Texas Society of
Certified Public Accountants

July 9, 2013

Ms. Lisa A. Snyder, Director
Professional Ethics Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036

RE: Proposed Revised AICPA Code of Professional Conduct

Dear Ms. Snyder:

One of the expressed goals of the Texas Society of Certified Public Accountants (TSCPA) is to speak on behalf of its members when such action is in the best interest of its members and serves the cause of Certified Public Accountants in Texas, as well as the public interest. The TSCPA has established a Professional Standards Committee (PSC) and a Federal Tax Policy Committee (FTPC) to represent those interests on accounting, auditing and federal tax matters. The views expressed herein are written on behalf of the PSC and FTPC, which have been authorized by the TSCPA Board of Directors to submit comments on matters of interest to the committees' membership. The views expressed in this letter have not been approved by the TSCPA Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policy of the TSCPA.

Our letter represents a joint effort by the TSCPA's PSC and FTPC, and both committees are in agreement with the issues presented in this letter.

Our overall assessment of the proposed revision is favorable. We believe the revised AICPA Code of Professional Conduct (Code) is comprehensive in its coverage and will serve as an excellent resource document for practitioners wishing to clarify their responsibilities in providing professional services to their clients.

The one issue we wish to raise for consideration by the Professional Ethics Executive Committee is the identification of Code provisions pertaining to CPAs involved in federal tax practice before the IRS. Based on currently published IRS statistics on the issuance of preparer tax identification numbers (PTINs), these rules apply to more than 211,000 CPAs. Our concern stems from the fact that Treasury Regulations mandate ethical standards that differ from and supersede AICPA professional standards in some material aspects. The guidance in the Code largely ignores these important rules that affect the ethical behavior of member tax practitioners. The guidance in the Code largely ignores these important rules that affect the ethical behavior of member tax practitioners and by such omission risks misleading these members. Although there are direct references in the Code to other governmental standards that may apply to accounting and auditing services, conspicuous by its absence is any reference to the Treasury Circular 230 standards applicable to "tax practitioners" as that term is defined in Circular 230. The dichotomy and lack of cross reference could lead members to believe that the Code represents the most applicable, highest or perhaps the only standard relevant to CPAs who may also prepare tax returns or perform other functions that subject them to the Circular 230 standards.

Clearly, CPA tax practitioners are subject to the Statements on Standards for Tax Services (SSTSs) and other applicable AICPA Professional Standards. However, as drafted, they might be led to believe these standards are the exclusive guidance to which they must adhere. Although the Code includes a very general statement that CPAs preparing tax returns might be subject to other standards, it does not specifically reference any tax standards outside the SSTSs. This is in sharp contrast to the numerous cross references in the Code to other standards pertaining to audit and financial services. This conspicuous difference can, and almost certainly will, lead many CPAs to believe that the SSTS standards are the highest authority and, other than perhaps state or local standards, they do not need to be aware of any other rules. The AICPA Code should directly reference these other enforceable standards applicable to tax practitioners, including specific Internal Revenue Code sections, IRS regulations and Circular 230. Moreover, even for those CPAs who do understand there are other standards to which they must adhere, it would be most helpful for the AICPA to specifically reference those authorities. Doing so would enhance the efficiency of a CPA's compliance with those standards.

The requirements for waiving a conflict of interest are a good example where Section 10.29 of Circular 230 presents a higher and different standard than that of the Code and SSTSs. Underlying the distinction between the Code and Circular 230 conflict of interest rules is the fact that Circular 230 Section 10.29 tracks the American Bar Association (ABA) Model Code of Professional Responsibility rules. Unlike the Code which is based on underlying core values of integrity and objectivity, the ABA (and Circular 230) rules rest on core values of loyalty and advocacy. These differing core values can (and do) produce different responses to whether a conflict exists within a particular set of facts. Also, under the AICPA Code, an oral waiver is sufficient, but Circular 230 requires written approval. It is crucial in this example that members understand the requirements of Circular 230 are both different from and more stringent than the Code, because failure to comply with the Circular 230 standard can subject the member to IRS sanctions (and could be used against the member practitioner in a lawsuit).

We strongly believe that the AICPA Code should include references to Circular 230 where appropriate. In an effort to highlight the inclusion of reference to Circular 230 Section 10.29 in the Code revision, we have provided the following list of sections that merit a reference:

1. **0.200.02**

2. **0.300.040** and in particular .02 and .04

3. **1.000.010.09**, .10 and .13

4. **1.000.010.20**

5. **1.000.020** There should be a reference to a multi-party representation and a reference to Section 10.29.

6. **1.100.010** In addition at .03 thereof, the differences between 10.29 and the AICPA Code should be emphasized.

7. **1.130.010** Should reference use of financial statements in tax returns.

8. **1.290** There is a restriction and limitation regarding actual litigation that is limited to an attest client. There is a potential violation of the conflict of interest rules of Section 10.29 and the reference should not be so limited.

9. **1.700.001.02** Query whether a specific reference of the various whistle-blower may be an exception to the confidential client information rules.

10. **1.700.020** Reference should be made to the rules of Circular 230 and the implications of Sections 7216 of the Internal Revenue Code regarding disclosure of tax return information in an unauthorized manner.

