional standards and defenses) exist in the Internal Revenue Code. See IRC 6694, 6695, 6713.
<table>
<thead>
<tr>
<th>IRC Code</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRC 6695A</td>
<td>Incorrect Appraisals</td>
</tr>
<tr>
<td>IRC 6700</td>
<td>Promoting Abusive Tax Shelters, etc.</td>
</tr>
<tr>
<td>IRC 6701</td>
<td>Aiding &amp; Abetting Understatement of Tax Liability</td>
</tr>
<tr>
<td>IRC 6707/08</td>
<td>Failure to Report or Maintain List of Reportable Transactions</td>
</tr>
</tbody>
</table>
## Criminal Penalties Applicable to Tax Advisors

<table>
<thead>
<tr>
<th>IRC Section</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>7201</td>
<td>Tax Evasion</td>
</tr>
<tr>
<td>7206(1)</td>
<td>Filing a False Return</td>
</tr>
<tr>
<td>7206(2)</td>
<td>Aiding or Assisting the Filing of a False Return</td>
</tr>
<tr>
<td>7212</td>
<td>Any Attempt to Interfere with the Administration of the Internal Revenue Laws</td>
</tr>
<tr>
<td>7216</td>
<td>Disclosure or Use of Information by Return Preparers</td>
</tr>
<tr>
<td>371</td>
<td>Conspiracy</td>
</tr>
<tr>
<td>1001</td>
<td>False Statement to a Federal Official</td>
</tr>
</tbody>
</table>
Standards Applicable to Tax Practitioners Practicing Before the IRS

<table>
<thead>
<tr>
<th>Treasury Department</th>
<th>Regulations Governing Practice before the Internal Revenue Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Circular No. 230</td>
<td></td>
</tr>
<tr>
<td>(Rev. 6-2014)</td>
<td></td>
</tr>
<tr>
<td>Catalog Number 16586R</td>
<td></td>
</tr>
<tr>
<td><a href="http://www.irs.gov">www.irs.gov</a></td>
<td></td>
</tr>
</tbody>
</table>

| Department of the Treasury | Title 31 Code of Federal Regulations, Subtitle A, Part 10, published (June 12, 2014) |

9
DEALING WITH THE IRS
Practice before the IRS comprehends all matters connected with a presentation to the IRS relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the IRS.

Such presentations include, but are not limited to:
- preparing documents;
- filing documents;
- corresponding and communicating with the IRS;
- rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion; and
- representing a client at conferences, hearings, and meetings.
Circ. 230 § 10.3: Who May “Practice” Before the IRS?

- Attorneys
- Certified Public Accountants
- Enrolled Agents
- Enrolled Actuaries (limited)
- Enrolled Retirement Plan Agents (limited)
Circ. 230: Does It Apply to In-House Tax Professionals?

- IRS Office of Professional Responsibility (OPR) position is clear (even if the flush terms of Circular 230 are not):

In-house attorneys and CPAs ARE subject to the standards of practice set forth in Circular 230 and any practice by such attorneys before the IRS is within the OPR’s jurisdiction. “Practice” broadly means representing a taxpayer before the IRS.
Circ. 230: Does It Apply to In-House Tax Professionals

Examples of activities in-house tax professionals routinely engage in that may fall within the coverage of Circular 230:

- Advising on potential tax return positions;
- Preparing, signing or filing tax returns and refund claims;
- Communicating with IRS examination agents during audit conferences face-to-face;
- Routine interactions with Service Center personnel;
- Responding to Information Document Requests (IDRs);
- Participating as the taxpayer representative during IRS Appeals conferences and settlement negotiations.
Ethical Considerations for In-House Professionals
Hypothetical 1: Signing the Return
Your company’s return preparer presents you and your CEO with the company’s return.

The tax return includes a tax position that you have been previously advised has a reasonable basis. Your tax advisor is unable to say it is more likely than not to be sustained if challenged.

You are called into your CEO’s office and she asks “are you sure that I should sign this?”
Filing Standards for Tax Returns

- No accuracy-related penalty (I.R.C. Section 6662) if:
  - “Substantial authority” for position (33%-40%) or
  - Disclosed on return and “Reasonable basis” (20%-33%)
    - Exclusion does not apply to “tax shelters”

- For reportable transactions, no penalty if special level of reasonable cause under Section 6664:
  - Disclosed on return;
  - Substantial authority; AND
  - Reasonably believe more likely than not.
Filing Standards for Tax Returns

- There is also a tax return preparer penalty for preparing a tax return that takes an “unreasonable position.” I.R.C. § 6694.

- Penalty does not apply if:
  - If not a “tax shelter” or reportable transaction:
    - “Substantial authority” for position, or
    - Disclosed on return and “Reasonable basis” (20%-33%)
  - If tax shelter or reportable transaction, then more likely than not standard applies.
Best Practices

- Internal procedures to confirm to CEO and CFO that tax positions in the tax returns meet relevant standards.
  - NOTE: Communications regarding matter to be reported on tax return may not be privileged.
    - Advice received prior to a transaction is less likely to be found for purposes of tax return preparation.
    - Advice during or after transaction has higher risk of being found not privileged.
- Tax return should be signed by corporate officer with most knowledge
Hypothetical 2: Requesting a Tax Opinion
Your company is preparing to engage in a transaction that is in a grey area of the law and you believe may be challenged by the IRS. You request that your outside advisor prepare a tax opinion on the substance of the transaction and their proposed structure. In response, your advisor quotes two fee amounts to prepare the tax opinion: (1) $50,000 or (2) 20% of the tax savings achieved by the structure.
Requirements for Written Advice
(§ 10.37)

- A practitioner may give “written advice” (including by means of e-mail) concerning one or more Federal tax matters subject to the following requirements:
  - (1) Base written advice on reasonable factual and legal assumptions (including future events);
  - (2) Reasonably consider all relevant facts and circumstances;
  - (3) Use reasonable efforts to identify and ascertain facts relevant to written advice;
  - (4) Not rely upon representation, statements, findings, or agreements of the taxpayer if reliance would be unreasonable;
  - (5) Relate applicable law and authorities to facts; AND
  - (6) Not take into account the possibility that a return will not be audited or that a matter will not be raised on audit
Penalty Protection

- No penalty shall be imposed under section 6662 . . . if it is shown (1) that there was a reasonable cause for [the underpayment of tax] and (2) that the taxpayer acted in good faith. I.R.C. § 6664(c)(1).

