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CHAPTER 10

Ethics and the Tax Professional: Coping with 21st Century Challenges

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§ 10.01 INTRODUCTION

As Robert Coplan worked in his office during 2000 and 2001, he could not have imagined that within 10 years he would be serving prison time for his tax work. A former IRS branch chief, Mr. Coplan worked for the international accounting firm of Ernst & Young LLP in a group named VIPER (Value Ideas Produce Extraordinary Results) designing, implementing, and defending “tax-advantaged products” (*i.e.*, tax shelters) marketed to individuals with taxable income of \$10 million or more. In May 2007, the Justice Department indicted Mr. Coplan,¹ and by January 2010, he had been found guilty and sentenced to three years behind bars. As of April 2010, he remains out of prison pending the appeal of his conviction.²

U.S. District Court Judge Sidney Stein has ordered Mr. Coplan, following his release from prison, to complete 120 hours of community service each year including 60 hours devoted to speaking with accountants and lawyers explaining the consequences of disregarding professional standards. Judge Stein told Mr. Coplan that he must “set forth his experiences and explain to these people the dangers of misleading the IRS, the dangers of going along with what everyone else is doing, the dangers of thinking all you are doing is your job . . . but realizing that, at some point, it tips over into criminal liability.”³

No doubt, many tax professionals wade into murky ethical waters during their careers.⁴ Considering the myriad changes to substantive tax laws, cascading disclosure

¹ Press Release, Four Individuals Charged in Criminal Tax Fraud Related to Ernst & Young Tax Shelters (May 30, 2007), available at <http://www.justice.gov/usao/nys/pressreleases/May07/eyindictmentpr.pdf>.

² Mark Hamblett, *Tax Lawyers' Sentences Income 'Explaining Dangers of Misleading IRS'*, N.Y.L.J. (January 22, 2010), available at <http://www.law.com/jsp/article.jsp?id=1202439373266>.

³ *Id.*

⁴ See Lynnley Browning, *7 Indicted on Charges of Selling Tax Shelters*. N.Y. TIMES, June 10, 2009, at B1, available at <http://www.nytimes.com/2009/06/10/business/10tax.html>. See generally the forthcoming TANINA ROSTAIN, CONFIDENCE GAMES: LAWYERS, ACCOUNTANTS AND THE TAX SHELTER INDUSTRY (MIT Press, 2011).

provisions, and changes to regulations governing practice before the Internal Revenue Service (IRS), working in the tax profession can be challenging. Answers are rarely black and white, and practitioners must base their advice on nebulous levels of authority for positions rather than a clear answer. Even practitioners who have worked for years in specialized areas of tax have found themselves scrutinized by the IRS's Office of Professional Responsibility for giving advice consistent with accepted norms at the time it was given.⁵ Expanded whistle-blower rules also broaden the potential for aggrieved third parties to initiate complaints about tax practitioners.⁶

The tax professional must be aware of these challenges while practicing in a world increasingly focused on taxes. Indeed, consider the fate of several of President Obama's cabinet nominees. Linked to individual tax problems, some were forced to withdraw while others faced tough questioning during confirmation.⁷ Many seemed to be completely unaware of their incorrect tax positions. Regardless of the fairness or proportionality of the outcome in particular cases, this situation confirms that ethics is a matter of growing personal importance for professionals. Understanding conflicts of interest, potential conflicts of interest, and perceived conflicts of interest—central to ethical decision-making—is a key survival skill for modern tax professionals. Being able to demonstrate adherence to a code or standards of conduct is another.

In determining how ethics rules shape the nature of tax practice, it is important to first assess the legal and ethical obligations of tax professionals. An understanding of the current environment and the current rules is essential for the tax professional to remain on the right side of the ethical divide. This article surveys the landscape of tax professionalism in light of recent developments (*e.g.*, increased transparency and whistleblower statutes) and discusses a process for making sound ethical decisions.

§ 10.02 CLASSIC HIERARCHY OF ETHICAL OBLIGATIONS GOVERNING TAX PRACTICE

There are clear indications that professional standards have eroded in some corners of the practitioner community. Attorneys and accountants should be pillars of our system of taxation, not the architects of its circumvention.

—Mark W. Everson, Former Commissioner of Internal Revenue

Ethics and rules of professional conduct emanate from the legal framework of the Constitution, formal professional rules, organizational policies and culture, and finally from one's own personal convictions (or risk tolerance). With this many sources, tax

⁵ OPR Complaint No. 2006-1 (January 29, 2009), available at http://www.irs.ustreas.gov/pub/irs-utl/sykes_alj_dec_redacted.pdf.

⁶ Dan Levine, *Ex-Bechtel Lawyer Acquitted in Tax-Credit Prosecution*, THE RECORDER (December 19, 2008) available at <http://www.law.com/jsp/article.jsp?id=1202426888992>.

⁷ Jeff Zeleny, *Daschle Ends Bid for Post; Obama Concedes Mistake*, N.Y. TIMES, February 4, 2009, at A1, available at http://www.nytimes.com/2009/02/04/us/politics/04obama.html?pagewanted=2&_r=1&ref=your-money; Jackie Calmes, *Geithner Questioned on Tax Returns*, N.Y. TIMES, January 14, 2009, at A1, available at <http://www.nytimes.com/2009/01/14/us/politics/14geithner.html?pagewanted=all>.

professionals may find it difficult to obtain a clear answer to the more sticky ethical questions they confront in practice. Making things even more challenging, the principles that guided the formation of some existing ethical rules may change over time. During periods of ethical flux, following one rule may cause the tax practitioner to be in danger of violating another. For example, attorneys generally must maintain the confidentiality of information obtained from a client,⁸ but Congress and the IRS have expanded the disclosure of taxpayer information on tax returns and in response to information requests.⁹ This increased “transparency” cannot help but strain the traditional role of an attorney as confidant.

Before addressing possible changes to professional tax practice as a result of regulatory changes, greater taxpayer transparency, and tax whistleblower developments, a review of the traditional elements of ethical conduct is helpful.

[1] Legal

Tax professionals often think of the Constitution and the various state analogues as relating primarily to jurisdictional issues only. These organic documents, however, are foundational to the government and legal systems that underlie the norms and mores that define professionalism. Indeed, for government officials, who are duty-bound to uphold their constitutions, making ethical choices regarding tax administration should always begin with consideration whether constitutional principles prescribe the boundary of options available. For other tax professionals, constitutions provide the foundation of tax laws and practice that create the professional environment that is the subject of their livelihood.

[a] Statutory

Legislatures at the federal and state levels create and change the laws that make up a particular tax system. Tax administrators are bound to carry out the express and implied intent within a particular statute. Likewise, professionals are engaged in applying or interpreting tax laws on behalf of their clients, assisting taxpayers in planning, compliance, and defense tax positions. In addition, criminal statutes and civil penalty provisions in tax codes circumscribe legal boundaries for compliance and punish wrongdoers. Conflict-of-interest and post-employment statutes prescribe acceptable professional conduct of government employees.¹⁰

Recent high profile tax convictions have highlighted the importance of criminal statutes to tax practitioners. Robert Coplan of Ernst & Young (see § 10.01) and his co-defendants were certainly not the only practitioners who allegedly violated these rules. Enough professionals were advocating illegal tax strategies during the late 1990s

⁸ See MODEL RULES OF PROF'L CONDUCT R. 1.6 (2002).