11. **1.700.030** Reference to Section 10.29 ought to be made because of the potential conflicts and the necessity for waiver of conflict letter in any tax engagement of a joint tax return or other multi-party representation in a tax engagement of a divorcing couple.

12. **2.000.020.01** Reference should be made to the member's responsibility in connection with any applicable whistle-blower acts.

13. **2.110** Reference to Section 10.29 should be made noting that it is not a higher or lower standard, but a completely different standard based upon different core values, specifically, loyalty and advocacy in addition to integrity. Objectivity is not necessarily a consideration in a tax engagement where a member is acting as a practitioner subject to Circular 230. (Advocacy is potentially inconsistent with objectivity.)

14. **2.400.050** Reference is made in connection with the preparation of financial statements or records to the rules of many governing bodies; there is no such reference to Treasury and Circular 230, notwithstanding that Circular 230 is the primary controlling ethical set of rules in connection with practice before the Internal Revenue Service.

In addition, we are attaching two appendices that provide further clarification and illumination on the differences between the Code and certain of the Circular 230 rules:

- "Tax Practice Responsibilities," an article by Kenneth M. Horwitz that appeared in the November 2011 issue of the Tax Advisor, subtitled, "Conflicts of Interest: IRS Rules Differ from AICPA Professional Standards."

- "2013) TNT 82-6 Beware Conflicts of Interest," by Kip Dellinger that appeared in the April 23, 2013 issue of Tax Notes Today.

We appreciate the opportunity to provide input regarding the proposed revision of the AICPA Code of Professional Conduct.

Sincerely,

Carol Warley

Carol G. Warley, CPA, JD
Chair, Federal Tax Policy Committee
Texas Society of Certified Public Accountants

Sandra K Brown

Sandra K. Brown, CPA
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants

Attachments (2)

Tax Practice Responsibilities

Editor:
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Author:
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Conflicts of Interest: IRS Rules Differ from AICPA Professional Standards

Circular 230, the Treasury regulations governing ethical standards applicable to practice before the IRS, deals with conflicting interests at Section 10.29 (31 C.F.R. §10.29). It forbids federal tax practitioners from having conflicts of interest, defined as representation of one client that is directly adverse to that of another client, or representing a client in circumstances creating a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client, or a third person or by a personal interest of the practitioner.

However, a practitioner may represent a client despite a conflict of interest if the practitioner reasonably believes he or she can provide competent and diligent representation to each affected client and if all affected clients waive the conflict by giving their written informed consent.

Circular 230 has at least two major potential effects on covered practitioners: (1) Violation of a Circular 230 standard may subject the practitioner to sanction by the IRS Office of Professional Responsibility (OPR); and (2) Circular 230 may be used in a lawsuit for damages filed by a client in connection with asserted errors and omissions by the practitioner as the standard to which the practitioner should be held in performing services. Thus, CPAs have a strong interest in understanding the standards to which they will be held under Circular 230. This column is a limited discussion of the application of conflict-of-interest rules in a federal tax practice.

The original version of Section 10.29 (essentially unchanged since before 1976) was a simple three-line prohibition against representing clients with conflicting interests except by express consent of all directly interested parties after full disclosure. In 2002, Section 10.29 was amended to its current form, with additional enhancements in 2007 that included requiring that a known conflict of interest may be waived only by the informed consent of each affected client, confirmed in writing by the client.

The rules in Section 10.29 are relatively terse and contain numerous terms that are subject to varying possible interpretations. The AICPA opposed any change to Section 10.29 from the 1992 version in a comment filed with then-IRS Commissioner Charles Rossotti on July 7, 2000. Proposed regulations published by the IRS on January 12, 2001, were substantially revised to meet objections (including those of the AICPA). However, the preambles to the final regulations in 2002 (T.D. 9011) and again in 2007 (T.D. 9359) made clear Treasury's intent to strengthen the language of Section 10.29 and to modify it to conform more closely with Model Rule 1.7 of the American Bar Association Model Rules of Professional Conduct. The preamble to T.D. 9359 in 2007 stated that Section 10.29 as amended was broader than the ABA model rule (by, for example, requiring client confirmation in writing). The preamble said that the rules were designed to "protect taxpayer interests and protect settlements from future collateral attack." One pair of writers has commented that "precedent from comparable ethical rules, rule commentaries, bar opinions, and the like may be helpful applying the rules, but are not binding" (Cavanagh and Hynes, *Navigating an OPR Disciplinary Proceeding*, 2010 TNT 95-6 (May 18, 2010)).

The rules of Section 10.29 apply only where the CPA is acting as a practitioner as defined in Circular 230. Thus, for example, if a CPA is an expert witness in a state law trial dealing with federal tax issues, he or she is not acting as a practitioner as defined in Circular 230. However, the AICPA Code of Professional Conduct and other AICPA and state professional standards may still apply to such testimony. A CPA subject to the Statements on Standards for Tax Services (SSTS), the enforceable tax practice standards for members of the AICPA, is generally required to follow them with respect to tax practice and to follow other AICPA professional standards as applicable, unless a stricter standard applies. Thus, if Section 10.29 provides a stricter rule on the definition of conflict of interest and how to deal with such a conflict in the context of acting as a practitioner (as defined in Circular 230), a CPA should follow Section 10.29. However, he or she should in all events follow the AICPA professional standards as a minimum standard.