- Special rules and exceptions apply for:
  - Transactions found to lack economic substance under IRC §7701(o) (no reasonable cause exception)
  - Reportable transactions (require disclosure, substantial authority and more likely than not)
  - Certain charitable contributions (require qualified appraisal)
Waiver of the Attorney-Client Privilege When Contesting Penalties

- There may be a waiver of the attorney-client privilege with respect to a tax opinion or other professional advice if the taxpayer relies on it in defense to an asserted penalty.

- Privilege may be waived under the implied waiver doctrine if a taxpayer asserts a penalty defense based on the taxpayer’s belief or state of mind relating to professional advice received, even if the taxpayer explicitly disclaim. AD Invest. 2000 Fund LLC v. Comm’rs reliance on a tax opinion., 142 T.C. No. 13 (2014).
Best Practices

- Courts hold sophisticated corporate taxpayers to a high standard.
- Hourly fee arrangements with advisors
- Maintain supporting documentation (particularly if you “anticipate litigation”)
- Facts and assumptions:
  - Accuracy is critical
  - Retain records of information supplied to advisor
  - Question where facts seem incomplete or sparse
  - Question assumptions
- For full confidence in penalty protection, use independent counsel unrelated to advisors implementing transaction.
Hypothetical 3: IRS Agent’s Mistake
Your company is audited by the IRS and the agent disallows a deduction associated with the transaction.

The agent’s audit report identifies a technical issue as the basis for disallowing the deduction, but fails to address the business purpose/economic substance issue that you were concerned about.

Your company’s outside counsel handling the audit is made aware of the agent’s omission. Is the attorney ethically obligated to alert the agent of his mistake?
Attorney’s Duty of Candor to IRS

- ABA Formal Opinion 314 (1965)
  - A lawyer practicing before the IRS may not deliberately mislead the IRS either by misstatements or by permitting the client to mislead the IRS.
  - However, a lawyer representing a client before the IRS may present the strong points of the client’s case and is not required to disclose weak points.
  - If the client makes misstatements, the lawyer has a duty to counsel the client to correct the misstatements (and could ultimately be required to withdraw).
Attorney’s Duty of Candor to IRS

- Circular 230 § 10.21
  - A practitioner who knows that the client has made an error or omission from any paper which the client submitted must advise the client promptly of the fact of such omission.
  - The practitioner must also advise the client promptly of the consequences as provide under the Internal Revenue Code and regulations of such omission.
Requirement to File an Amended Return?

- A taxpayer “should” file an amended tax return and pay any tax due after discovering an error or omission involving an understatement of income or an overstatement of deductions. See Treas. Reg. §§ 1.451-1(a), 1.461-1(a).

- Supreme Court has stated that a taxpayer is under no legal obligation or duty to file an amended return even after an error or omission is discovered. Badaracco v. Comm’r, 464 U.S. 386 (1984).

- AICPA Statements on Standards for Tax Services No. 6: “It is the taxpayer’s responsibility to decide whether to correct the error”
Hypothetical 4: Document Retention
- Your company receives an audit notice from the IRS regarding its taxable year 2015.
- A key employee in the company’s tax department leaves.
- That employee worked on a large transaction that resulted in a loss for 2015.
- As part of your company’s normal document retention procedures, it deletes the key employee’s e-mails and wipes her hard drive clean.
- In connection with the IRS’s audit, the company receives an Information Document Request ("IDR") regarding that transaction.
CASE IN POINT

BUT I DON'T WANT THE DATA TO SPOLIATE
Preparing for an IRS Audit

- What should you retain?
  - Transactional documents
  - Drafts and final versions of opinions and internal memoranda
  - E-mails or other documents supporting the business purpose
  - Legal research
  - E-mails, notes, or other communications with tax advisors and return preparers
- Maintain electronic documents, communications, and data in native format with metadata.
Laws Governing Retention

- Important to consider legal and business requirements:
  - Legal: local, state, federal laws and regulations may mandate that certain documents be kept for a certain period of time.
  - Business: business practices may require information be kept for a certain period of time.

- Common law duty to preserve documents and information when litigation is reasonably anticipated.

- ABA Model Rules of Professional Conduct:
  - Lawyers cannot obstruct opposing party’s access to evidence or unlawfully alter, destroy or conceal a document having evidentiary value. A lawyer cannot counsel a client to assist in destroying or altering documents. ABA Model Rule 3.4.
Spoliation of Evidence

Spoliation is “the destruction or alteration of evidence, or the failure to properly preserve property for another’s use as evidence in pending or reasonably foreseeable litigation.” Zubulake v. UBS Warburg LLC (“Zubulake V”) (S.D.N.Y. 2004)

Court may impose sanctions, which can include:

- Dismissal of claims
- Exclusion of evidence
- Draw an adverse inference
- Monetary penalties