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Dealing with Ethical Problems in Tax Practice

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I. INTRODUCTION

A. A basic knowledge of professional ethics is
   1. an important tool for all practitioners
   2. an indispensable tool for tax practitioners

B. The subject of professional ethics centers on three duties of the practitioner
   1. duty to client
   2. duty to system
   3. duty to third parties

C. These duties frequently come into tension with one another
   1. The preamble to the American Bar Association Model Rules of Professional Conduct describes this problem as follows: "Virtually all difficult ethical problems arise from conflict between a lawyer's responsibilities to clients, to the legal system, and to the lawyer's own interest in remaining an upright person while earning a satisfactory living."
   2. These kinds of tensions among the three duties seem to arise more frequently in tax practice than in other practice areas

D. Our purpose in this discussion is limited
   1. We will not attempt to define what is ethically "right" or ethically "wrong" conduct
   2. Instead, we will identify and discuss some basic ethical concepts that are largely shared by the legal and accounting professions, and we will
illustrate their application in particular hypothetical situations

3. Our objective is to provide some insight into the principles that should guide a practitioner in resolving difficult professional choices

E. At the outset, we need to distinguish between the practitioner roles of advisor and advocate

1. A practitioner acts as advisor where the client is contemplating a future action (such as the filing of a tax return) and seeks advice as to the various options (tax return positions) that are available to him.

2. The practitioner acts as advocate where the client has already acted (such as by filing a tax return) and seeks assistance in defending that action (against an IRS challenge).

3. As advisor, the practitioner "provides the client with an informed understanding of the client's legal rights and obligations and explains their practical implications" ABA Model Rules, Preamble.

4. As advocate, the practitioner takes the facts as they are and zealously asserts the client's position within the bounds of the law and within the rules applicable to the particular adversarial setting See, e.g., ABA Model Rules, Preamble.

5. In attempting to resolve ethical issues, the practitioner does well to consider whether he or she is acting as advisor or advocate, for the ethical rules differ as between the two roles

F. We will proceed by

1. Summarizing briefly the nature of the tax practitioner's duties to client, system, and third parties

2. Discussing the ethical considerations that the tax practitioner must consider by reason of the client-taxpayer's legal responsibilities under the tax laws

3. Discussing ethical rules that are imposed directly on the tax practitioner by various authorities
4. Presenting for discussion some hypothetical situations that illustrate the application of the ethical rules in the context of tax practice

G. The discussion will focus primarily on issues arising in relation to the Federal income tax

II. A BRIEF SUMMARY OF THE TAX PRACTITIONER'S DUTIES TO CLIENT, SYSTEM, AND THIRD PARTIES

A. The practitioner's duty to client

1. Under this duty, the practitioner owes to the client obligations of

   a. loyalty
   b. confidentiality
   c. competence

2. Loyalty

   a. the obligation of undivided loyalty requires that the practitioner carry out the representation of the client free from the influences of present or potentially conflicting interests—see § 10.29 of Circular 230; ABA Model Rule 1.7; and AICPA Rule 101

   b. clients may waive a conflict and thereby allow the practitioner to go forward with the representation

      (1) waiver requires that all affected clients be fully informed as to the nature of the conflict and as to its possible effect upon them and concur in the waiver

      (2) the practitioner should not solicit a waiver from clients unless the practitioner concludes that the affected clients can be adequately represented despite the conflict

   c. the obligation of loyalty also requires that a practitioner not engage in a business relationship with a client unless the terms are fair and reasonable to the client, the client has the opportunity to consult independent counsel, and the client consents
the obligation of loyalty extends also to a former client with respect to any matter that is substantially related to the prior representation of that client--see ABA Model Rule 1.9

3. Confidentiality

a. the obligation of confidentiality requires that the practitioner not disclose any matters that the client might reasonably prefer not be divulged--see ABA Model Rule 1.6; AICPA Rule 301

b. such matters may, however, be disclosed with the consent of the client

c. the rule, as articulated by the ABA, permits disclosure without the client's consent in two circumstances

(1) where the practitioner reasonably believes that disclosure is required to avoid death or substantial bodily harm to another, or

(2) in proceedings involving disputes between the practitioner and the client

d. the ethical obligation of confidentiality should be distinguished from the attorney/client privilege (or, where one exists, the privilege accorded to communications with other professionals)