Underlying Values

Integrity and Objectivity

The Circular 230 standard on conflicts of interest and ABA Model Rule 1.7 on which it is based emphasize conflicting professional responsibilities—when the representation of one client may be directly adverse to another client. In this respect, they differ from the AICPA Code of Professional Conduct and other standards, which emphasize the broader values of integrity and objectivity (and, in attestation engagements, independence) (see Code of Professional Conduct ET §102-2.03). What effect this difference may have in Section 10.29's application requires further exploration. Section 10.29 does not include the rest of the ABA Model Rules upon which the interpretation of Rule 1.7 rests. Sections 10.29(a) and 10.29(b) define when a conflict of interest exists and when, notwithstanding the existence of a conflict of interest, a practitioner may represent a client. Unstated is the extent to which the interpretations of Section 10.29 will follow the comments on the ABA Model Rules or case law interpreting them.

Under the AICPA professional standards, a CPA is required to maintain objectivity and integrity, be free of conflicts of interests, and not knowingly misrepresent facts or subordinate his or her judgment to others. These requirements are not inconsistent with any provision of Circular 230. These ethical standards also inherently underlie Section 10.29. CPAs employed by others to perform tax services are charged with the same responsibility of objectivity under the AICPA standards as CPAs in public practice. Integrity, objectivity, and independent judgment are essential elements in a CPA's relationship with a client or employer in a federal tax practice and in his or her status as a practitioner under Circular 230.

The AICPA Code of Professional Conduct differentiates between objectivity and independence. ET Section 55.03 provides that, for a CPA in public practice, maintaining objectivity and independence requires a continuing assessment of client relationships and public responsibility. A CPA who provides auditing and other attestation services should be independent in fact and appearance. However, this standard does not apply to a practitioner under Circular 230 in the absence of any attestation service performed by a CPA or his or her firm for a client. Thus, CPAs providing such attestation services should consider (1) whether such engagement may materially limit the ability of such CPAs and their firms to provide federal tax advocacy services for the client under Section 10.29(a)(2), and (2) whether there is a significant risk that the representation of the client in federal tax advocacy matters will be materially limited by the personal interest of the practitioner or his or her firm due to the independence requirement of the attest engagement. In such cases, the CPA would need to follow the procedures under Section 10.29 regarding consent to waive such conflict (assuming the tax engagement could be managed so as to not violate the independence requirements).

Loyalty and Advocacy

Although Section 10.29 tracks ABA Model Rule 1.7, many of the practices the section regulates differ from law practices; therefore, its application should not track that of the ABA Model Rule. Law practice requires loyalty to the client (see Comment No. 1 to ABA Model Rule 1.7), and the client of a lawyer is entitled to rely on very broad rules regarding the protection of client-attorney communications. That protection is incorporated in federal and state law. Loyalty, however, does not underlie the AICPA standards. The AICPA standard for confidentiality for the CPA's client (see Code of Professional Conduct ET §301) is not the same as that of the ABA Model Rules for the lawyer's client. The CPA's client confidentiality duty is subject to serious limitations under both federal and state law (see, for example, the limited protection available under Sec. 7525). Thus, even though there is a common value of advocacy between the ABA Model Rules and Section 10.29 and practices regulated thereby, the standards of Section 10.29 must vary from and be more limited than the interpretation of the ABA Model Rule 1.7. Similarly, even though a CPA is required to act with integrity and objectivity, unlike most aspects of a CPA's practice, his or her practice under Circular 230 inherently involves advocacy. Thus, the interpretation of what is a conflict of interest under Section 10.29 will differ from that set forth in the AICPA professional standards. Unfortunately, the IRS and Treasury have not provided further guidance, and to date there is no case law or administrative law judge decision that could provide guidance as to how OPR will interpret Section 10.29.

Confidentiality in Multiparty Representations

In any multiparty representation, a CPA must consider, in addition to the above-stated standards and values, the confidentiality requirement under ET Section 301, as well as the practitioner-client communication privilege under Sec. 7525. Normally, a CPA's clients have a more limited right to confidentiality than under the attorney-client communication privilege, but that right is still of great significance. Commencing or continuing common representation would almost certainly be inappropriate if one client asks the CPA to not disclose to the other client information relevant to the common representation. The CPA must act with integrity and objectivity with respect to each client equally; each client has a right to be informed of anything bearing on the representation that might affect the client's interests and the right to expect that the CPA will use that information to the client's benefit. Therefore, in any consent to a waiver of conflict as required in Section 10.29, suspension of a client's rights to confidentiality under ET Section 301 and Sec. 7525 must be anticipated and provided for with respect to the other client being commonly represented.

The CPA should, at the outset of the common representation and as a part of the process of obtaining each client's informed consent, advise each client that the information will be shared and that the CPA will have to withdraw if one client decides that information material to the representation should be kept from the other. In limited circumstances, it may be appropriate for the CPA to proceed with the representation when the clients have agreed, after being properly informed, that the CPA will keep certain information confidential. For example, the CPA may reasonably conclude that not disclosing one client's trade secrets to another client will not adversely affect representation involving a joint venture between the clients and, with the informed consent of both clients, agree to keep that information confidential.

