

Ethics for EA's (Enlightened Accountants)

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What is “Ethics”?

- Dullest class of the entire seminar?
- The “snoozer/loser” session?
- Best time to check messages and return telephone calls?
- NO!
- From the Greek word “ETHOS” meaning CHARACTER
- Study of moral behavior

What is “Ethics”?

- Codify the “Golden Rule”
- Input your specific “Facts and Circumstances”
- Output goes into the proper pigeon hole
- But what happens if you don’t have enough pigeon holes?
- You suffer the “The Chauffeur and the Professor Syndrome” (with apologies to Jerry Clower for the paraphrased version)

What is “Ethics”?

- What is the solution?
- More pigeon holes?
- No! Who needs to memorize hundreds upon thousands of more pigeon holes?
- Need a “flexible framework” to use for analysis of situation

Flexible Framework

3 Questions

1. Is there a DUTY?
2. Is there a BREACH of the DUTY?
3. How much does it COST to fix it?

(As explained by a retired Federal Judge)

1. Is there a DUTY?

- Sources
 - Government agencies – federal, state & local
IRS, SEC, DOL, FinCEN, U.S. Tax Court, OTC, OESC)
 - Statutes, if constitutional – federal, state & local
 - Administrative Regulations, if constitutional and within scope of authority – federal, state & local
 - Professional Associations – national & state
 - Common Law (often overlooked)

1. Is there a DUTY?

- Sources
 - Often interwoven and overlapping
 - If in doubt, use the strictest interpretation
 - Pay attention to the “burden of proof” standards
 - Civil – preponderance of the evidence
 - Criminal – beyond a reasonable doubt
 - Split decision in O. J. Simpson’s criminal and civil trials
 - Example of different standards are like expectations for Football Coaches
 - OU – win the Big 12 championship, be a contender for the national title, and win their bowl games
 - OSU – Beat OU! (and keep T. Boone Pickens happy)
 - TU – graduate STUDENT athletes

1. Is there a DUTY?

- Recipients – to whom is the DUTY owed?
 - Client
 - Client’s employees
 - Independent Contractors
 - Employer i.e. Internal Auditors
 - Extraordinary Circumstances by Cynthia Cooper describes the WorldCom debacle – an accounting whodunit
 - The AJE’s had over 3 million lines of corrections
 - Yeah, Bernie knew what was going on
 - Shareholders
 - Government Agencies
 - Banks and other lenders
 - Other 3rd Parties that rely upon your work

1. Is there a DUTY?

- Recipients
 - Chauffeur negligently collides with another car filled with dynamite, causing an explosion
 - A is on a nearby sidewalk and is killed
 - B is sitting in a window across the street and is injured
 - C is sitting in a window 1 block away and is injured
 - D is sitting in a window 10 blocks away and is injured
 - D drops a baby
 - To whom is a DUTY owed? A? B? C? D? Baby?

1. Is there a DUTY?

- Recipients
 - Palsgraf v. Long Island Railroad Co., 248 N.Y. 339, 162 N.E. 99 (N.Y. 1928)
 - 2 Italian passengers trying to board the train as it pulls out of the station.
 - The 1st Italian makes it okay, The 2nd Italian starts to fall
 - The 1st Railroad Guard pulls the tipsy Italian while the 2nd Railroad Guard pushes – The 2nd Italian is successfully and safely boarded
 - BUT, the commotion causes a package to drop onto the tracks
 - The package contains fireworks which EXPLODE ... KA-BOOOM!
 - The shock from the explosion knocks over set of scales 10-25 feet away which fall onto Helen Palsgraf while holding her ticket; her 2 daughters are okay
 - Helen Palsgraf injuries are not physical; she has a “nervous disorder”
 - Helen Palsgraf sues the Long Island Railroad Co. for NEGLIGENCE