(1) the privilege is a rule of evidence, is available only in very carefully circumscribed situations, and is durable, in the sense that it can be claimed even in the face of a legal order to disclose

(2) in contrast, the ethical obligation is widely available for virtually all information concerning a client, but it is not durable, in the sense that it disappears as soon as the practitioner is under legal compulsion to disclose, e.g., where ordered to do so by a court
4. Competence

a. this obligation requires that the practitioner accept only those representations that he is competent to handle   ABA Model Rule 1.1; AICPA Rule 201A

b. competent representation requires the professional knowledge, skill, thoroughness, and preparation reasonably necessary for the representation

c. in the complex and ever changing world of tax law, it becomes harder and harder for practitioners to honor the obligation of competence

B. The practitioner's duty to system

1. The term "system" refers to all of the various societal interests that may be affected by activities in pursuit of the representation

a. it is fundamental that the representation of the client must occur within the bounds of the law because the practitioner may not assist a client in illegal conduct, and the practitioner may not himself engage in illegal conduct

b. in addition, the representation must occur within the rules established by any authority under whose authorization the practitioner carries on his particular calling -- this includes courts, state licensing authorities, and, in the case of practice before the IRS, the Treasury Department

2. The essence of duty to system is that the practitioner must observe societal and professional rules in advancing the interests of the client

C. The practitioner's duty to third persons

1. The issue to be considered under this heading is whether the practitioner has a duty to limit his activities in pursuit of the lawful objectives of a client merely because those activities may adversely affect the interests of third parties

2. While the various professional standards contain statements suggesting the existence of a duty to
avoid damage to the interests of third parties (see e.g., ABA Model Rules 4.1 through 4.4) they
do not provide explicit recognition of such an obligation.

3. The comment to ABA Model Rule 1.2 states that a lawyer "should assume responsibility for technical
and legal tactical issues but should defer to the client regarding such questions as the expense to
be incurred and concern for third persons who might be adversely affected" (Emphasis added.)

4. Some of the most difficult ethical choices are presented when actions in support of a client's
lawful objectives collide with the interests of third parties.

III. ETHICAL CONSIDERATIONS OF THE TAX PRACTITIONER THAT DERIVE
FROM THE LEGAL RESPONSIBILITIES OF THE TAXPAYER-CLIENT

A. The client-taxpayer establishes the objectives of the representation so long as those objectives are lawful

1. The practitioner's responsibility is to respond to the objectives defined by the client—see, e.g.,
ABA Model Rule 1.2

   a. the practitioner, however, should consult with the client as to the propriety of the client's objectives

   b. the practitioner should discuss the legal consequences of action that would be taken to pursue the objectives defined by the client

   c. the practitioner may advise the client as to the bounds of the law, including legal aspects of questionable conduct

2. The practitioner may not counsel the client to engage in unlawful conduct and may not assist in such conduct—see, e.g., ABA Model Rules 1.2, 1.16

   a. the practitioner should seek to dissuade the client from unlawful conduct

   b. if the client insists on pursuing a course of action that is clearly unlawful, the practitioner must withdraw from the representation
c. the client's legal responsibilities are thus a limitation on the permissible activities of the practitioner

3. In the field of tax practice, most clients desire to pay no more tax than the law requires of them, and this often requires that tax practitioners make decisions "at the margin" of the tax law

   a. a client is entitled to exercise all of his rights under the law, including the right to pay the lowest amount of tax legally required

   b. in determining what the law requires of a client, it is important to recognize the general principle that a client's legal rights are neither expanded nor contracted by reason of the fact that the client has sought the counsel of a practitioner (but see discussion at IV.D.2.b. below)

   c. when advising a client, the practitioner must ascertain exactly what the law requires of the client and must insure that the advice given is neither overly restrictive (which might deprive the client of legal entitlement) or overly permissive (which might cause the client to engage in unlawful conduct)

B. The client-taxpayer's legal responsibilities for tax return reporting

1. The client has a statutory duty to file a return and to execute the attestation clause

   a. the client is required under section 6011 to file a tax return on forms provided for that purpose

   b. the forms provided require that the taxpayer attest that the return is true and correct to the best of his belief