⁹ See, e.g., Announcement 2010-09, 2010-7 I.R.B. 408, available at http://www.irs.gov/irb/2010-07_IRB/ar08.html.

¹⁰ For example, Title 18, U.S. Code, Chapter 11—Bribery, Graft, and Conflicts of Interest, contains the federal government's criminal statutes dealing specifically with ethics. Most of these provisions apply to District of Columbia government officials as well, and nearly all the states have similar provisions.

and early 2000s that the judge in Mr. Coplan's trial noted he likely felt his practice was no different from those of other tax professionals—that he was merely doing his job.¹¹ Examples abound of other professionals caught in similar ethical traps.¹² The accounting firm BDO Seidman had a group of partners that marketed tax shelter products to its wealthy clients.¹³ Those activities ultimately led to the indictment of the firm's former chief executive. Accounting firms were not alone in tax shelter fallout. The once prominent law firm Jenkins & Gilchrist eventually folded as a result of a federal investigation into its tax shelter practice.¹⁴

[b] Regulatory

Governments rely on regulatory expansion of the statutory framework to administer the tax laws. Tax administrations are charged with faithful implementation of the tax laws in their administrative practices, not only in regulations, but also in rulings, notices, and other administrative processes. Similarly, formal administrative rules govern the conduct and practice of both government workers and practitioners, and the federal government and many states have agencies (such as the IRS's Office of Professional Responsibility) charged with enforcing governmental standards of conduct.

[2] Professional

State bar associations regulate the licensing of attorneys. Similarly, certified public accountants are licensed by the board of accountancy for the state or jurisdiction in which they practice.¹⁵ Additionally, government agencies may have their own practice standards.

[a] Rules of Professional Conduct for Attorneys

Historically, attorney regulation was achieved through common law doctrines eventually codified into national standards in the American Bar Association's Canons of 1908.¹⁶ The rules supported an unflinching devotion of a lawyer to the client without

¹¹ See Hamblett, *supra* note 2.

¹² The Treasury Inspector General for Tax Administration concluded in a study that as many as 280 licensed practitioners received some penalty related to tax shelters during the 2005 through 2007 period. Treasury Inspector General for Tax Administration, *Tax Practitioners Promoting Abusive Tax Shelters are Still Able to Represent Tax Payers Before the Internal Revenue Service*, Reference No. 2009-10-039 (February 20, 2009) available at <http://www.treas.gov/tigta/auditreports/2009reports/200910039fr.pdf>.

¹³ See Browning, *supra* note 4.

¹⁴ *Id.*

¹⁵ In many states, anyone can call him- or herself an "accountant." In order to become a Certified Public Accountant (CPA), however, almost all states require that an individual meet educational, experience, and ethical requirements and pass the Uniform CPA Examination. Only then are individuals granted licenses to practice by state boards of accountancy. Also, only CPAs can perform the SEC-required audits of publicly traded U.S. companies. AICPA Frequently Asked Questions, <http://www.aicpa.org/MediaCenter/FAQs.htm>, accessed March 2010. By comparison, the unauthorized (unlicensed) practice of law is widely prohibited.

¹⁶ "These [Canons] were based principally on the Code of Ethics adopted by the Alabama Bar

significant concern for the interests of other parties or the government.¹⁷ That long-established tradition of fealty has given way to an ever more pronounced role for a lawyer's and accountant's duty to the tax system in general.¹⁸ Recent legislative and regulatory efforts to increase taxpayer transparency have reinforced (or advanced) that evolution.

Most states have enacted a version of the ABA's Model Rules of Professional Conduct¹⁹ or its predecessor, the Model Code of Professional Responsibility,²⁰ and licensed attorneys are subject to the standards promulgated by their licensing jurisdictions (in many case more than one) and enforcement by their state bars. The ABA has issued a several opinions directed at the role and limitations of attorneys engaged in the tax practice. The most recent of those opinions, however, was issued 25 years ago, and provides that "[a] lawyer may advise reporting a position on a tax return so long as the lawyer believes in good faith that the 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."²¹ More recent changes to federal statutory return preparer standards and Circular 230 (which governs "practice before the IRS")²²—arguably promulgated in part because of the ABA's failure to update its guidance—have effectively supplanted the levels of authority approved in the ABA's guidance.

[b] AICPA Standards of Tax Practice

Certified public accountants are licensed by the board of accountancy for the state or jurisdiction in which they practice. The American Institute of Certified Public Accountants (AICPA) has promulgated a code of professional conduct for CPAs. In addition, the AICPA's Tax Executive Committee has promulgated Statements on

Association in 1887, which in turn had been borrowed largely from the lectures of Judge George Sharswood, published in 1854 as *Professional Ethics*, and from the fifty resolutions included in David Hoffman's *A Course of Legal Study* (2d ed. 1836)." See MODEL RULES OF PROF'L CONDUCT, Preface (2002).

¹⁷ For an insightful analysis of the shifting allegiances between clients and the tax systems, see David J. Moraine, *Loyalty Divided: Duties to Clients and Duties to Others—the Civil Liability of Tax Attorneys Made Possible by the Acceptance of a Duty to the System*, 63 Tax Law. 169, 170 (2009).

¹⁸ *Id.* "Nevertheless, developments in ethical discourse and changes in substantive law have caused tax lawyers to consider factors extrinsic to the interests of their clients while representing those clients, causing their duty of loyalty to become diluted by a duty owed 'to the system.'" *Id.* at 170.

¹⁹ As of February 26, 2009, all 50 states and the District of Columbia have adopted the Model Rules of Professional Conduct. The Model Rules are available at http://www.abanet.org/cpr/mrpc/mrpc_home.html.

²⁰ The Model Code of Professional Responsibility is available at <http://www.abanet.org/cpr/ethics/mcpr.pdf>.

²¹ ABA Comm. On Ethics and Prof'l Responsibility, Formal Op. 85-352 (1985).

²² U.S. Treasury Department Circular 230, Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service (Circular 230), available at <http://www.irs.gov/pub/irs-pdf/pcir230.pdf>.

Standards for Tax Services (SSTS) Nos. 1 through 8 and Interpretation No. 1-1, “Realistic Possibility Standard,” of SSTS No. 1, which reflect the AICPA’s standards of tax practice and delineate members’ responsibilities to taxpayers, the public, the government, and the accounting profession.²³

[c] Governmental Agencies Practice Standard

An obvious example of governmental practice standards is the U.S. Treasury Department’s Circular 230.²⁴ Section 10.34 of Circular 230 sets forth the standards with respect to tax returns and documents advising clients on tax positions taken on returns. There are currently three versions of section 10.34 that a practitioner should consider. The original version of section 10.34 was effective prior to September 26, 2007. The current version of section 10.34 became effective on September 26, 2007. The third version is a proposed amendment to section 10.34 that was published by the Department of Treasury on September 25, 2007, the day before the scheduled effective date of the current version. These proposed amendments have not been finalized. All three versions of section 10.34 address the practitioner standards for advising clients on a tax issue. The old version of section 10.34(a) prohibited practitioners from advising a client to take a position on a tax return unless “[t]he practitioner determines that the position satisfies the realistic possibility standard.” As set out in old section 10.34 (d), a “position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well informed analysis of the law and the facts by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater likelihood of being sustained on its merits.” The current version of Circular 230 does not include a practitioner standard, and the proposed version contains a “more likely than not” standard.