1. Is there a DUTY?

- Recipients
 - Palsgraf v. Long Island Railroad Co., 248 N.Y. 339, 162 N.E. 99 (N.Y. 1928)
 - Smells like NEGLIGENCE
 - Jury and Trial Judge say YES (1 yea)
 - Appellate Court says YES (3 yea's, 2 nay's)
 - Supreme Court says NO (2 yea's, 4 nay's)
 - 7 of 13 judges favor Palsgraf – the majority, but she still loses her case
 - The Supreme Court is not final because they are right, they are right because they are final

1. Is there a DUTY?

- Recipients
 - Chief Justice Benjamin Cardozo authored the majority opinion (Future U.S. Sup. Ct. Justice)
 - Long Island RR Co. owes a DUTY to the 2nd Italian
 - Long Island RR Co. DOES NOT owe any DUTY to anybody else including Helen Palsgraf
 - Injury not “Reasonably Foreseeable”
 - Never should have gone to the jury
 - Adding insult to injury, cold-hearted Cardozo imposes the costs upon Helen Palsgraf!

1. Is there a DUTY?

- Recipients - BONUS ROUND #1
 - Kinsman Transit Co., 338 F.2d 708 (2nd Cir. 1964) aka Kinsman I
 - Kinsman Transit Co. v. City of Buffalo, 388 F.2d 821 (2nd Cir. 1968) aka Kinsman II
 - The first boat operated by the Kinsman Transit Co. was improperly moored
 - During a storm, it broke free and crashed into a 2nd ship, which also broke free
 - Both boats crashed into a bridge which collapsed, and blocked the river
 - The river flooded the adjacent land and prevented any traffic from traversing the river until wreckage cleared

1. Is there a DUTY?

- Recipients - BONUS ROUND #1
 - Is there a DUTY owed by Kinsman Transit Co. ...
 - To the property owners adjacent to the river?
 - To the boat and cargo owners unable to move until the river was cleared?

1. Is there a DUTY?

- Recipients - BONUS ROUND #1 – ANSWERS
 - Is there a DUTY owed by Kinsman Transit Co. ...
 - To the property owners adjacent to the river?
 - To the boat and cargo owners unable to move until the river was cleared?
 - The COURT said ...
 - YES to the property owners adjacent to the river
 - NO to the boat and cargo owners unable to move until the river was cleared

1. Is there a DUTY?

- Recipients – BONUS ROUND #2
 - Grandfather pays \$5,000 for a used car; intends the car to be a gift for Grandson
 - Father drives car from Oklahoma to Texas
 - Car breaks down in Texas causing an injury to the Father and car is towed the rest of the way
 - Grandson never gets to drive the car
- Is there a DUTY owed by the Used Car Dealer ...
 - To the Grandson?
 - To the Father?
 - To the Grandfather?

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.20 Information to be furnished
 - Upon a proper and lawful request (not privileged), promptly submit records or information
 - Chapter 3 of *Freakonomics*. Drug dealers kept better books and records than the frat boys.
 - Does not include a “Dear NSA” letter (Dear NSA, I accidentally deleted an important email. Could you please send me your copy?)

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.21 Knowledge of client's omission
 - When practitioner knows that a client has not complied with the revenue laws or has made an error or omission, practitioner must advise client of consequences
 - 2 primary rules of bureaucracy
 - #1 – Let someone else pay for it
 - #2 – Let someone else do the work
 - Does it sound like the practitioners are now doing some of the IRS's work? If so, is that a bad thing?

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.22 Diligence as to accuracy
 - Standard is “Due Diligence”
 - Reliance on others. Presumption of “due diligence” if use reasonable care
 - Look to common law for interpretation of “due diligence”

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.23 Prompt disposition of pending matters.
 - May not unreasonably delay the prompt disposition of any matter before the IRS
 - One practitioner cancelled 5 meetings/hearings by calling the night before and leaving a very brief message that he was not available - He did not make the IRS “Nice” list

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.24 Assistance from or to disbarred or suspended persons and former IRS employees
 - Do not assist or accept assistance from TOXIC persons (i.e. disbarred, suspended or certain former IRS employees)
 - DANGER: Not only will it kill you, but it will really hurt the whole time you are dying

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.25 Practice by former government employees, their partners and their associates
 - If you worked on a matter while with the IRS, you can't quit and switch sides

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.26 Notaries
 - You can't be your own notary
 - Isn't this rather obvious?