Potential Conflicts

Section 10.29 refers not only to actual conflicts but to situations where there is significant risk that representation of one or more clients will be materially limited. Thus, the potential for conflicts must be considered in appropriate situations.

If a conflict of interest may exist or may be likely to develop before an engagement is undertaken, the engagement must be declined unless the CPA obtains the informed consent of each client under the conditions set forth under Section 10.29(b). To determine whether a conflict of interest may exist or is likely to develop, a CPA should adopt reasonable procedures appropriate for the size and type of firm and practice and determine the persons and issues involved. It should be assumed that ignorance caused by failure to institute such procedures will not excuse a CPA's violation of Section 10.29. The CPA should carefully consider whether a CPA-client relationship exists or, having been established, is continuing. As an engagement proceeds, a CPA may become aware of additional conflicts. In each such instance, as discussed below, a new consent to waiver must be drafted and obtained.

If, after the engagement has been undertaken, a conflict exists, or if the CPA determines that there is significant risk that a conflict will likely occur (either because clients will be directly adverse to each other or because representation will be materially limited), the CPA must withdraw from the engagement unless he or she has obtained the written informed consent of all affected client(s) under the terms and conditions of Section 10.29(b). Whether the CPA may continue the engagement with respect to any remaining clients is determined by either the CPA's ability to comply with the duties owed to the former client or clients or by the CPA's ability to represent adequately the remaining client(s), given the CPA's duties to any former client.

Unforeseeable developments such as a change in corporate or other organizational affiliations or in personal relationships (such as divorce, pending divorce, or conflict between spouses) may cause a conflict during an engagement. A CPA may also become aware of facts that alert (or should alert) him or her to a conflict of interest. Depending on the circumstances, the CPA may have the option or requirement to withdraw from one of the engagements to avoid the conflict. The CPA must continue to protect the confidences of the client from whose representation he or she has withdrawn.

Identifying Directly Adverse Conflicts

Identifying conflicts of interest in directly adverse situations is critical to avoid undertaking an engagement that is directly adverse to a client without that client's informed consent. Thus, absent consent, a CPA may not act as an advocate in one federal tax matter against a person the CPA represents in some other matter (whether or not a federal tax matter). One example is spouses who are jointly liable with respect to a tax liability, but one spouse may have defenses to the detriment of the other spouse (such as the innocent spouse defense). It would be difficult if not impossible for the CPA to represent both spouses in such a situation because their interests are directly adverse to each other in a conflict for which consent probably cannot be waived. In such a case, the CPA may not ask both spouses to consent to common representation.

Similarly, with divorcing spouses, CPAs should carefully consider whether a conflict is consentable and whether drafting appropriate disclosures is appropriate if the CPA seeks a consent of waiver to a conflict. For example, a CPA is asked to represent the seller of a business in negotiations with the buyer, who is also a client of the CPA or the CPA's firm in an unrelated matter. The CPA could not undertake the engagement without the written informed consent of each client, and even then would do so at significant risk should the transaction turn sour. Outside a federal tax engagement, however, this may not be the case (compare AICPA Consulting Services Special Report 93-2, *Conflicts of Interest in Litigation Services Engagements* §110.17). Simultaneous representation of clients in unrelated matters where those clients' interests are only economically adverse does not ordinarily constitute a conflict of interest and thus may not require consent.

Material Limitation

Even where there is no directly adverse relationship, a conflict of interest exists if there is a significant risk that the CPA's ability to consider, recommend, or carry on an appropriate course of action for the client will be materially limited as a result of the CPA's other responsibilities or interests. For example, assume a CPA is asked to provide federal tax services to several individuals seeking to form a joint venture. The CPA's ability to recommend or advocate all possible positions that each client might take is likely to be materially limited because of the CPA's relationship and loyalty to the others, impairing his or her integrity or objectivity. The conflict, in effect, may foreclose alternatives to a client.

However, a mere possibility of subsequent harm does not require disclosure or consent. The critical questions are whether a difference in interests is likely to arise, and, if it does, whether it will materially limit or interfere with the CPA's independent professional judgment in considering alternatives or will foreclose courses of action that reasonably should be pursued on behalf of the client. In such a situation, a CPA should consider whether a consent to waiver of the conflict is appropriate or whether he or she should refuse the engagement altogether.

Relevant factors in determining whether there is a significant potential that the representation will be materially limited include the duration or intimacy of the CPA's relationship with the client(s) involved, the functions the CPA is performing, the likelihood that disagreements will arise, and the likely prejudice to the client from the conflict. The question is often one of proximity and degree. For example, a CPA may be called upon in connection with estate planning for several family members, such as a husband and wife, and, depending upon the circumstances, a conflict of interest may be present.

