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ETHICAL RELATIONSHIP OF LAWYER AND C. P. A. IN INCOME TAX PRACTICE

by

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This independent study submitted by George E. Nellermoe in partial fulfillment of the requirements for the Degree of Master of Science in the University of North Dakota is hereby approved by the Committee under whom the work has been done.

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INTRODUCTION

Who can perform services in a speciality field, such as tax practice where the question of law and accounting are so closely associated that there may be no line of demaracation? Should such practice be handled by the lawyer, CPA, lawyer and CPA, or an individual with dual qualifications?

The actual controversy between CPA's and Lawyers over rights in tax practice started with the 16th amendment to the constitution but was not officially brought into the open until 1932. The steps that have been taken by the two professions in establishing an ethical relationship in tax practice will be cited, based on proposals made by the individual and joint ethics committees plus views of leaders in the individual professions.

The preceding questions and proposed solutions will be analyzed to determine the possible future developments for cooperative practice.

I. PROFESSIONAL ETHICS AND PUBLIC OPINION

A brief history of each profession is necessary before discussing the ethical boundaries of the two professions in tax practice. The history of the accounting profession will be given first.

The earliest accounting firms in the United States are believed to have been formed by Scottish and English Chartered accountants. One of the first actions taken by this group was to form, in 1887, the American Association of Public Accountants. In 1896, New York State enacted the first Cetified Public Accountant's law which provided for the issuance of a certificate to all candidates who successfully passed a written examination administered by the New York State board of accountants. Similar laws were later enacted by all states and territories. Today the American Institute of Certified Public Accountants offers a Uniform Certified Public Accountant examination to state boards of accountancy. These tests are given simultaneously on the same days covering auditing, accounting theory, accounting practice, and commercial law.

In 1916, the American Institute of Accountants was reorganized into the American Institute of Certified Public Accountants with the objectives of raising standards of the profession by regulating practitioners and establishing ethical codes to guide the profession. Its constitution sets forth the

following objectives:

1. Unite accounting profession of United States.
2. Promote and maintain high standards.
3. Safeguard interest of public accountant.
4. Advance science of accounting.
5. Improve accounting education.
6. Provide exam for membership.
7. Encourage cordial intercourse between accountants.

Each state has followed the example of the American Institute of Certified Public Accountants and has established statutes to regulate the practice of the Certified Public Accountants in all states.[1] Only those accountants who have met and passed requirements of the American Institute of Certified Public Accountants examination may be designated a CPA.

While the accounting profession is a relatively new profession, the legal profession dates back to around the year 1200. Law in the United States was studied in the Inn of Court from which students carried knowledge back to their home communities. The progress of the legal profession was curtailed in the mid 19th century when both it and the Bar Associations were deemed undemocratic and un-American. As a result of this action the law profession reached its lowest ebb right after the Civil War.

By 1875, leading lawyers realized what was happening and began to reestablish and rebuild standards of character, education, training, and to organize professional Bar Societies throughout the country. The profession has done a tremendous job. Now every state has requirements of education and legal training plus an examination as a means of insuring high standards of those who practice law.

The American Bar Association, which was organized in 1878, fostered the establishment of bar societies in all states because lawyers realized that:

> It is the Bar Association, not the individual lawyers that can maintain high educational standards insuring a learned profession, that can maintain high standards of character as a prerequisite of admission to practice, that can formulate and maintain high standards of ethical conduct in relation both with clients and with courts. The public has a deep interest in having a well organized bar, part of the machinery of administering justice in a complex social and economic order.[2]

What should "profession" mean to the public? "A profession consists of a limited and clearly marked group of men who are trained by education and experience to perform certain functions better than their fellowmen."[3] A further criterion is that it must give evidence of advance preparation and skill through standards to eliminate unfit members.

The professions cannot rely on the public to punish offenders because most often instead of directing legislation against and boycotting offending members the public condemns and punishes the professions at large. Thus, each profession must establish certain standards of conduct for control and public policy.

Both the American Institute of Certified Public Accountants and the American Bar Association have adopted formal procedures for disciplining offending members. The rules or standards the members must abide by are known as the "Rules of Professional Conduct" for Certified Public Accountants and "Canons of Professional Ethics" for the Lawyers. Neither of

these will be reproduced in this paper but frequent reference will be made to them.

Enforcement of these rules is attained through their professional societies, state statutes, courts, and government bodies.