2. The level of accuracy problem

   a. because the client's legal responsibilities constrain the practitioner's conduct, we must define the level of accuracy that the tax law requires of the client with respect to tax return positions in order to understand the practitioner's ethical responsibilities
b. the law could impose various alternative accuracy standards on the taxpayer
c. for example, the law could require that a position be
   (1) correct
   (2) probably correct
   (3) as likely as not correct
   (4) probably wrong, but having a realistic possibility of being correct
   (5) frivolous
d. while there exists some uncertainty on the point, the standard that the law currently requires of taxpayers appears, for the reasons discussed below, to be somewhere in the area of (4) above, as distinguished from any higher standard

3. The minimum level of accuracy legally required of a taxpayer is effectively established by the fact that the client is entitled to pursue litigation in the United States Tax Court on a pre-assessment basis
   a. under section 6213, taxpayers are entitled to test tax return positions for certain taxes in the Tax Court before the IRS may assess a deficiency
      (1) this right at least suggests, if it does not compel, the conclusion that the law allows a taxpayer to report on his tax return any position that may be litigated in the Tax Court
      (2) were it otherwise, the taxpayer could not avail himself of the right to preassessment litigation in the Tax Court--the taxpayer would instead have to report in accordance with some higher standard, pay the tax, and sue for a refund in a court having refund jurisdiction
   b. it thus appears that the range of return positions that the taxpayer is legally entitled to adopt is coterminous with the
the general standard for determining what are litigable positions is established for lawyers in Rule 3.1 of the Model Rules of Professional Conduct adopted by the American Bar Association

(a) Rule 3.1 provides that a lawyer shall not bring a suit "unless there is a basis for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."

(b) a position that is not litigable under this standard is often referred to as a frivolous position

(2) Rule 33 of the Tax Court Rules of Practice points in a similar direction that counsel's or a party's signature on a pleading certifies that "it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law"

(3) while these ABA and Tax Court rules govern primarily the conduct of practitioners, as distinguished from taxpayers, it seems evident that, if a practitioner may bring a case of given quality before a court, his client is equally entitled to have a case of that quality presented to the court on his behalf

4. Mechanisms to achieve a higher level of compliance than that required by the litigation standard

a. if taxpayers are legally entitled to report any return position that is litigable, compliance can be expected to be quite low, absent other measures to encourage a higher level of compliance

b. other measures that are available to encourage a higher level of taxpayer compliance are
(1) IRS audit activity at a level sufficient to assure that most, if not all, issues that should be challenged by the government are in fact identified and challenged, or

(2) a penalty structure under which taxpayers are provided with an incentive to report in accordance with a higher standard

c. the United States has chosen not to pursue the audit alternative, and it has chosen to pursue, at least to a modest degree, the penalty alternative

(1) the IRS audits less than one percent of all returns, an audit rate that is unlikely to have much influence on taxpayer behavior

(2) on the other hand there exists a penalty system in which accuracy penalties are imposed on understatements that fall short of specified levels of accuracy

(3) we should recognize that this situation results from a public policy choice and that the government could choose instead to provide the funds required for broader audit coverage

(4) some commentators argue that, because the government has chosen not to devote adequate resources to audit activity, thereby facilitating an "audit lottery," tax practitioners have a duty to encourage clients to report in accordance with a standard that is higher than the legally-required litigation standard

(a) such action that may not be consistent with their clients' economic interests

(b) it is questionable whether such a duty in fact exists

d. two civil penalties have an influence on taxpayers in terms of the accuracy of tax return positions
5. The role of the substantial understatement penalty in defining the taxpayer's reporting responsibilities

a. the substantial understatement penalty is in the nature of a no-fault penalty

(1) it applies if the return understates the taxpayer's liability by a given amount unless either

(a) there is "substantial authority" for positions that caused the understatement, or

(b) the taxpayer adequately disclosed those positions on the return

b. the substantial understatement penalty does not appear to modify the general rule that the taxpayer is entitled to report in accordance with the litigation standard

(1) the substantial understatement penalty simply introduces a risk element or toll charge that the taxpayer must consider

(2) in deciding whether to adopt a position, the taxpayer must assess whether there is substantial authority for that position

(3) if substantial authority does not exist, the taxpayer then must consider whether to adequately disclose the position on the return in order to avoid the risk of penalty

c. rather than establishing a rule of conduct under which a taxpayer must report only those positions that are supported by substantial authority, this penalty appears instead to offer only an optional incentive to report in accordance with the higher standard (or to disclose) so as to avoid the risk of penalty
d. Congress could strengthen the role of the substantial understatement penalty in encouraging either a higher level of accuracy or more voluntary disclosure of questionable positions