Although the version of Circular 230 currently in effect does not specify the applicable level of authority that must support a tax position, civil preparer penalties contained in the Internal Revenue Code serve as a proxy. On May 25, 2007, former President Bush signed the Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110-28 (121 Stat. 190), into law. The Act amended several provisions of the Internal Revenue Code to extend the application of the income tax return preparer penalties to all tax return preparers and altered the standards of conduct that must be met to avoid imposition of penalties for preparing a tax return under I.R.C. § 6694. Specifically, the legislation increased the return-preparation standard—*i.e.*, the standard of conduct that must be met to avoid the imposition of the penalties for preparing a return with respect to which there is an understatement of tax—to “a reasonable belief that the position [taken on the return] would more likely than not be sustained on the merits.” The Emergency Economic Stabilization Act of 2008 changed the return preparer standard under I.R.C. § 6694 from more likely than not to substantial authority conforming the preparer standard to the taxpayer standard in I.R.C. § 6662.

²³ See <http://tax.aicpa.org/Resources/Professional+Standards+and+Ethics/>. The SSTS are available at <http://www.aicpa.org/download/tax/SSTSfinal.pdf>.

²⁴ See note 22 *supra*.

The law keeps the standard at more likely than not for situations involving tax shelters.

The IRS also modified the original version of section 10.34(b) related to advising clients on potential penalties. That section was moved to section 10.34(c) and the language broadened to expand those documents covered by section 10.34. The original version arguably only covered tax returns while the current version applies to “any document, affidavit or other paper submitted to the IRS.” Thus, a practitioner could be held accountable under section 10.34 even if the practitioner is not the tax preparer subject to I.R.C. § 6694.

Circular 230 also includes rules requiring professionals practicing before the IRS to exercise due diligence in the preparation of tax advice for their clients. Section 10.22(a) of Circular 230 provides:

A practitioner must exercise due diligence—(1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters; . . . (3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

In a recent case, an administrative law judge (ALJ) dismissed a complaint brought by the IRS’s Office of Professional Responsibility against John M. Sykes who was alleged to have violated his obligation to exercise due diligence.²⁵ Mr. Sykes, an attorney with a well-known New York-based law firm, had issued short-form tax opinions addressing the tax basis of certain corporate stock held by his clients. These opinions “contained ‘facts, assumptions and conclusions without setting forth any analysis.’ ”²⁶ Mr. Sykes testified that he had performed the necessary research and due diligence, and that short form opinions of the type that he had provided in this instance were commonly used at the time. Larry R. Langdon, a former Commissioner of the IRS’s Large and Mid-Size Business Division, testified at the hearing stating “that while, ideally, a taxpayer might prefer to receive a long form opinion detailing all of the facts, all of the possible contingencies, and all of the legal issues, . . . the short form opinion [w]as the ‘gold standard of opinion writing at that point in time.’ ”²⁷ Thus, the ALJ dismissed the complaint finding that Mr. Sykes had conducted adequate due diligence to satisfy the requirement of Circular 230 in effect at that time.

That case would likely come out differently under the current rules. Revisions made to Circular 230, effective December 20, 2004, require practitioners to “relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts” when issuing certain tax opinions.²⁸ The ALJ in his decision said that this

²⁵ OPR Complaint No. 2006-1 (January 29, 2009) available at http://www.irs.ustreas.gov/pub/irs-utl/sykes_alj_dec_redacted.pdf.

²⁶ *Id.*

²⁷ *Id.*

²⁸ See Section 10.35(c)(2) of Circular 230 (as in effect December 20, 2004).

amendment “would have been unnecessary if this were already required by the due diligence standard in Circular 230.”²⁹

No state has expressly adopted Circular 230 in its entirety. A few states, however, have adopted some concepts of Circular 230 or applied Circular 230 to limited circumstances. The District of Columbia requires that any representative signing a power of attorney on behalf of a taxpayer attest that they are “aware of” Circular 230. South Carolina has adopted Circular 230 in part, but not section 10.35 (relating to covered opinions) or 10.37 (relating to other written advice). In South Carolina, representatives of taxpayers must comply with the duties and restrictions contained in sections 10.20 through 10.24 and 10.27 through 10.34 of Circular 230.³⁰ Hawaii has proposed a regulation requiring all opinions relating to the application of its film production income tax credit meet the requirements for a covered opinion under Circular 230.³¹

[3] Organizational

Informal expressions of ethical standards address appropriate behavior for tax practitioners. Ranging from corporate mission statements to standards of conduct promulgated by professional associations, these expressions do not have the status of law but are made to enhance public confidence in the uprightness of a particular membership, business, or agency. In addition to the ABA and AICPA (whose standards have been almost universally adopted by governing authorities), other professional tax groups and associations, such as Tax Executives Institute and the Institute for Professionals in Taxation, have codes or standards that members agree to abide by.³² Federal and state taxing agencies also frequently have mission statements and standards of conduct that employees are to uphold. Businesses generally have values statements, codes of conduct, or similar credos, and in the case of publicly traded companies, Sarbanes-Oxley mandates a code of ethics for senior financial officers.³³

[a] Organizational Policies & Culture

A high percentage of companies have had some version of a code of ethics for many years, and yet some of these companies also now find their names on the corporate scandal scorecard. More than having an expressed statement of ethics or code of conduct, active efforts to suffuse these policies through all levels of the corporation is required. If good ethics and professionalism are not a matter of routine practice by management, or are notably disregarded, the integrity of the organization will quickly

²⁹ OPR Complaint No. 2006-1 (January 29, 2009), available at http://www.irs.ustreas.gov/pub/irs-utl/sykes_alj_dec_redacted.pdf.

³⁰ S.C. Code § 12-60-90(E).

³¹ Haw. Proposed Reg. 18-235-17-18.

³² See http://www.tei.org/membership/Pages/Standardsof_Conduct.aspx; and <http://www.ipt.org/learncenter.asp?id=178410&sessionid=3-8FF18BC2-6558-4BE3-9B2D-157A7A9107C8&page=29>.

³³ For example, Johnson & Johnson—which received accolades for its ethical reaction to the “Tylenol scare” in the early 1980s—has adopted a comprehensive policy on business conduct. <http://www.investor.jnj.com/governance/conduct.cfm>.

erode both internally and externally and the consequences can be tremendous for the company. Witness the public “black-eye” that large corporations and financial institutions must now deal with as result of the notorious activities of a few.³⁴ As a result, greater responsibility for establishing and maintaining a company’s ethical mores will continue to shift to the board of directors.³⁵

[b] Long-Term & Short-Term Interests

Long-term and short-term interests focus consideration on things such as a company’s or practitioner’s relationship with tax officials, how a decision may affect professional credibility or reputation in the future, and other ramifications. This is the level at which risk management plays an important role, for it focuses on how important is a particular action compared with the potential negative effect, sooner or later, that it may have. These considerations are particularly important when weighing options that are otherwise ethically neutral.