Ethics are the necessary standards by which professional men distinguish right from wrong. These standards are formulated not only to assure cordial relationship among members but also to provide moral persuasion and a tangible basis for public judgement. The profession may also use them as a standard for self judgement.[4]

The code of ethics places the practice of the Certified Public Accountant on the same level as any profession which renders expert service to the general public. These rules and precepts are designed to reflect a professional attitude, behavior, and product on the part of the Certified Public Accountant and to build, maintain, and increase public confidence in the accounting profession. The more rigid the code of ethics the greater will be the esteem and confidence of the public.[5]

Like the accountants code, the legal ethics were first formulated and adopted by a state. In the case of professional ethics this was done by the state of Alabama in 1887. Using as a basis the ethics adopted by the states, the American Bar Association later adopted its own code and by 1914, 31 states had adopted a similar code; some for the first time, others in

place of their state code or as a combination of the state and national codes.

The American Bar Association Standing Committee on Professional Ethics which was established in 1914 was changed to the Committee on Professional Ethics and Grievances. This committee is now authorized to express its opinion concerning proper professional or judicial conduct when consulted by members of the Bar or by any officers or committee of a state or local bar association.

The legal profession grants those admitted to the Bar some exclusive rights and privileges in return, for which, the lawyer has an obligation to perform in a ethical manner.[6] By adopting and uniting their practice under a professional code the legal profession has come again to be recognized by the public as one of the leading professions as evidenced by the Survey of Legal Professions.[7]

CHAPTER I ENDNOTES

1.Penny, Louis H., "The American Institute of CPAs-Past and future," Journal of Accountancy, January, 1962, p 34.

2.Pound, Roscoe, The Lawyer from Antiquity to Modern Times, West Publishing Co., 1953, p 11.

3.Taeusch, Carl F., Professional and Business Ethics, Henry Holt and Company, 1926, p 13.

4.Holmes, Arthur W., Auditing Principles and Procedures, 5th. Ed., Chapter 3, p 51.

5.Johnson, Arnold W., Principles of Auditing, Rinehart and Company, Inc., N.Y., 1955, p 2.

6.Drinker, Henry S., "Legal Ethics," Bylaws, Art. X, Sec. 12.

7.McCracken, Robert T.,"Report on observances by the Bar of Stated Professional Standards," 37 Virginia Law Review XX, 399,1951.

II. INTERPROFESSIONAL CODE FOR ATTORNEY AND C. P. A.

The philosophy of practice and ethical standards of the legal and accounting professions are substantially identical in their emphasis on obtaining the greatest public good and providing the most responsible public service possible. "Both professions have common requirements of basic and technical education, good moral character, passing of a professional examination, and both are subject to disciplinary control through similar codes of ethics of their professional associations."[1]

Now that a little background of professional ethics has been given let us consider the areas in which most of the ethical clashing between the two professions takes place...tax practice.

Ethical problems are continually arising in the tax field which neither profession has been able to solve. To illustrate, the rules of Professional Conduct of the American Institute of Certified Public Accountants throughly defines the Certified Public Accountant's ethical responsibility in his capacity as an independent auditor, yet remains silent on his ethical responsibilities in tax practice. Both professions, however, realize the need for rules of practice in the tax field.

One reason for this deficiency may be that tax practice is not the exclusive field of either the legal or accounting profession but is a mixed practice. Neither profession has

formulated canons or rules of ethics specifically for tax practice. Each profession uses its own rules as a basis for discipline within this area.[2]

Misunderstanding by members from both professions has nourished the controversy over rights in tax practice. Where does accounting end and law begin and vice versa? Each profession tried to work independently of the other until the 1930's when the first step towards a cooperative effort of the two professions was made as a result of the "unlawful practice of law" issue. Both professions, through the American Bar Association and the American Institute of Certified Public Accountants, presented their position on this matter but neither would accept the other's proposal.

The committees, by working together in this area realize the "question of accounting and question of law are frequently intertwined in the same state of facts." [3] Thus, it is difficult to draw a precise line in tax practice between the field of the accountant and the field of the lawyer. Unless it is recognized that a common ground exists for the lawyer and accountant in tax practice, a line of demarcation must be drawn and observed. Tax practice is a hybrid of law and accounting. The accountant should either be permitted to practice law or be allowed jurisdiction over incidental questions of law and denied the right as a consultant to give advice.