The CPA should not allow his or her own interests to have an adverse effect on the representation of a client. For example, if the probity of the CPA's own conduct or quality of work in a transaction is in serious question, it may be difficult or impossible for him or her to give a client detached advice with integrity and objectivity. Such a situation may occur if the CPA is representing a client at the IRS Office of Appeals and penalties are proposed to be imposed on the client with respect to a return that the CPA or his or her firm prepared. If the CPA learns that the IRS is proposing to assert penalties on the CPA (or another preparer in the CPA's firm) under Sec. 6694 in the same matter, the representation would be materially limited by the CPA's personal interest in avoiding a penalty (or action by OPR).

Consenting to Waiver

As indicated in Section 10.29(b), clients may not consent to some conflicts. This means the CPA cannot properly ask for such an agreement or provide representation on the basis of the client's consent. When the CPA is representing more than one client, the question of consent must be resolved for each client. The clients' ability to consent is typically determined by considering whether their interests will be adequately protected if they give their informed consent to a representation burdened by a conflict of interest. Thus, representation is prohibited if, under the circumstances, the CPA cannot reasonably conclude that he or she will be available to provide competent and diligent representation. Considerations include (1) possible effects on integrity and objectivity, (2) the Sec. 7525 practitioner-client privilege and confidentiality requirements under ET Section 301, and (3) the advantages and risks involved in the common representation.

Preventing or Resolving Conflicts

Whether clients can consent to a conflict depends on the circumstances. For example, a CPA should not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other. However, common representation is permissible where the clients are generally aligned in interests even though there may be some differences among them. Thus, a CPA may seek to establish or adjust an amicable and mutually advantageous relationship between clients. Examples could include helping to organize a business in which two or more clients are entrepreneurs, working out the financial reorganization of an enterprise in which two or more clients have an interest, or arranging a property distribution in settlement of an estate. In such instances, the CPA seeks to resolve potentially adverse interests by developing the parties' mutual interests. Otherwise, each party may have to obtain separate representation and perhaps face additional costs, complications, or even litigation. After considering these and other relevant factors, the clients may prefer that the CPA provide services to all of them.

In considering whether to represent multiple clients in the same matter, however, a CPA should be mindful that if common representation fails because the potentially adverse interests could not be reconciled, the result can be additional costs and other problems for all involved, including forced withdrawal from representing all the clients. Where adverse interests clearly are not likely to be reconciled, the risk of failure is so great that multiple representation is plainly impossible and thus nonconsentable. For example, a CPA cannot undertake common representation of clients where contentious negotiations are imminent or contemplated. Because the CPA is required to be impartial between commonly represented clients, representation of multiple clients is improper when it is unlikely that he or she could maintain impartiality and when integrity and objectivity could be impaired.

Under some circumstances, it may be impossible to make the disclosures necessary to obtain consent to a waiver. For example, when the CPA represents different clients in related matters and one of the clients refuses to agree to a disclosure necessary to permit the other client to make an informed decision, the CPA cannot properly ask the latter client to consent. The affected clients may need to consider the additional costs and benefits of separate representation in determining whether common representation is in each of their best interests.

Obtaining and Recording Consent

Section 10.29(b) requires the CPA to obtain the written informed consent of each client confirmed at the time that the CPA knows of the existence of a conflict of interest. Written confirmation may be made within a reasonable period after the informed consent, but no later than 30 days after.

Section 10.29(c) requires CPAs and other practitioners to retain copies of written consents for at least 36 months after the date of the conclusion of the representation of the affected clients, and the written consents must be provided to any IRS officer or employee on request. CPAs should consider, in consultation with legal counsel, whether to redact confidential portions of communications between clients and the CPA that may be subject to privilege under Sec. 7525.

The client's written confirmation does not supplant the need for the CPA to talk with each client and to explain any risks and advantages of the representation burdened with the conflict of interest, as well as reasonably available alternatives. This gives each client a reasonable opportunity to consider the risks and alternatives and to raise questions and concerns, as well as to object before any disclosures of confidential information are made to another client. As joint representations proceed, one or more of the clients may develop concerns regarding disclosures to other clients. The written confirmation is required not only to comply with Section 10.29 but to impress upon the clients the seriousness of the decision and to avoid disputes or ambiguities that could occur later.

A client who has given consent to a conflict may revoke that consent and may terminate the CPA's representation at any time. Whether a client's revoking consent to the representation precludes the CPA from continuing to represent other clients depends on the circumstances, including the nature of the conflict, whether the client revoked consent because of a material change of the circumstances, the reasonable expectations of the other client(s), and whether material detriment to the other clients or the CPA would result.

Special Situations

A CPA engaged by a corporation or other organization does not necessarily represent any constituent or affiliated entity, such as a parent or subsidiary. An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders, and other constituents. A CPA engaged by an organization may also represent a principal officer or major shareholder of that organization. In such an instance, the CPA should be alert to the potential for conflict of interest between the principal officer or major shareholder and the organization. Their interests may not be congruent and may be in conflict. For example, an organization's method of accounting for tax purposes desired by an equity holder for a particular item or expense may be in conflict with the best interests of the organization and the other equity holders.