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.27 Fees
 - Practitioner can't charge an unconscionable fee
 - My conscience or the IRS conscience?
 - Anthony Tiongson disbarred for @ least 5 years for accepting unconscionable fees for frivolous positions on client's tax returns
 - Be careful with contingent fees – more scrutiny

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.28 Return of client's records
 - Promptly return any and all client's records necessary to comply with Federal tax obligations
 - This includes information provided by client or 3rd parties
 - Practitioner allowed to keep a copy
 - Practitioner allowed to keep “work papers” until paid
 - Be careful! Even if right, could be difficult to clean-up.

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.29 Conflicting interests
 - Representation of one client is directly adverse to another client – OR –
 - Representation will be materially limited by responsibility to another client, former client or 3rd person or personal interest of the practitioner
 - Clients can waive conflict
 - If representation is not illegal
 - Keep copy of written consent for at least 36 months

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.29 Conflicting interests (continued)
 - Watch-out for “accidental” conflicts
 - Husband & wife (innocent spouse relief?)
 - Divorcing spouses – request copy of divorce decree, court order of letter from divorce lawyer as to treatment of tax matters
 - Parents & children (elderly parents; college students with friends that are accounting majors)
 - Business owners, companies, shareholders, partners, owners, officers, etc

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.30 Solicitation
 - Advertising and solicitation restrictions
 - Be careful with adjectives i.e. expert, specialist
 - Fee information – 30-day freeze on fees
 - Honor “opt-outs” by prospective clients
 - Keep copies for at least 36 months
 - Marketing Proverb – Only 50% of my advertising works; I just wish I knew which 50% worked!

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.31 Negotiation of taxpayer checks
 - A practitioner who prepares tax returns may not endorse or otherwise negotiate any check issued to a client by the government in respect of a Federal tax liability.
 - You can be a tax return preparer or a bank, but not both!

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.32 Practice of law
 - Nothing in the regulations in this part may be construed as authorizing persons not members of the bar to practice law.
 - CAREFUL! Could be held to the same “DUTY OF CARE” as a lawyer

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.33 Best practices for tax advisors
 - Communicate clearly with the client regarding terms of the engagement
 - Establish the facts, relevancy, reasonableness of assumptions, applicability of law and subsequent conclusions
 - Advise the client as to your conclusions
 - Act fairly and with integrity before the IRS
 - Tax advisors overseeing a firm should take steps to ensure everyone meets these requirements

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.34 Standards with respect to tax returns and documents, affidavits and other papers
 - May not willfully, recklessly, or through gross incompetence ...
 - Sign a tax return or claim for refund, or
 - Advise a client
 - These activities cannot have an unreasonable basis be a willful attempt to understate the tax liability

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.35 Requirements for covered opinions (2005)
 - Written advice concerning transactions that the IRS has determined to be a tax avoidance transaction and identified by published guidance must comply with standards of practice
 - Get ready for the storm
 - Look for the safe harbors

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.35 Requirements for covered opinions (2005)
 - PROPOSED REVISION to this section intends to clarify that a practitioner must possess competence defined as knowledge, skill, thoroughness and preparation necessary for the engagement

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.36 Procedures to ensure compliance (2011)
 - Establish procedures to ensure compliance with previous section (§10.35), OR
 - If you know, or should have known that other firm members were not complying with the previous section
 - You are subject to discipline too!