In 1944, the Joint Committee was dropped and a new organization was created called the National Conference of

Lawyers and CPAs which consisted of five members from the American Bar Association and five from the American Institute of Certified Public Accountants. This group worked together and adopted the following resolution for tax practice:

> 1. That the public will be best served if income-tax returns are prepared either by CPAs or lawyers.
>
> 2. That it is in the public interest for lawyers to recommend the employment of CPAs and for CPAs to recommend the employment of lawyers in any matters where the services of either would be helpful to the client; and that neither profession should assume to perform the functions of the other.
>
> 3. That CPAs should not prepare legal documents, such as articles of incorporation, corporate by-laws, contracts, deeds, trust agreements, wills, and similar documents. Where in connection with such documents, questions of accountancy are involved or may result, it is advisable that CPAs be consulted.[4]

No further cooperative accomplishment was made until 1951, when several court decisions revived relations. That same year the National Conference issued a joint Statement of principles relating to practice in the field of Federal Income Taxation.

The preamble is as follows:

> In our present complex society, the average citizen conducting a business is confronted with a myriad of governmental laws and regulations which cover every phase of human endeavor and raise intricate and perplexing problems. These are further complicated by the tax incidents attendant upon all business transactions. As a result, citizens in increasing numbers have sought the professional services of Lawyers and CPAs. Each of these groups is well qualified to serve the public in its respective field. The primary function of the lawyer is to advise the public with respect to the legal implications involved in such problems, whereas the CPA has to do with the accounting aspects thereof. Frequently the legal and accounting phases are so interrelated and interdependent and overlapping that they are difficult

to distinguish. Particularly is this true in the field of income taxation where questions of law and accounting have been inextricably intermingled.

The principles issued by the Joint Committee were adopted by both the American Bar Association and the American Institute of Certified Public Accountants. These principles, although they have no legal effect, are a large step toward improved relations of the two professions.

The principles as listed in the Joint Statement are:

> (1) it is proper for either to prepare tax returns, but lawyers should consult accountants on accounting problems, and vice versa; (2) in ascertaining the probable tax effects of transactions, when uncertainties of interpretation of law arise, the accountant should advise the taxpayer to enlist the services of a lawyer; and when question of accounting or the interpretation of the financial results, the lawyer should advise the taxpayer to enlist the services of an accountant; (3) only a lawyer may prepare legal documents, and only an accountant may advise as to preparation of financial statements and as to accounting methods of procedure; (4) descriptions such as "tax consultant" or "tax expert" are objectionable for either profession; (5) since both lawyers and accountants are authorized to represent taxpayers in proceedings before the treasury department, lawyer should consult accountants when accounting problems arise, and accountants should consult lawyer when legal problems arise; (6) though nonlawyers may be admitted to practice before the Tax Court, it is in the best interests of the taxpayer that the advice of a lawyer be sought when a notice of deficiency is issued, since a choice of remedies is offered the taxpayer; (7) lawyers and accountants may prepare claims for refund, though lawyers should be consulted when controversial legal issues or possible litigation is involved; (8) lawyers should be consulted when there is a possiblity of criminal prosecution.[6]

The conclusion of the Joint Statement emphasised that the Joint Statement of Principles is a tentative statement and subject to revision and amplification with future experience. The principal objective is to indicate the importance of voluntary

cooperation between the two professions whose members should use their knowledge and skills to the best advantage of the public. They also recommend that the local societies of these professions establish similar statements.

Negotiations continued between the American Institute of Certified Public Accountants and the American Bar Association Committee on Professional Relations and in 1958 two important steps were made. The first step was the amendment to Circular 230 which added a formal definition of "practice" before the Internal Revenue Service. The other step was made in helping to settle the problems presented in the association of the lawyer and the CPA practitioner.

CHAPTER II ENDNOTES

1.Austin, "Relations Between Lawyers and CPAs in Income Tax Practice," Journal of Accountancy, 805, 807, 1951.

2.Carey, John L., "Practical Application of Professional Ethics," CPA Handbook, Chapter 5, Volume I.

3."Relationship Between Lawyers and Certified Public Accountants in Federal Tax Practice," Monthly Digest of Tax Articles, October, 1963, p 11.

4.Levy, Saul, "The Scope and Limitations of Accountants' Practice in Federal Income Taxation," Journal of Accountancy, June, 1950, p 472.