(1) by increasing the penalty rate from 20 percent to some substantially higher level, such as 50 percent, and

(2) by elevating the accuracy level required by the penalty from "substantial authority" to "more likely than not correct"

(3) it is difficult to see these actions as unfair to taxpayers so long as the option to avoid penalty risk through disclosure is maintained

(4) a substantial advantage of a strengthened penalty would be to place the incentive to report conservatively where it belongs, i.e., on the client-taxpayer, rather than on the practitioner

6. The role of the negligence penalty in defining the taxpayer's reporting responsibilities

a. the negligence penalty applies when a taxpayer fails to make a reasonable attempt to comply with the tax law or when the taxpayer disregards rules and regulations

b. the negligence penalty is thus fault based, in the sense that the taxpayer must do something wrong in order to incur it

c. a tax return position that would result in a negligence penalty for the taxpayer could also be a frivolous position and thus fail to satisfy the litigation standard

d. for this reason, it is arguable that the negligence standard (reasonable effort) and the litigation standard (litigable position) in many instances demand a comparable level of accuracy from the taxpayer

(1) if a taxpayer adopts a litigable position (which is not contrary to a
rule or regulation), he is fairly unlikely to incur the negligence penalty.

(2) the negligence penalty and the general return reporting standard (litigable position) thus appear to be at least in part congruent with one another.

C. Conclusions regarding the client-taxpayer's return reporting obligations

1. The taxpayer's legal reporting obligation requires that his tax return positions be litigable, i.e., nonfrivolous.

2. While the civil penalty system provides an incentive (in the form of the substantial understatement penalty) for the taxpayer either to disclose questionable positions or to report in accordance with a higher accuracy standard (substantial authority), it does not appear to alter the taxpayer's legal right to report in accordance with the litigation standard.

3. In the context of tax practice, whether or not the conduct proposed by the client is unlawful should be determined by reference to the client's responsibilities under the tax law, as discussed above.
   a. reporting a position that is probably incorrect but that is not frivolous is not unlawful conduct, even though it might result in the imposition of an accuracy-related penalty unless it is adequately disclosed.
   b. reporting a position that is frivolous and would result in the imposition of the negligence penalty, or possibly the civil fraud penalty, should be viewed as unlawful and the practitioner should withdraw from the engagement if the client insists on taking the position.

4. While the practitioner may not advise or assist in illegal conduct, he has no obligation to attempt to convince the client to observe a higher standard than that which is legally required.

5. The practitioner should point out to the client any advantages of observing a higher standard or of making disclosure, but the practitioner is not
obligated to seek to dissuade the client from lawful conduct

6. The practitioner does have a duty to advise the client if the proposed conduct will potentially give rise to a penalty

IV. ETHICAL CONSIDERATIONS THAT ARE IMPOSED DIRECTLY ON THE TAX PRACTITIONER

A. Introduction

1. In the previous section, we explored the ethical considerations of the tax practitioner that are derived from the requirement that the client-taxpayer act in accordance with the law

2. In this section, we consider certain specific ethical considerations that are imposed directly on the tax practitioner without regard to the client's legal responsibilities

B. The reasonable basis standard imposed an ethical limitation on the conduct of tax practitioners

1. In 1965, the ABA adopted its Formal Opinion 314, stating that a lawyer could ethically recommend that a client adopt a position on a tax return without special disclosure so long as there was "reasonable basis" for that position

2. In 1977, the AICPA followed suit by adopting Statement on Responsibilities in Tax Practice No. 10, in which the term "reasonable support" was used rather than "reasonable basis"

3. In 1977, the reasonable basis standard was also adopted as the conduct standard for purposes of the return preparer penalty under section 6694--see Reg. § 1.6694-1(a)(4)

4. Circular 230, governing the conduct of practice before the Internal Revenue Service required only that practitioners exercise "due diligence" in preparing and filing returns and other documents with IRS--see Circular 230, § 10.22

5. The reasonable basis standard appears to have been generally congruent with the legal responsibility of taxpayers to report only litigable standard--thus practitioners were not held to a higher standard than were their clients
C. The "realistic possibility of success" ("RPOS") standard superseded the reasonable basis standard