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.37 Requirements for other written advice
 - Your written advice should not be based on unreasonable facts, legal assumptions, representations, etc.
 - If written advice to be relied upon by 3rd party, then a higher DUTY will be imposed

1. Is there a DUTY?

- Circular 230, Subpart B – DUTIES owed the IRS
- §10.38 Establishment of advisory committees
 - IRS authorized to establish advisory committees to obtain feedback
 - Advisory committees are supposed to be balanced among types of practitioners

1. Is there a DUTY?

- Circular 230, Subpart C – DUTIES owed the IRS
- §10.51 Incompetence and disreputable conduct
 - Paragraphs (a)(1) through (a)(18) impose additional DUTIES
 - Some DUTIES are borrowed from other Recipients
 - Conviction of any criminal offense involving dishonesty or breach of trust
 - Could be a STATE conviction

2. Is there a BREACH of the DUTY?

- Analyze the specific “facts and circumstances” of your situation.
- Review your documentation
- *The Cuckoo’s Egg* by Cliff Stoll. An astronomer turned system manager at Lawrence Berkeley Lab started looking for a 75-cent accounting error and found a spy in Hanover, Germany. He kept a daily diary of his work.
- Review your written documentation
 - If it is not written down, it didn’t happen
 - If it is not written down, it didn’t happen
 - If it is not written down, it didn’t happen

2. Is there a BREACH of the DUTY?

2011 Discipline Results	Attorney	CPA	EA	Totals
Total Receipts				726
Disbarments	2	4	1	7
Final Agency Decisions	5	7	1	13
Consent Suspensions	6	4	2	12
Expedited Suspensions	106	39	4	149
Reprimands				280
Censure				2
Deferred Discipline Agreements				3
CWOS, LOJ				245
Reinstatement				11
Total Dispositions (IRS reported 744 and 883)				722

2. Is there a BREACH of the DUTY?

2012 Discipline Results	Attorney	CPA	EA	Unenrolled	Totals
Total Receipts					516
Disbarments (FAD/Consent)		1		1	2
Suspensions (FAD/Consent)	2	2	3		7
Expedited Suspensions	29	25	7		61
DDA/Other Conditions		1	2		3
Censure	1	2	1		4
Reprimands/Soft Letter					150
Cease & Desists					50
CWOS, LOJ, NCOA, CWOA					409
Reinstatement					25
Total Dispositions (IRS Reported 813)					711

2. Is there a BREACH of the DUTY?

2013 Discipline Results	Attorney	CPA	EA	Other	Totals
Total Receipts					784
Disbarments (FAD/Consent)	1	4	4	2	11
Suspensions (FAD/Consent)	1	1	1	---	3
Expedited Suspensions	16	24	4	4	48
DDA	2	4	6	1	13
Censure	---	2	---	1	3
Reprimands/Soft Letter					128
Cease & Desists					25
CWOS, CWOA, Referred, Other					509
Reinstatement Request					26
Total Dispositions					766

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3. How much does it COST to fix it?

- Circular 230, Subpart C – SANCTIONS imposed by the IRS
- §10.50 Sanctions
 - Monetary – not to exceed amount of gross income derived (NOTE: other government agencies frequently impose a fine of 3x the amount of money/profits received); AND/OR
 - Public humiliation (placed in modern version of medieval stocks) – the Commissioner may ...
 - Censure
 - Suspend
 - Disbar

3. How much does it COST to fix it?

- Domino effect
 - For example, IRS sanctions can “trigger” automatic sanctions of professional associations, or state governmental agencies
- Double check monetary penalties
 - Some penalties allow stacking
 - Some penalties allow offsets

Recommended Reading

- *Extraordinary Circumstances: The Journey of a Corporate Whistleblower* by Cynthia Cooper
- *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything* by Steven D. Levitt and Stephen J. Dubner
- *The Cuckoo's Egg: Tracking a Spy Through the Maze of Computer Espionage* by Cliff Stoll
- *Never Enough: One Lawyer's True Story of How He Gambled His Career Away* by Michael J. Burke
- *The Loyal Lieutenant: Leading Out Lance and Pushing Through the Pain on the Rocky Road To Paris* by George ("Big George") Hincapie