[4] Personal

Ultimately, any ethical decision will take into account some measure of an individual’s personal mores. An individual’s own moral code will often be the first level at which a potential action is scrutinized. Morals, however, can evolve over generations. Consider, for example, the changes in technology that have revolutionized the way in which we communicate. Cell phones have evolved from briefcase-sized voice-only devices for only most well off to handheld multimedia communication tools available to almost anyone, and the Internet puts incredible amounts of information at the user’s fingertips. Researchers have begun to study whether these developments have changed established societal values. A recent survey indicates that 35 percent of teens use their cell phones to cheat in school.³⁶ Techniques for cheating included finding test answers on Internet enabled cell phones, copying written work from the Internet and turning it in as the student’s original work, and calling or texting friends to alert them of a “pop quiz” in an upcoming class. More concerning perhaps, 25 percent of those surveyed felt that texting answers for a test to a friend did not constitute cheating. Rather, many students stated their belief that they merely “share” information in an apparent egalitarian approach to schooling. In response, some schools have installed cell phone jammers and cheat resistant computers in test taking locations. These changes to personal views on the importance and ownership of

³⁴ Similarly, misconduct by a few government employees—recall congressional hearings in 1997 on “IRS abuses” (even though many of the complaints were subsequently discounted)—can adversely affect an entire agency.

³⁵ For example, Douglas H. Shulman, Commissioner of Internal Revenue, has urged corporate boards to become more involved in the oversight of the tax department. *See* Prepared Remarks of IRS Commissioner Douglas Shulman to New York State Bar Association Taxation Section Annual Meeting in New York City (January 26, 2010), available at <http://www.irs.gov/newsroom/article/0,,id=218705,00.html>.

³⁶ *See* Survey, *Hi-Tech Cheating: Cell Phones and Cheating in Schools, A National Poll*, Common Sense Media, Inc., available at www.common SenseMedia.org/hi-tech-cheating.

information may well alter the way in which ethical decisions are made by tax practitioners years from now.

[a] Individual Character

Tax administrators and practitioners both exercise significant discretion in their professional work, and given the complexity of tax and ethics laws, will rely heavily on their own sense of right and wrong in making decisions. Whether referred to as the “smell test” or “gut feeling,” for more mundane activity, internal moral barometers can make quick work of ethical choices. A word of caution is in order: Consideration at this level works best as a flag, an indication that further consideration is warranted. The myriad and complex system of rules now in place makes navigating the potential pitfalls using conscience alone a potentially career-limiting act.

[b] Disincentive of Public Disclosure

The disincentive of public disclosure is also known as the “What Would Your Mother Say?” test and, particularly at the organizational level, the “Wall Street Journal” test. At the personal level, it is simply a consideration whether an individual would want his or her name publicly associated with a certain activity. If character is who you are when no one is looking, this test serves as a practical check on behavior by assuming everyone is looking. In the corporate context, consideration of a potential action’s deleterious effect on a company’s reputation if publicly disclosed operates as a similar check.

§ 10.03 INCREASED TRANSPARENCY IN THE 21st CENTURY

Sunlight is the ultimate disinfectant.

—U.S. Supreme Court Justice Louis Brandeis

Increased transparency has characterized efforts by Congress and the IRS to more efficiently identify and audit tax shelters and other challengeable tax positions. IRS Commissioner Douglas Shulman recently stated, “Today, we spend up to 25 percent of our time in a large corporate audit searching for issues rather than having a straightforward discussion with the taxpayer about the issues.”³⁷ Additionally, financial regulators have awoken to the importance of tax to the accurate presentation of financial statements. In 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 (“FIN 48”), *Accounting for Uncertainty in Income Taxes*, a standard designed to increase “relevance and comparability in financial reporting of income taxes by clarifying the way companies account for uncertainty in income tax assets and liabilities.”³⁸ The transparency revolution has changed the landscape for tax practitioners who must now consider the presentation of tax issues to government

³⁷ Prepared Remarks of IRS Commissioner Douglas H. Shulman, *supra* note 37.

³⁸ Financial Accounting Standards Board, Financial Accounting Series, No. 281-B, *FASB Interpretation No. 48—Accounting for Uncertainty in Income Taxes* (2006). FIN 48 was issued by the Financial Accounting Standards Board in July 2006 and is effective for fiscal years beginning after December 15, 2006. Under the codification of accounting standards, the relevant portions of FIN 48 are now contained in Accounting Standards Codification subtopic 740-10, Income Taxes. FASB ASC 740-10.

regulators and investors in addition to the written advice traditionally provided to clients.

[1] Tax Shelters

The Internal Revenue Code defines a “tax shelter” as a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, “if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.”³⁹ Inasmuch as most tax professionals—whether employee or outside adviser—view a portion of their job as assisting their company or clients in minimizing their tax liability, this definition can prove ethically problematic. “A significant purpose of my job,” the tax professional might confess, “is lawfully and ethically to avoid tax.”⁴⁰

Thus, the area of tax shelters is an ethicist’s dream and a tax professional’s nightmare. The U.S. tax system has all the elements that make conflict inevitable—

- a very complicated, but essentially closed, rules-based system that sets forth (in some considerable detail but not always with unassailable clarity) the governing rules,⁴¹ augmented by
- several doctrinal overlays (such as the substance-over-form doctrine, the business purpose and economic substance tests, the step-transaction doctrine, and the sham transaction doctrine) created by the courts as “backstops” to the Code’s technical rules to prevent “unintended,” “too good to be true” results.⁴²

The question, for the ethicist as much as the tax professional, is not only where do you draw the line but why. (The line in this case is the ethics line, for by definition the taxpayer erred in respect of the tax position it took.) A definitive answer to these

³⁹ I.R.C. § 6662(d)(2)(C)(iii). Before the provision was amended in 1997, the operative phrase was “principal purpose” rather than “significant purpose.”

⁴⁰ In the seminal case of *Gregory v. Helvering*, 293 U.S. 465 (1935), the Supreme Court affirmed the right of taxpayers to consider the tax effects of transactions in which they enter and to consciously plan their affairs in a manner to minimize or even eliminate their taxes by the means that the law permits, but in that case the taxpayer lost.

⁴¹ “The Internal Revenue Code . . . provides specific rules regarding the computation of taxable income, including the amount, timing, source, and character of items of income, gain, loss and deduction. These rules are designed to provide for the computation of taxable income in a manner that provides for a degree of specificity to both taxpayers and the government. Taxpayers generally may plan their transactions in reliance on these rules to determine the federal income tax consequences arising from the transactions.” STAFF OF THE JOINT COMMITTEE ON TAXATION, TECHNICAL EXPLANATION OF H.R. 5095 (“THE AMERICAN COMPETITIVENESS ACT OF 2002”), JCX-78-02, at 2 (July 19, 2002).