1. In 1985, out of concern that the reasonable basis standard did not adequately express the ethical standard for lawyers advising on tax return positions, the ABA issued its Formal Opinion 85-352, revising the ethical standard to require that a position have a "realistic possibility of success if litigated"

   a. the discussion surrounding the issuance of this new standard indicates that it was the ABA's intention to elevate the standard above what reasonable basis had come to mean--see Report of Special Task Force of the ABA Tax Section, 39 Tax Lawyer 635 (1986)

   b. Opinion 85-352 did not deal directly with the question whether a position not meeting the RPOS standard could be adopted if adequately disclosed on the return

      (1) Opinion 85-352 can be read to permit a lawyer to advise a position not meeting the RPOS standard if that position is disclosed

      (2) however, the Task Force Report rejected such an interpretation, although it did state that a lesser position could be advanced in a claim for refund

2. In 1988, the AICPA also adopted the RPOS standard, with minor differences in language, in Statement No. 1 of its revised Statements on Responsibilities in Tax Practice

   a. the AICPA version does hold that a position not meeting the RPOS standard may be adopted so long as adequately disclosed

   b. on this important point, there existed a difference between the two organizations

3. In 1989, in connection with the general revision of civil penalties, section 6694 was amended to adopt the RPOS standard for purposes of the return preparer penalty

   a. amended section 6694 permits penalty-free adoption of a position not meeting the RPOS
standard so long as the position is adequately disclosed and is not frivolous

b. thus, with the exception of the role of disclosure, there was general congruence among the ABA and AICPA ethical standards and the civil penalty standard

4. Circular 230 continues to require only due diligence and has not been amended to provide a more specific standard for practitioners

a. amendments were proposed to Circular 230 in 1986 under which a practitioner standard requiring "substantial authority" would have been adopted

b. in virtually identical submissions, the ABA and the AICPA objected to this proposal and advocated instead the adoption of the RPOS standard

c. in their submissions, both the ABA and the AICPA advocated adoption of a rule that would permit reporting of positions that do not satisfy the RPOS standard so long as those positions are adequately disclosed, thereby eliminating the apparent difference between the two organizations on this point that arose from the Task Force Report

d. the general expectation of practitioners is that the Treasury Department will, in due course, amend Circular 230 to adopt the RPOS standard for practice before the IRS

D. Questions regarding possible discontinuity between the RPOS standard for tax practitioners and the litigable position standard for taxpayers

1. The effect of the RPOS standard on the practitioner/client relationship turns on its interpretation

a. if the RPOS standard requires of the practitioner the same level of accuracy that the law imposes on the taxpayer-client, i.e., that a position be "not frivolous" and supported by a "good faith argument for an extension, modification or reversal of existing law," there is congruity between the practitioner's ethical duty and the client's legal responsibility
b. if, however, the RPOS standard requires something more, the practitioner operates under a more restrictive standard than is applicable to his client.

2. If the practitioner and client standards are not the same in the tax area, troubling questions arise

a. if the client is legally permitted to pursue a course of action, why is it that the practitioner cannot assist in that action, as a practitioner is ethically permitted to do in virtually all other areas of practice

b. similarly, should the fact that a client seeks representation from a practitioner effectively limit the rights of the client—compare the principle discussed at III.A.3.b. above

3. These questions must be considered as the RPOS standard is subjected to interpretation by the ABA and the AICPA in their ethical directives and by the Treasury Department in the proposed regulations under section 6694 and in the forthcoming amendments to Circular 230

V. HYPOTHETICAL SITUATIONS FOR DISCUSSION

A. In the context of return preparation

1. Determining "substantial authority" and "RPOS"

Hypothetical No. 1

You are considering a tax return position for your client. The U.S. Tax Court has agreed with this position three times in the past five years. However, in the past three months a court of appeals has reversed one of the Tax Court decisions. A district court in a different circuit has followed the court of appeals' logic.

a. What are the implications for purposes of substantial authority and realistic possibility of success?

b. Does it matter whether or not your client is in the same circuit as the court of appeals? Would the answer be the same if the court of
appeals opinion was favorable and the others unfavorable?

c. Would your conclusions be the same if the appellate decision was one of the Court of Appeals for the Federal Circuit?