Another special area of potential conflict is agreements prospectively limiting a CPA's liability from malpractice. Unless the client is independently represented in making the agreement, such agreements create the potential for a conflict of interest because they are likely to undermine competent and diligent representation. (This practice is also deemed to impair independence in an attestation engagement.) Many clients cannot evaluate whether they should make such an agreement before a dispute has arisen, particularly if they have been represented by the CPA seeking the agreement. This is an instance where the client's interests conflict with the CPA's personal interests. However, a CPA should not be prohibited from entering into an agreement with a client regarding alternative procedures to resolve a conflict, such as arbitrating malpractice claims, provided such an agreement is enforceable and the client is fully informed of the scope and effect of the agreement.

Obviously, after termination of a client-CPA relationship, the CPA has certain continuing duties with respect to confidentiality and conflicts of interest and thus may not represent another client except in conformity with the rules of Section 10.29. For example, a CPA who has represented multiple clients in a matter may not represent one of the clients against the others in connection with a federal tax matter that could cause the IRS to act adversely against the other clients, unless all affected clients give informed consent.

Conclusion

CPAs in federal tax practice face risks from potential conflicts of interest that they may not have fully identified or focused on. CPAs need to carefully analyze these risks and may as a result want to strengthen their client acceptance practices and procedures. Situations that bear special scrutiny include those involving services in multiparty representation situations, such as related entities and equity holders, spouses, and clients being represented before the IRS Office of Appeals.

TTA

EditorNotes

Thomas Purcell III is a professor of accounting and professor of law at Creighton University in Omaha, NE. Kenneth Horwitz is of counsel at Glast, Phillips & Murray, P.C., in Dallas, TX. Prof. Purcell and Mr. Horwitz are members of the AICPA's Tax Practice Responsibilities Committee. For more information about this article, contact Mr. Horwitz at kmh@gpm-law.com.

APRIL 29, 2013, MONDAY

DEPARTMENT: News, Commentary, and Analysis; Viewpoint

CITE: 2013 TNT 82-6

HEADLINE: 2013 TNT 82-6 BEWARE CONFLICTS OF INTEREST. (Release Date: APRIL 23, 2013) (Doc 2013-9902)

ABSTRACT: Kip Dellinger discusses IRS Office of Professional Responsibility Director Karen Hawkins's comments about the failure of tax practitioners, primarily non-attorney Circular 230 practitioners, to properly recognize and address conflicts of interest.

SUMMARY:

Published by Tax Analysts(R)

Kip Dellinger discusses IRS Office of Professional Responsibility Director Karen Hawkins's comments about the failure of tax practitioners, primarily non-attorney Circular 230 practitioners, to properly recognize and address conflicts of interest.Dellinger, Kip

GEOGRAPHIC: United States

REFERENCES:
Subject Area:
Tax system administration issues;
Professional responsibility;
Practice and procedure

TEXT:

Beware Conflicts of Interest

Release Date: APRIL 23, 2013

Published by Tax Analysts(R)

[Photo Omitted]Kip Dellinger is a CPA in Santa Monica, Calif. He is a former chair of the American Institute of Certified Public Accountants Tax Division's Practice Responsibilities Committee, and he writes and teaches in the areas of tax practice, quality control, and ethics. He is also the recipient of the 2011 Saul Braverman Memorial Award of the California CPA Society's Committee on Taxation for distinguished service in tax practice.

Dellinger discusses IRS Office of Professional Responsibility Director Karen Hawkins's comments about the failure of tax practitioners, primarily non-attorney Circular 230 practitioners, to recognize and address conflicts of interest. He suggests that commentators in the practitioner community inform professionals of the need to adhere to conflict provisions and discusses some areas in which practitioners are remiss in following the rules and their rationalizations for their conduct.

* * * * *

IRS Office of Professional Responsibility Director Karen Hawkins recently said that tax practitioners "should pay close attention to the potential presence of conflicts of interest but need not recuse themselves in every situation in which there's a conflict." [1]

The conflict of interest rules in Circular 230 section 10.29 are conceptually difficult for most non-lawyer practitioners, who generally are unfamiliar with conflict procedures, Hawkins said during an American Law Institute Continuing Legal Education webcast on Circular 230. After having been on several panels with Hawkins over the past three years, I've learned that awareness of the conflict of interest rules in the return preparer community is of paramount importance to the IRS.

Hawkins is correct in her assessment. Tax practitioners who write for and speak to other tax professionals, or who advise other tax professionals, regarding conduct matters need to regularly counsel their audience to recognize the potential for conflicts of interest in their work and to continually monitor client relationships to identify significant potential conflict situations.

Law schools and the legal profession in general place a strong emphasis on an attorney's recognition of, and sensitivity to, potential and actual conflicts of interest among parties. This includes conflicts not only among the parties but those with the attorney or firm. Consequently, although tax attorneys are usually well prepared to spot and address conflicts of interest in their work, other professionals often aren't as diligent.

A. Conflicts

Conflicts of interest are far more pervasive than most practitioners recognize. They can arise when several parties are involved in an enterprise or relationship and little thought is given to situations in which the parties' interests may vary. In those cases, practitioners can find themselves squarely in the middle of a tug of war between the once amicable parties.

These situations can involve married couples, family relationships involving business entities, partner and partnership tax issues, and corporation and officer/shareholder issues. The practitioner should evaluate the potential for conflict early in the engagement to prevent problems from arising later.