⁴² “In addition to the statutory provisions, courts have developed several doctrines that can be applied to deny the tax benefits of tax motivated transactions, notwithstanding that the transaction may satisfy the literal requirements of a specific tax provision. . . . [I]nvoication of these doctrines can be seen as at odds with an objective, ‘rules-based’ system of taxation. Nonetheless, courts have applied the doctrines to deny tax benefits arising from certain transactions.” *Id.* (footnote omitted). Congress recently codified the economic substance doctrine in section 1409 of the Health Care and Education Reconciliation Act of 2010, H.R. 4872. The new statutory language will be added to the Code as section 7701(o).

questions is beyond the scope of this article, or perhaps any article, in significant part because constantly shifting legislative and regulatory sands have made the rules governing tax shelters a moving target. The purpose here is to highlight the inevitability of the ethical conundrum.

Stated simply, uncertainty is part of tax life, and in that lies the opportunity and the challenge. Because the tax law is unclear, certainty of result is impossible to attain. Instead of a Manichaeism⁴³ duality of black and white, good and evil, acceptable and unacceptable, there is an ocean of gray that tax professionals must navigate. In some countries, a taxpayer's filing of its return may be seen as a "first offer," a position taken only for negotiation purposes. That is not the system in the United States, but because "getting it right" is often impossible, "getting it wrong" does not by itself mean that the taxpayer (or the tax professional) has stepped over the ethical line.

One result of uncertainty is that taxpayers may appropriately give themselves the benefit of the doubt in planning their tax affairs. How certain must a taxpayer be before asserting a particular position? There is a sliding scale of certainty required to avoid penalties—from "not frivolous or patently improper" (which requires that the taxpayer's position be "more than merely colorable"), to "reasonable basis" (which is defined as "significantly higher than not frivolous or not patently improper"), to "realistic possibility of being sustained on the merits" (which Treasury regulations provide means a one-in-three, or greater, likelihood of being sustained on the merits),⁴⁴ to "more likely than not," to "should" to "will." In recent years, the trend has been to require a higher level of certainty.

One factor affecting the required level of certainty is the taxpayer's disclosure of the so-called tax shelter on its return. The thought here is that where a taxpayer is not operating by stealth it is more entitled to the benefit of the doubt than where, having played the "audit lottery," it loses.⁴⁵ This same principle would seem to permit, from an ethics perspective, more aggressive tax planning. The question remains, however, whether the taxpayer's willingness to accept the risk of penalties (for example, by forthrightly disclosing the position and inviting scrutiny) is a substitute for more demanding ethical standards.

In summary, although the current state of the tax law may make it impossible for the

⁴³ Manichaeism, a religion founded in the third century B.C.E., teaches dualism between good and evil: "To account for the existence of evil in a world created by God, Mani posited a primal struggle in which the forces of Satan separated from God; humanity, composed of matter, that which belongs to Satan, but infused with a modicum of godly light, was a product of this struggle, and was a paradigm of the eternal war between the forces of light and those of darkness." COLUMBIA ENCYCLOPEDIA (6th Ed. 2001), available at <http://www.bartleby.com/65/ma/Manichae.html>.

⁴⁴ Circular 230 (version in effect prior to September 26, 2007), as well as applicable ABA and AICPA standards, propound some variation of the "realistic possibility of success" standard, requiring that the practitioner have a good-faith belief that the position espoused has a one-in-three chance (or better) of prevailing before rendering an opinion (or signing a return).

⁴⁵ In determining whether a position has a realistic possibility of success, a taxpayer (or practitioner) may not take into account the possibility that a return will not be audited.

tax professional to always “get it right” (without doing violence to his or her obligation to be an effective advocate in the company’s or client’s behalf), a finding that a particular transaction or arrangement constitutes a tax shelter—or even that the taxpayer’s participating in it warrants a penalty—is not the end of ethical analysis. Professional standards, organizational policies, long-term and short-term interests, and personal mores are also implicated.

[2] FIN 48

Noting an absence of guidance addressing uncertainty in accounting for income taxes, and “noncomparability” in reporting related tax assets and liabilities, the Financial Accounting Standards Board promulgated Interpretation No. 48—Accounting for Uncertainty in Income Taxes (FIN 48).⁴⁶ For fiscal periods beginning after December 15, 2006, companies preparing financial statements under U.S. generally accepted accounting principles (GAAP) must apply the provisions of FIN 48 with respect to their uncertain tax positions (UTP). Under FIN 48, an enterprise may not recognize the financial statement effects of a tax position unless the business determines that the position would more likely than not be sustained upon examination. For those tax positions that meet the more likely than not threshold, enterprises recognize “the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority.”⁴⁷

Complying with FIN 48 requires companies to expend considerable resources to review and document their UTP’s, in large part because the approach departed substantially from the approach in Financial Accounting Standard No. 5 for assessing and accounting for tax contingencies. In addition, companies have had to establish policies and procedures to identify, assess, and evaluate each UTP on an ongoing, periodic basis to determine what changes, if any, are required. These changes may also affect the analysis of professionals confronted with certain ethical questions. For example, when an error is found on a previously filed return, a business subject to FIN 48 would need to establish a reserve for that position if it is not more likely than not to be sustained upon examination—regardless of whether the taxpayer files an amended return. A professional might be more likely to suggest that the business file an amended return in this instance given the incremental expense for the uncertain position since it must be recognized in the entity’s financial statements.

[3] From the Schedule M-1 to the M-3 to Announcement 2010-9

The financial maelstrom created by scandals including Enron and WorldCom increased the interest on the part of governmental agencies in greater tax disclosures and concomitantly reduced opposition (or the effectiveness of opposition to that additional disclosure on the part of the business community).⁴⁸ By June 2003, the IRS

⁴⁶ See note 38 *supra*.

⁴⁷ FASB ASC 740-10-30-7.

⁴⁸ Charles Boynton & Lillian Mills, *The Evolving Schedule M-3: A New Era of Corporate Show and Tell?*, 57 NAT’L TAX J. 757–772 (September 1, 2004), available at [http://ntj.tax.org/wwwtax\ntjrec.nsf/EE9132BE0BE0551F85256F3A006B2E66/\\$FILE/Article%2014-Mills.pdf](http://ntj.tax.org/wwwtax\ntjrec.nsf/EE9132BE0BE0551F85256F3A006B2E66/$FILE/Article%2014-Mills.pdf).

and Treasury had formed a working group to revamp Schedule M-1. Working expeditiously, the Treasury Department and the IRS issued Schedule M-3 in late 2004. To help provide auditors with information more useful in the identification of suspect tax positions, the new schedule forced corporate taxpayers to separately state all permanent book-tax differences. These items warranted additional scrutiny since the associated tax benefits would never be made up over time in the same way as those generated by temporary book-tax differences. Presumably, if the new schedule could help examiners “identify areas of compliance risk (and areas of lesser risk) more effectively, not only should compliant taxpayers be subject to less audit burden, but better issue identification should shorten examination times.”⁴⁹

To further increase the efficiency with which it audits large corporate returns, in January 2010 IRS Commissioner Douglas Shulman announced the agency’s plans to release a form requiring large corporate taxpayers to disclose all uncertain tax positions.⁵⁰ Announcement 2010-9 states:

The information developed in the course of complying with FIN 48 or other accounting standards is highly relevant to understanding the taxpayer’s tax positions and assessing how those positions affect the taxpayer’s tax liability. That information also would aid the Service in focusing its examination resources on returns that contain specific uncertain tax positions that are of particular interest or of sufficient magnitude to warrant Service inquiry, as well as allowing examination teams to identify all of the issues underlying the tax returns more quickly and efficiently.