5.Monthly Digest of Tax Articles, op. cit. p 12.

6.Ibid., p 13.

III. PROBLEM AREA IN DUAL PRACTICE

The positions taken by both professions have varied over the years. When the question of ethics of dual practice was raised by the National Conference of Lawyers and CPAs in 1946, neither profession had a regulation in their code to prohibit such action but they did pass on the desirability of such practices.

The American Institute of Certified Public Accountants rules of professional conduct prohibit members from engaging in any business or occupation conjointly with the practice of public accounting, which is incompatible or inconsistent. In their opinion the dual practice would not be incompatible or inconsistent but they do think it is undesirable. The undesirability may be outweighted in tax practice where questions of law and accounting are frequently intermingled and an individual may combine the knowledge and skill of a lawyer and a certified public accountant to benefit his client.[1] Therefore, it seems clear that the accounting profession does sanction dual practice from a ethical standpoint.[2]

On the other hand, the American Bar Association Committee on Professional Ethics expresses the opposite view. They feel that even through they have no restriction in their canons, a lawyer should not hold himself out as employable in another independent professional capacity.

No definite action was taken to change the preceeding opinions until February 24, 1961, when the American Bar Association Committee on Professional Ethics issued Opinion No. 297. This opinion is a reiteration of the 1946 American Bar Association disapproval of dual practice and declares that a person with dual qualifications "must choose between holding himself out as a lawyer and holding himself out as an accountant."[3]

Many problems connected with business require the combined skills of the lawyer and the certified public accountant. Although close cooperation is desirable, it may create problems of ethical conduct that are detrimental to the profession and to the public.[4]

The relationships that may create ethical problems are:

1. Lawyer employed by Certified Public Accountant.
2. Certified Public Accountant employed by law firm.
3. Partnership between Lawyers and CPA.
4. Individual who possesses dual qualifications.

1. Lawyers employed by CPA firm.

Canon 35 of the Canons of Professional Ethics of the American Bar Association prohibits control of professional services of a lawyer by a lay agency. His relation must be personal and direct to the client. According to the committee on Grievances of the American Bar Association "a lawyer may properly be employed by a firm of accountants on a salaried basis to advise the accounting firm, but such employment may, under no circumstances, be used to enable the accounting firm to render legal advice or legal services to its clients."[5]

The mere employment of a lawyer does not raise any

questions of ethics or proper accounting practice if he renders services that a CPA firm is authorized to render. The American Institute of Certified Public Accountants code of conduct does not forbid employed lawyers from practicing law on their own free time but the CPA firm could not participate in fees for such services.[6]

2. CPA employed by a law firm.

The relationship is proper providing the function of CPA is to act on behalf of law firm itself, but not if on behalf of a client of the law firm.

The American Institute of Certified Public Accountants does not consider it unethical for a CPA to work under his own name unless he shared fees with the lawyer-employer for services rendered.

Publication of any type of relation is prohibited by the American Bar Association Canon 27 and the American Institute of Certified Public Accountants Rule 4. To avoid a misunderstanding by the public no reference should be made to the association or employment of a CPA by the law firm.

3. Partnership between lawyers and CPAs.

Canon 33 of the Canons of Professional Ethics of the American Bar Association prohibits partnership with non-lawyers. But the Ethics and Grievances Committee ruled that the relationship is permissible in income tax work if the lawyer completely disassociates from law practice.[7]

"Neither a lawyer nor an accountant may retain membership

in both a law firm and an accounting firm at the same time."[8] If the individual shall choose to practice law, then he may not at the same time hold himself out to his clients or to the public as qualified to serve as a CPA and vice versa.[9]

4. Dual qualifications.

The Committee on Professional Ethics and Grievances of the American Bar Association does not sanction dual practice because of Canon 27, which states, that joint practice by a lawyer-CPA results in indirect soliciation of business.

The American Institute of Certified Public Accountants Committee on Professional Ethics says that besides the fact that dual representation implies special ability, a lawyer-CPA engaging in the joint practice of law and accounting occupies a divided position as a lawyer with the duty of loyalty to his client on the one hand and as a CPA with a duty of impartiality on the other.[10]

As mentioned earlier in this paper the American Institute of Certified Public Accountants does not consider it unethical to be dually qualified but they think it is undesirable; because as a rule, each field is too vast for one to attempt to practice both.