Other areas of concern are return preparation and giving advice on returns. After the IRS has examined the returns, issues related to potential taxpayer penalties might arise that would place the practitioner in conflict with the client. This may happen, for example, when there is an error in the return that could lead to assessment of the accuracy-related penalty. Although the practitioner may want to try to reduce his exposure to penalties or IRS disciplinary measures, that could create a prohibited conflict between the client and the practitioner.

B. Circular 230 and Conflicts

Circular 230 governs tax professionals in their federal tax practice activities. [2] Enrolled agents and registered tax return preparers who are authorized under Circular 230 [3] are subject to the conflict of interest provisions. And while attorneys and CPAs have their own professional standards on conflicts of interest, the provisions of Circular 230 must be followed when they are more extensive than, or differ from, the general standards of the profession. For example, oral waivers of conflicts of interest may be provided by clients to the lawyer or CPA in some areas of their practice, but Circular 230 requires a written waiver. [4]

C. Identification Is Critical

To properly deal with a conflict, a tax professional must first identify and define it, and then determine if representation is possible. The presence of a conflict does not necessarily mean that a practitioner must withdraw. Instead, when a conflict has been identified, the professional must have a conversation with the taxpayer. And because section 10.29 includes as potential conflicts "the significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person, or by a personal interest of the practitioner," the practitioner may need to address the matter with more than the one party. Great care must be taken to protect the confidentiality of all parties. If that is impossible, the professional should not represent any party.

The importance of identifying a potential conflict cannot be overemphasized. Generally, when an attorney assesses a prospective client representation, potential conflicts are evident. However, when initially engaged, the CPA, enrolled agent, or other representative usually fails to look beyond the mutual interests in the outcome.

The failure of non-attorneys to identify potential conflicts can seriously damage the taxpayers represented. For the practitioner, it can risk Circular 230 disciplinary exposure and lead to malpractice claims.

D. Directly Adverse Conflicts

Identifying conflicts of interest in directly adverse situations is crucial. Without consent, a practitioner may not act as an advocate in a federal tax matter against a person the practitioner represents in some other matter -- even if it's not tax matter. An example is a case involving spouses who are jointly liable regarding a tax liability, but one spouse may have defenses to the detriment of the other, such as an innocent spouse claim. It is probably impossible for the practitioner to represent both spouses in that situation, because their interests are directly adverse. The practitioner may not ask both spouses to consent to common representation.

Also, the tax practitioner must consider whether, in a divorce, a spouse may actually consent and whether drafting appropriate disclosures is appropriate if the practitioner seeks a waiver of a conflict. Similar difficulties arise in areas involving the representation of family members, partners and partnerships, fiduciaries, grantors, and beneficiaries of trusts and estates, and regarding corporations and shareholders.

E. Other Material Limitations

A conflict of interest exists if there is a significant risk that the tax practitioner's ability to consider, recommend, or carry out an appropriate course of action for the client will be materially limited as a result of her other responsibilities or interests. For example, assume she is asked to provide federal tax services to several individuals seeking to form a joint venture. The ability to properly advise on all possible positions that each client might take may be materially limited because of the relationship and loyalty to the others. Nonetheless, the mere possibility of harm does not require disclosure or consent.

The crucial question is whether an actual conflict of interest is *likely* to arise. And, assuming it does arise, whether it will materially limit or interfere with the tax practitioner's professional judgment when evaluating alternatives. The practitioner should consider whether a waiver of the conflict is possible or whether she should refuse to undertake the representation.

The tax professional must be mindful that the provision of advice on federal matters is regulated under Circular 230 and that when providing advice, the conflict of interest provisions must be heeded. It may sometimes be impossible to make the disclosures necessary to obtain consent to a waiver. For example, when a tax practitioner represents different clients in related matters and one client refuses to agree to a disclosure necessary to permit the other client to make an informed decision, the practitioner cannot properly request the second client's consent. The affected clients may need to consider the added costs and benefits of separate representation in determining whether common representation is in their best interests.

F. The Problem

The same requirement applies to the tax professional as to the doctor: Do no harm.

Acknowledging that fundamental duty is especially important in addressing conflict of interest matters, particularly for a non-attorney, who is often inadequately trained to identify either an actual conflict or the seriousness of a potential conflict. But those tax practitioners must also recognize the damage that can result from disregarding conflict of interest limitations to serve their client. This is a problem in the tax practitioner community, particularly among CPAs in smaller firms, who generally represent the type of clients and their entities for which conflicts are most prevalent. [5]

1. Ignorance. Too many practitioners don't even think about the conflict of interest potential when undertaking engagements for related parties whose interests may become adverse. Smaller firms and sole practitioners often represent a partnership and one or more of its partners, several family members and their trusts or estates, or corporations -- particularly S corporations -- and multiple shareholders. Of course, that is not prohibited, and potential conflicts rarely rise to a level requiring a conflict waiver or withdrawal.

However, practitioners must remain vigilant in monitoring all client engagements to identify changes in facts and circumstances under which:

- "There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person, or by a personal interest of the practitioner" [6] ; or
- "The representation of one client will be directly adverse to another client." [7]

Too often, the problems that arose were readily apparent and the practitioner undertook the engagement at significant cost or harm to a client anyway.