Some commentators believe disclosure of uncertain tax positions alone is not enough and advocate complete transparency achieved by making public the tax filings of all taxpayers.⁵¹ That practice already exists in countries including Norway and Finland. To this end, in 2002, Senator Charles Grassley has even written to both the Securities and Exchange Commission (SEC) and Treasury Department inquiring into whether shareholders would benefit if tax return information of public companies was disclosed to the SEC or to the public.⁵² Although the SEC and Treasury ultimately responded by taking no action requiring public disclosure, the subject was recently raised in an essay published in the *New York Times* indicating a continuing belief by some that sunlight may indeed be the best disinfectant to a perceived infection in the tax system evidenced in part by the continuing revelations of corporate scandals.⁵³

⁴⁹ *Id.* at 767.

⁵⁰ Prepared Remarks of IRS Commissioner Douglas Shulman to New York State Bar Association Taxation Section Annual Meeting in New York City (January 26, 2010), available at <http://www.irs.gov/newsroom/article/0,,id=218705,00.html>.

⁵¹ David Lenter, Joel Slemrod, Joel & Douglas Shackelford, *Public Disclosure of Corporate Tax Return Information: Accounting, Economics, and Legal Perspectives*, 56 NAT’L TAX J. 803–830 (December 1, 2003), available at [http://ntj.tax.org/wwwtax/ntjrec.nsf/EAED82147310D5B485256DE10066959A/\\$FILE/A07.pdf](http://ntj.tax.org/wwwtax/ntjrec.nsf/EAED82147310D5B485256DE10066959A/$FILE/A07.pdf).

⁵² *Id.* at 803.

⁵³ Anna Bernasek, *Should Tax Bills Be Public Information*, N.Y. TIMES, February 14, 2010, at BU 11.

§ 10.04 THIRD-PARTY ENFORCEMENT THROUGH WHISTLEBLOWER STATUTES, CONSUMER PROTECTION LAWS, AND *QUI TAM* STATUTES CREATE ANOTHER LAYER OF ENFORCEMENT

Cindy, you know by tattling on your friends, you're really just tattling on yourself. By tattling on your friends, you're just telling them that you're a tattletale. Now is that the tale you want to tell?

—Mike Brady, to daughter Cindy, in *The Brady Bunch Movie* (1995)

[1] Whistle Blowing Under Section 7623 of the Internal Revenue Code

Under the federal False Claims Act, anyone who knowingly presents false information to the government to obtain money or property is subject to a penalty of between \$5,000 and \$10,000 plus three times the amount of the damages sustained by the government.⁵⁴ The Act allows private persons to prosecute violations of the Act on behalf of the government (*i.e.*, *qui tam* actions). If the government proceeds with the prosecution of the suit initiated by a private person and prevails in the case, the private person who initiated the prosecution receives between 10 percent and 25 percent of the proceeds of the action. If the government does not intervene and the private person prosecutes the case on his or her own, a successful plaintiff will receive between 25 percent and 30 percent of the proceeds of the action.⁵⁵

The federal False Claims Act explicitly “does *not* apply to claims, records, or statements made under the Internal Revenue Code of 1986.”⁵⁶ Private parties must instead pursue tax claims under the whistleblower provisions of the Internal Revenue Code currently found in section 7623 of the Code. Under the IRS’s “whistleblower award program,” informants may receive an award for providing the IRS with information relating to a violation of the internal revenue laws.⁵⁷

Prior to 2006, the whistleblower provisions had existed nearly unchanged since 1867. During that time, amounts awarded under the program were entirely discretionary. With the passage of the Tax Relief and Health Care Act of 2006, Congress instituted ranges for awards given to whistleblowers who provide information to the IRS used to successfully prosecute a tax case where the tax, penalties, interest, additions to tax, and any additional amounts exceed \$2,000,000. Whistleblowers in those cases now receive an award of between 15 percent and 30 percent of the proceeds collected by the IRS. The award is reduced to a maximum of 10 percent when the information provided by the whistleblower is publicly available.⁵⁸ The IRS also retains the discretionary authority to grant (or to deny) awards to whistleblowers

available at <http://www.nytimes.com/2010/02/14/business/yourtaxes/14disclose.html?scp=1&sq=should%20tax%20bills%20be%20public%20information&st=cse>.

⁵⁴ 31 U.S.C. § 3729.

⁵⁵ 31 U.S.C. § 3730(d).

⁵⁶ 31 U.S.C. § 3729(e) (emphasis added).

⁵⁷ Treas. Reg. § 1.7623-1.

⁵⁸ 26 U.S.C. § 7623.

providing information used in cases that do not reach the \$2,000,000 threshold. The amendments passed in 2006 also mandated the creation of a Whistleblower Office within the IRS. The IRS has since established a Whistleblower Office and has issued guidance providing instructions on how to file claims under the new rules.⁵⁹

Blowing the whistle can be a very lucrative proposition. In the well-publicized *UBS* case, Bradley C. Birkenfeld exposed efforts undertaken by the Swiss bank UBS to assist numerous wealthy Americans evade U.S. taxes. Now Mr. Birkenfeld is arguing that he should be entitled to a reward for his assistance. That award could rise to multiple billions of dollars.⁶⁰ In Mr. Birkenfeld's case, he will need to wait until at least 2013 to claim any reward—that is when he will be released from prison for his participation in these schemes.

[2] State *Qui Tam* Statutes

Currently, no states have adopted a whistleblower statute directly applicable to state taxes. Some states, however, do allow private parties to prosecute tax cases under state versions of the federal False Claims Act. In one Illinois case, the Illinois Court of Appeals reviewed a suit brought by a law firm on behalf of the state under Illinois' false claims statute.⁶¹ The law firm alleged that numerous Internet retailers selling products to Illinois customers had falsely stated that they did not have nexus in Illinois for use tax purposes through documents including receipts and invoices stating that no Illinois use tax was due on purchases made by Illinois residents. Unlike the federal False Claims Act, the Illinois statute does not expressly prohibit private parties from prosecuting tax cases (other than those related to the state's income tax). The court of appeals held that the Illinois False Claims Act applies to the Illinois Use Tax Act when fraudulent records and statements exist, and actions under the Illinois Use Tax Act can be prosecuted by private persons under the Illinois False Claims Act.