Hypothetical No. 2

Parent purchased all of the stock of Target for cash last year in a "friendly" acquisition. Target was publicly traded, and, in accordance with state law, Target's board of directors requested a "fairness" opinion from an investment bank. Target paid $750,000 for this opinion. In considering whether this amount is deductible on Target's final return, you find three authorities:

a. a court of appeals opinion (affirming the Tax Court) to the effect that such expenditures are not deductible

b. IRS directives (GCMs and technical advice memoranda) holding that fairness fees are deductible in hostile but not in friendly takeovers, and

c. an article in the Ohio State University Law Review criticizing the Tax Court decision

(1) What are the implications for substantial authority and realistic possibility?

(2) Should disclosure be made?

(3) If you advise disclosure and the client rejects that advice, what are your responsibilities?

Hypothetical No. 3

You are advising a client with respect to a return position for a transaction that has already occurred. The position that you are contemplating is contrary to a proposed regulation. You nonetheless believe that the position is probably correct.

a. What are the implications for substantial authority and realistic possibility?
b. Should disclosure be made?

c. Is the situation the same if the position is contrary to a final regulation?

d. Is your situation any different if the transaction in question has not yet occurred and your advice is being sought as to the means by which it is to be accomplished?

Hypothetical No. 4

The client for whom you are preparing a return has a farm. Based on your research into the hobby loss rules, you conclude that there is a substantial risk that, if challenged by the IRS, the client would be hard pressed to establish that the loss is allowable. Despite this, you know that occasionally some taxpayers with even worse cases have prevailed.

a. When you explain this to the client, he asks you to explain just what the odds are that this would ever come to the attention of the IRS. How do you respond?

b. What weight would you give to the likelihood of audit in determining whether claiming the farm loss is appropriate?

c. If the client is willing to disclose the position, how does that affect your position?

Hypothetical No. 5

You are preparing a client's income tax return and are considering a position favorable to the client on a material item. You are aware of the fact that a bill pending in Congress would, if enacted, authorize this position. Absent that legislation, you do not believe that substantial authority exists for the position or that it has a realistic possibility of success. The legislation seems quite likely to be adopted and to contain the desired language.

a. How do you advise the client?

b. Would your position be the same if current law allowed the position but the pending legislation would end that situation?
Hypothetical No. 6

You are preparing the return of a corporation that has engaged in a transaction that previously provided substantial tax benefits. However, a recently enacted statute would foreclose those benefits. The corporation did not have notice of the enactment of this new section, which has a retroactive effective date that is prior to your client's transaction. You believe that the legislation, as applied to your client's situation, is very inequitable. On the other hand, the statute is clearly drafted and seems without doubt to apply. You find nothing helpful in the committee reports.

a. What are the implications for substantial authority and realistic possibility?

b. What role does disclosure play in evaluating the situation?

c. Would the situation be different if the Joint Committee "Bluebook," issued after the statute was enacted, indicated that the legislation was not intended to reach your client's transaction?

2. Other return preparation issues

Hypothetical No. 7

In preparing the return of a client, you discover that the client's closing inventory for the prior year was understated, with the result that its cost of good sold was overstated and its taxable income understated. The amount is clearly material. After some investigation, you conclude that the error was inadvertent. If the client were to be audited for the prior year, there would be no defense to an adjustment to correct the error. You discuss the situation with the representative of the client to whom you report.

a. The client asks you to explain to him the client's obligations under the tax law. How do you respond?

b. Are penalty considerations covered in your discussion?

c. Are your professional duties at any tension with the client's responsibilities?
d. After hearing you out, the client advises you that you should do nothing with respect to the prior year and asks that you proceed with the return for the current year. What are the issues that you face?

Hypothetical No. 8

Until recently, B has been an 80% owned subsidiary of a consolidated group whose parent is A. For 1989, A filed a consolidated return for its group. On January 1, 1990, B purchased all of the B stock formerly held by A, and B is thus no longer affiliated with A. B has engaged your firm to prepare its tax return for 1990. In addition, A has decided to change accounting firms and asks your firm to prepare its 1990 consolidated return. The 1990 returns for A and B have been assigned to different partners in the firm. B's management now believes that certain deductions previously taken on the 1989 A return are instead allowable for 1990 on the B return. Your firm's partner assigned to the B return concurs. That partner is instructed by B not to talk with the partner assigned to the A return about this because B might be liable to A for any resulting deficiency caused to A by reason of the movement of deductions from A to B.

a. Notwithstanding B's request, does the partner in charge of B's return have a duty to inform the partner in charge of the A return?

b. If A is not apprised of the situation, may the firm prepare the B return, claiming the deductions in question?

c. Would a discussion of this matter with the personnel preparing the respective returns violate any sections of the Internal Revenue Code?