Practitioners must recognize that conflicts generally can't be solved just by withdrawal or by ceasing to represent one of the parties in a conflict situation and continuing to represent the other. (It is surprising how many practitioners believe resignation from one spouse in a divorce will permit them to continue representing the other spouse without a waiver from the first.)

Also, when advising clients on sensitive or complex tax matters, practitioners must be aware that a conflict may exist between the practitioner whose advice was relied upon and the client who could become subject to significant IRS penalty assessment.

Finally, the practitioner must be reminded of the risks in attempting to wear two hats and how that can hurt a client.

2. Privilege constraints. Non-attorneys frequently ignore the fact that the client's confidentiality privilege under section 7525 is very narrow, and virtually nonexistent in matters involving the preparation of a taxpayer's return. [8] The non-attorney practitioner's discovery of information that could damage a client itself creates a serious potential (and, in most situations, actual) conflict of interest with the client.

Tax practitioners, in attempting to be helpful and to earn fees, place themselves in the position of becoming a potential witness for the government in serious tax litigation. Tax practitioners often allow conversations with their clients to go on too long, past the point when the client should be referred to an attorney. That can happen when a client reveals previously undisclosed income, admits to inflated or misrepresented deductions, or discloses information on previously unreported foreign bank accounts and associated income.

3. Waiver. Circular 230 states: "Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if . . . the practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client." [9]

Perhaps not surprisingly, too many tax practitioners believe that a waiver is necessary only when the circumstances dictate withdrawal -- or they try to require the client to waive a conflict of interest in cases when most skilled tax practitioners would find themselves unable to meet the competent and diligent representation requirement.

Some practitioners request a waiver when a direct conflict exists between themselves and one or more affected parties. Those requests are unethical because they require the client to subordinate his interests to those of the representative. Again, an example would be situations involving possible preparer penalties.

4. Greed. Many of these problems arise not just from ignorance or from a lack of understanding of the absence of privilege, but from simple disregard, when the tax practitioner wants to charge a fee or fears losing a client. This is dangerous and unethical, because the tax practitioner is clearly placing her interest before the client's. But it happens all the time. And because often nothing detrimental to a taxpayer occurs, tax practitioners come to believe that adherence to professional standards is subject to their discretion.

Unfortunately, it takes only one adverse outcome to damage a client, and perhaps ruin a tax practitioner's career. A CPA may keep listening as the client reveals the reasons for not reporting significant earnings or foreign financial accounts for many years. Or a bar owner could reveal during the sale of the business to a third party that the bar's gross receipts are thousands of dollars more than what is shown on the financials, justifying a higher sales price.

5. Excuses. Some practitioners may argue that they need to perform services for clients in potential conflict situations because the client can't afford the services of multiple professionals or the services of an attorney. [10]

Or they'll argue that the clients don't want anyone else to handle the matter because they trust their longtime tax practitioner. Or that the client simply won't pay for the necessary professional services to prevent a possible conflict.

And finally, "I know my clients really well, and no adverse outcome is going to occur, so none of this stuff should be of concern."

These are all rationalizations designed to allow the tax practitioner to ignore conduct standards set forth in Circular 230 that are not dependent on the money involved or the client's needs. They are merely excuses. And they are too often simply the result of a tax practitioner fearing the loss of a revenue stream.

Above all, they compromise a client's best interests (regardless of the client's view of the matter) to serve the interests of the tax practitioner. Needless to say, this is a fundamental breach of the overriding duty of due care that all tax practitioners owe their clients.

FOOTNOTES:

n1

See Jeremiah Coder, "Recusal Not Always Required in Conflicts, Hawkins Says," *Tax Notes*, Apr. 1, 2013, p. 35 (Doc 2013-7491).

↑n2

While the Circular 230 section 10.29 conflict of interest provision is based on American Bar Association Model Rule 1.7, it does not include all the interpretations on which the model rule rests.

↑n3

The extent to which Circular 230 applies to persons other than attorneys, CPAs, enrolled agents, enrolled actuaries, and appraisers is uncertain. Nonetheless, to the limited extent any otherwise nonlicensed person is permitted to represent a taxpayer before the IRS under Circular 230, the conflict of interest provisions apply.

↑n4

See Circular 230, section 10.29(b)(3). Section 10.29 requires that if the tax professional proceeds with representation, all affected parties must provide a written acknowledgment of the conflict and a waiver of it. Oral waiver may be initially obtained, but each affected client must waive the conflict of interest and provide written, informed consent within 30 days.

↑n5

Unfortunately, the author has encountered evidence of this problem when serving on panels and at continuing education events.

↑n6

Circular 230, section 10.29(a)(2).

↑n7

Circular 230, section 10.29(a)(1).

↑n8

See Kip Dellinger, "The Statutory FATP Privilege," *Tax Notes*, Jan. 24, 2011, p. 475 (Doc 2011-1143).

↑n9

Circular 230, section 10.29(b)(1).

↑n10

This is often cited by non-attorney tax practitioners as justification for handling disclosures under the different offshore voluntary disclosure programs. One possible adverse outcome is that the client is refused admission because the IRS already had the information. The IRS would have the name of the non-privileged practitioner with whom the client has likely communicated potentially damaging information.

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