There is no provision in the Canons precluding a lawyer from being a CPA, or from using his knowledge and experience in accounting in his law practice. The committee is divided as to whether the Canons impliedly forbid a lawyer to practice accounting where it is done in accordance with the Canons and

not for purposes of feeding his law practice.

As a practical matter, however, a lawyer could not properly carry on a considerable accounting practice and keep it independent of his law practice or avoid other violations of the Canons.[11] In Opinion 257, Canons 33, 34, 35, and 47, a partnership between a lawyer and accountant in income tax work is permissible only if the lawyer ceases entirely to hold himself out as such.

CHAPTER III ENDNOTES

1."Official Decisions and Releases-accountants and Lawyers," Journal of Accountancy, 1947, p 172.

2.Hughes, Benny H., "Outlook for the Lawyer-CPA," The Texas CPA, May, 1961, p3.

3.Ibid., p 5.

4."Bar committee proposes ban on dual practice by lawyer-CPA; limits publicity," Journal of Taxation, October, 1958,p 198.

5."official Decisions...," ob. cit. Opinion No. 272, October 26, 1946.

6.Ibid., 1947, p 171.

7.Ibid., No. 269, June 21,1945.

8.Journal of Taxation, October, 1958, ob. cit., p 200.

9.Ibid.,

10."Legal Ethics," Harvard Law Review, Volume 63, 1457, 1458, 1950.

11."Official Decisions...," ob. cit., Opinion No.269, June 21, 1945.

IV. FUTURE OF DUAL TAX PRACTICE

Dual practice will be limited to those who are dually qualified to practice both accounting and law by meeting and passing all requirements of the individual professions. This does not include those of either profession hired by the other profession; thus, making it possible for the firm to provide services of both professions.

Do dual qualified persons have a future in tax practice?

Let us consider the individual practitioner who may be in a small community where he is the only qualified lawyer or CPA. In referring to an earilier statement made under dual qualifications, "the practice of both professions by one person affords the public the opportunity of more inexpensive and better service...."[1] If the attorney or accountant is allowed to practice where he can utilize his special skills to the public's best interest with more competence than could either an attorney or an accountant, then joint practice can hardly be called inherently unethical. It also provides a substantial saving to the small businessman, who might not otherwise be able to afford to retain both an attorney and an accountant.[2]

Also there is the problem in a small community that the lawyer or accountant is not interested or engaged in tax practice. This results in more encroachment on the other profession

than is desirable or that is permitted in communities which are properly and adequately served by both professions.[3]

Now let us consider the other side. What is the future of a dually qualified person in a large concern? This reverts to one of ethical relationship of one profession being employed by another. According to the individual's professional code, neither profession can ethically hire or employ persons to perform services other than those which the perticular firm is authorized to perform to the public.

The growth of national and international corporations has necessitated the development of national and international law and accounting firms to handle the complicated tax matters and corporation problems. The two can ethically work together but as a rule, each field is too vast for one to attempt to practice both.

The ultimate objective of the rules of ethics is the protection and advancement of the public interest; therefore, ethical propriety of joint practice must rest on the value to the public.

Both groups owe it to their own future and to the interest of the public to seek to solve differences peaceably and to adopt a course that seems feasible. The fact that neither profession has adopted an official policy on tax practice should not affect or delay mutual understanding on the rightful place of the two professions in the tax field.

CHAPTER IV ENDNOTES

1.Journal of Taxation, October, 1958, ob. cit. p 199.

2.Ibid.

3.William J. Jameson, Co-operation Between the Legal and Accounting Profession, Journal of Accounting, November, 1956, p 42.

CONCLUSION

The Sixteenth Amendment brought chaos to the law and accounting profession over ethical rights in tax practice.

At first the professions tried to apply their individual codes to this new field, tax practice, but this left much to be desired. Through cooperative efforts the two societies have been trying to devise a code that is more acceptable to this area, where the questions of law and accounting are so closely intermingled.

Several proposals have been made by minority groups within each profession but each group is interested only in advancement of their own private interests. Therefore, the two societies, the American Bar Association and the American Institute of Certified Public Accountants, have established a joint committee to work out an acceptable solution. No adequate solution has been advanced, as yet, but with the continued cooperation of the two major groups through the joint committee a solution may be obtained in the near future.