Hypothetical No. 9

In preparing an estate tax return, you must report a value for the stock of a privately held corporation in which the decedent held a controlling interest. The stock is difficult to value, but you believe that the value lies between $500 per share and $1,000 per share. You have one appraisal at $500 per share and another at $750 per share. You explain the difficult problem of
valuation to your client. The client states that she would be satisfied with a value of $750 per share. You know that if you report a value of $750 per share, the agent might pick another, higher value, perhaps $1,200 per share. Consequently, the only way to achieve the client's objective is to report a value at the lower appraisal ($500 per share), with the objective to compromise at the $750 level.

a. What ethical considerations are presented in this situation?

b. What role does the realistic possibility standard play in this setting?

B. In the context of tax controversy

Hypothetical No. 10

You are negotiating with an IRS agent on behalf of a client. During the negotiations, you are requested to make various representations with respect to factual matters related to the client's case.

a. To what extent are you required to assure the accuracy of any such representations?

b. Assume that your client provides you with information in response to the agent's request, and you pass that information on to the agent. Later you discover that the information was incorrect, and you suspect, although you do not know, that your client intentionally sought to mislead the agent. What do you do?

Hypothetical No. 11

You are negotiating with an Appeals officer when you learn that there is a flaw in the legal argument that you advanced on behalf of the client in the protest and have been pressing in the conference.

a. Are you required to advise the Appeals officer of this infirmity?

b. Instead of learning of an infirmity in an issue already identified and under discussion, you learn of another issue on the return for the same year that the client very probably would lose if the issue were
discovered by the IRS. What are your responsibilities with respect to disclosure of that issue?

Hypothetical No. 12

Your client has been unable to reach agreement with an agent and is considering accepting a 30-day letter and taking the unagreed issue to Appeals. Before doing that, the client consults you. You believe that the client has a good position on the issue in dispute and that the client should probably prevail on it. However, you discover another issue that the agent has not identified and that the client would probably lose were it raised. Notwithstanding this, the taxpayer's position on the unidentified issue would have a realistic possibility of success if challenged. The unidentified issue is much larger than the disputed issue. You know that the unidentified issue may well be raised if the case moves on to Appeals because the disputed issue can naturally draw attention to the unidentified issue.

a. Is it proper for you to advise the taxpayer to agree to the disputed adjustment and to file a claim for refund of the resulting tax just prior to the running of the statute of limitations on assessment for the year in question? The objective would be to be able to continue the present dispute in an atmosphere where there was no downside risk from the unidentified issue.

b. What are the standards that govern the filing of the claim for refund?

C. In the context of tax planning

Hypothetical No. 13

You are processing a request for private letter ruling from the National Office of the IRS. After filing the request for ruling, you become aware of additional facts that, if known to the tax law specialist handling the ruling request, would make a favorable ruling problematic. You, however, believe strongly that a favorable ruling should issue even with the new facts.

a. What are your disclosure responsibilities?
D. In the context of negotiation

Hypothetical No. 14

You are negotiating a transaction on behalf of your client. You advise your client that the other side has requested some information, and your client says, "The correct answer is "A," but tell them "B" because that is more favorable to me."

a. What do you do?

b. If you have already provided the erroneous information to the other side before you learn that it is incorrect, what do you do?

c. If the client had said, instead of what is quoted above, "They want to know what the value of X Unit is. I think that it is worth $4 million, but tell them that I value it at $6 million and wouldn't take a penny less."

Hypothetical No. 15

You are negotiating a transaction on behalf of your client in which the tax considerations should be of great concern to the other side. You become aware of the fact that the practitioner advising the other side does not understand the tax issues and, if the transaction is consummated as presently proposed, the result will be a tax disaster for the other side. On the other hand, the current structure is of great economic benefit to your client. That benefit would be greatly reduced if the transaction were restructured to accommodate what should be the tax goals of the other side were it adequately represented.

a. What are your responsibilities?

b. Is it relevant whether the opposing practitioner (or his client) is an old school chum of yours?