The same plaintiff law firm brought a similar action in Nevada to collect the state's sales tax on sales by out-of-state Internet retailers to Nevada customers under the state's version of the False Claims Act.⁶² Initially, the Nevada Attorney General declined to intervene in the case, but later reconsidered. Upon the Attorney General's intervention, he decided to dismiss the action. The Nevada Supreme Court held that, unlike the federal statute, the Nevada False Claims Act allows for the prosecution of tax cases by private parties. The court also held that the Attorney General could intervene in an action brought under the Nevada False Claims Act at any time and could subsequently move to have the action dismissed (as long as the decision to dismiss the case was rationally related to achieving a legitimate government purpose).

⁵⁹ 2008-2 I.R.B. 253, Notice 2008-4, available at www.irs.gov/irb/2008-02_IRB/ar13.html.

⁶⁰ Lynnley Browning, *Ex-UBS Banker Seeks Billions for Blowing Whistle*, N.Y. TIMES, November 27, 2009, at B1.

⁶¹ *State ex rel. Beeler, Schad and Diamond, P.C. v. Ritz Camera Centers, Inc.*, 878 N.E.2d 1152 (Ill. App. 1st Dist., 2007).

⁶² *International Game Technology, Inc. v. Second Judicial District Court of Nevada*, 127 P.3d 1088 (Nev. 2006).

In this case, the court affirmed the Attorney General's decision to dismiss the action on the basis that the Department of Taxation was better equipped to handle the uncertain and technical nature of the dispute (*i.e.*, constitutional and factual issues relevant to nexus determinations) in a way that could be applied broadly to other similarly situated taxpayers.

[3] State Consumer Protection Statutes

Some private citizens have begun using another tool to recoup taxes they allege to have been improperly collected by businesses. In one recent case, a Wal-Mart customer sued the giant retailer under Illinois's Consumer Fraud and Deceptive Practices Act requesting the refund of sales tax she claimed Wal-Mart incorrectly collected.⁶³ The customer in this case had purchased a trampoline on Wal-Mart's website, and Wal-Mart charged the customer sales tax on both the cost of the trampoline and the associated shipping charges. The suit was intended to be a class action lawsuit that could have exposed Wal-Mart to significant claims for repayment of sales tax collected on shipping charges. The court, however, found for Wal-Mart holding that the sales price for the trampoline included the shipping charges, and sales tax on the purchase was properly collected on the entire order pursuant to Illinois law.

§ 10.05 ETHICAL ANALYTICAL FRAMEWORK

You will be confronted with questions every day that test your morals. Think carefully, and for your sake, do the right thing, not the easy thing.

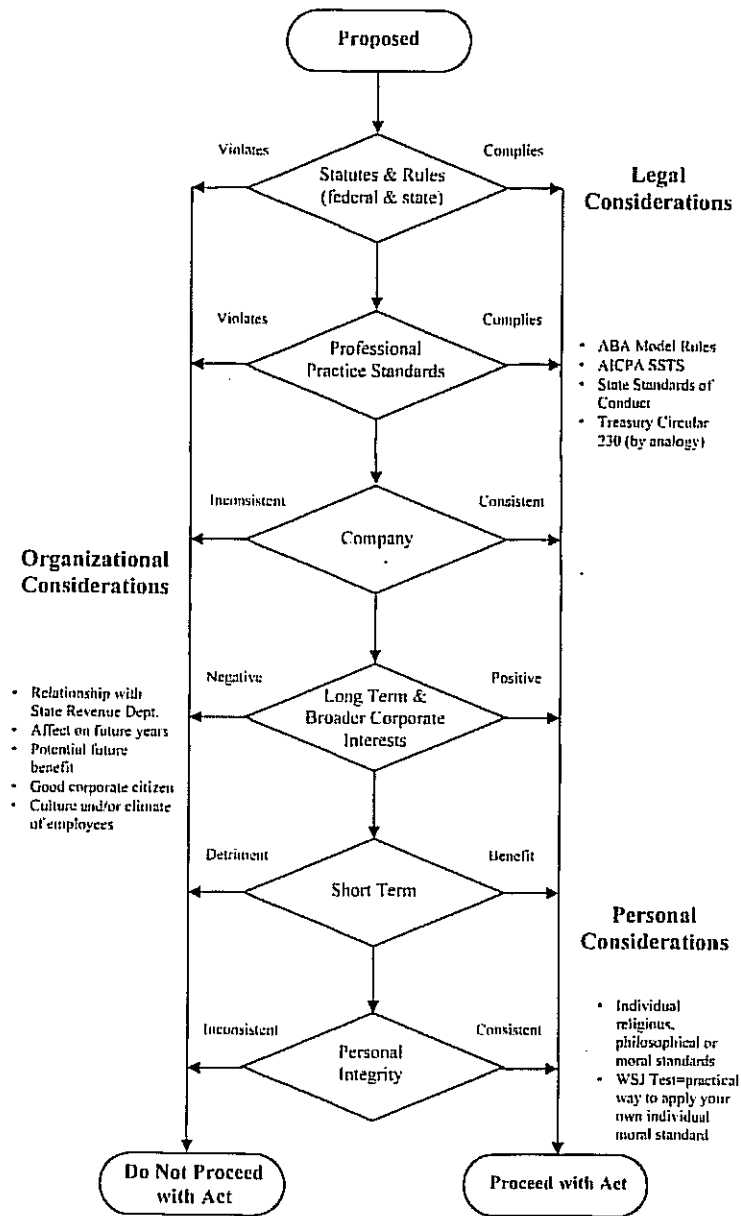
—Dennis Kozlowski, former CEO of Tyco International

[1] Ethical Decision Making

Tax administrators and practitioners face a multitude of ethical dilemmas as they plan transactions, prepare returns, conduct examinations, prosecute or defend enforcement actions, and interpret each jurisdiction's tax code. The choices made by people charged with representing taxing jurisdictions and taxpayers in the face of vague tax laws will be dictated by a range of legal and ethical issues. As with most ethical issues, except at the extremes, there are few hard-and-fast answers. Figure 1, *An Ethical Analytical Framework*, represents a process for thinking through possible actions when faced with such dilemmas. Although each stage in the framework is discussed seriatim, in practice no particular order is required.

⁶³ *Kean v. Wal-Mart Stores, Inc.*, 919 N.E.2d 296 (Ill. 2009).

FIGURE J – AN ETHICAL ANALYTICAL FRAMEWORK*



*Adapted with appreciation from materials prepared by Donald M. Griswold, *Reed Smith* Washington, D.C.

Ascertaining the particular statutory and regulatory provisions that pertain to a possible course of action is the beginning of the process, not the end. "Is it legal?" is

not the ultimate question, merely the first one. Defining the legal boundaries surrounding a particular action is very important, but does not discriminate among choices still within the bounds of the law. This is the first of two stages, or decision points, addressing legal considerations.

In addition to exploring statutes and regulations prohibiting, permitting, or otherwise relating to a course of action, tax practitioners must consider the effect of professional practice standards. Accountants and attorneys must be mindful of permitted and prohibited activities by virtue of their profession. “May I advise my client or company to undertake this action?” “Do I have a duty to disclose (or am I prohibited from disclosing) this information?” These questions all implicate the professional standards under which a practitioner is licensed to perform accounting or legal work.

Being able to properly assess what professional practice standards require of a practitioner requires knowing who the client is. This is not always static and may not always be clear to professionals employed within government agencies and companies. For government attorneys, the agency, the head of an agency, the natural constituents of the agency (*i.e.*, taxpayers for the tax agency), or the public at large may fill the role of client. For those employed by a corporation, the corporation, officers, board of directors, department head, or shareholders (or investing public) may fill this role. Before practitioners can confidently move past the professional practice consideration in making an ethical decision, both the client and the obligations with respect to that client must be understood.

The following three stages, or decision points, address organizational considerations. An organization’s mission, both verbally expressed and exhibited through past action, must be considered. Does the proposed action further the organization’s mission? For tax agencies, the mission is often expressed as one to collect the correct amount of taxes due. Understanding whether and how a particular course of action furthers or hampers the mission is a valuable exercise. It is indispensable in explaining the decision or action to others within your organization.

More than 80 percent of corporations have codes or standards of conduct. Many state tax agencies also have such codes in place for their employees. Codes of conduct and organizational policies can be helpful to ascertaining the particular culture within which organizational decisions must be made. The statement “We just don’t do that here” is an indicator of unwritten mores at work in organizational decision-making.

An assessment of long-term organizational interests, considering both risks to a company or agency, whether from a sullied reputation or erosion of talent, is critical. Even if an action is perfectly legal, or just not illegal, how does that action affect future activities? A “take no prisoners” approach to controversy may well impede more cost-efficient resolution of issues with tax authorities in the future. Similarly, efforts to secure tax incentives through the political process cannot be considered in a vacuum. Assessing how the organization will be perceived by community leaders and local tax authorities is a paramount consideration. This applies equally to government agencies—a hunkered down, distrustful mentality in respect of taxpayers and practitioners will have a debilitating effect long-term.

Short-term interests are those with relatively immediate effect: money saved on a return, compelled taxpayer behavior, and the like. Traditional cost-benefit analysis can often be used to identify the short-term interests at stake in tax practice. The likelihood of being audited, potential penalties, and exposure to other liabilities are short-term interests.

Lastly, personal integrity—the extent to which a proposed action or decision is either consistent or inconsistent with the internal beliefs and values of the tax practitioner—must be addressed. “Is this a decision I’m comfortable with?” is an important question to ask. Proper reflection at this level not only helps settle an issue within, but it can also suggest that further information is required, or that additional reflection at one of the other stages is needed, if a resolution cannot be found at this stage. It can also confirm the need to involve others in the process, including experienced counsel.

[2] Maintaining and Promoting Ethical Standards

There are at least two things that can help maintain and promote ethical standards within organizations and professions. The first is having a meaningful code of conduct. The second is regular interaction with other professionals with high standards. This is generally easiest to do by participating in an association that, among other things, takes professionalism seriously.

[a] Meaningful Codes of Conduct

Some expression of ethical values is important for any organization. It serves as a reminder for those within, and provides assurance to those without, that an organization has given thought to what principles will guide its activities. Codes of Conduct, standards of conduct, values statements, and the like are examples of such expressions. They are important and contribute to high organizational standards. They are meaningless, however, if they do not truly reflect the organization’s ethics.

Establishing, or reestablishing, a code of conduct is a process that should engage all levels of the organization. What are the organization’s values? Which values further the organization’s mission? How does the organization want to be perceived? These questions have answers, even if not formally reflected in a written document. Assessing what the answers currently are and then addressing what they should be, if different, is a process that works best with maximum participation. Once one is in place, strong leadership, periodic reflection, and continuing and prominent use will help instill the code within the organizations culture and demonstrate that it is not just a piece of paper.

[b] Professional Associations

Associations that promote professionalism will have codes or standards of conduct that express the values and ethics that members agree to abide by in conducting themselves in the practice of their profession. As an example, Tax Executives Institute’s *Standards of Conduct* is displayed in Figure 2. A code of conduct not only fosters professionalism among the individual members, and consequently the companies for whom they work, but also allows the association to promote the profession-

alism of its members and their companies collectively to government officials and the public.

Figure 2—TEI Standards of Conduct

Tax Executive Institute, Inc. recognizes the following as the standards of conduct for each member in administering tax affairs for which he or she is responsible:

- The member accepts taxes as a cost of civilization and accepts the laws imposing taxes as the mechanism for distributing that cost among businesses, individuals, and other entities. The member will comply with those laws, whether or not agreeing with them.
- The member recognizes an obligation to minimize company tax liability, within the bounds of the law and to the extent consistent with policies or objectives of the company, having due regard for the interests of society in sound tax policy, and will advise and support action to obtain that objective, to the best of the member's ability.
- The member recognizes an obligation to make an affirmative contribution to the sound administration of tax laws, and to the adoption of sound tax legislation, by cooperation and consultation with the persons charged with those functions, having due regard for the interests of society, as well as the interest of the company and its employees.
- The member accepts each government representative as a person devoted to fulfilling the obligation to collect revenue honorably in accordance with law. The member will deal with the representatives on that basis, and will take occasion with others to uphold this view of government representatives. In case of any deviation of a representative from that standard, the member will present the pertinent facts to the authorities authorized to take action with respect to the deviation.
- The member will present the facts required in tax returns and all the facts pertinent to the resolution of questions at issue with representatives of the government imposing the tax.
- The member will employ assistants and outside representatives upon the basis of their technical competence, always having due regard for the highest standards of professional ethics.
- The member will at all times recognize a duty of professionalism and will not use TEI membership to solicit business or sell products to other members.

§ 10.06 CONCLUSION

I think the best is yet to come, but it will come to those who treat the future

differently, who exercise discipline, who are ethical and who set high standards.

—William T. Esrey, former Chairman and CEO of Sprint

Ethics have always been of paramount importance to tax professionals. What the financial and accounting news, legislation, and enhanced enforcement efforts demonstrate is that the general level of scrutiny has increased and interest is keen in the ethical behavior of tax professionals as well as other accounting and legal professionals working in financially oriented practice areas. Understanding the current environment and the current rules is essential for the tax professional to remain on the right side of the ethical divide.

Navigating the tangle of rules, standards, and other factors implicated in tough ethical choices on instinct alone is foolhardy. Jiminy Cricket's advice to "always let your conscience be your guide" is useful as a warning system only, spurring thoughtful consideration of multiple factors and consequences through the ethical analytical framework.⁶⁴ Rather than living with a growing sense that tax professionals must now wander anxiously through a thicket of ethical rules, trying their best to avoid well-camouflaged snares, the framework serves as a navigation tool that allows tax professionals to move forward knowingly and confidently.

⁶⁴ Jiminy Cricket was appointed by the Blue Fairy to be the conscience of the puppet-brought-to-life, Pinocchio, in the Walt Disney's classic animated film, *Pinocchio*; professionals who rely solely on their own "Jiminy Cricket" when facing ethical dilemmas frequently end up also relying that "like a bolt out of the blue, fate steps in and pulls [them] through."