

Back to the Future!

By Charles P. Rettig

In light of indictments involving highly credentialed tax practitioners, Charles Rettig suggests best practices for tax practitioners to help their own reputations and the reputation of the profession.

Have the terms “tax” and “professional” become mutually exclusive? As tax practitioners, most of us maintain extremely high standards for care and competence. Although we diligently represent the interests of our clients, we do so as professionals cognizant of our role in the system of tax administration. Information set forth on a tax return, signed by a paid return preparer, must be substantially accurate with a reasonable foundation and reasonable support for the characterization of items set forth within the return. Tax returns simply should not be perceived as an offer to negotiate with the government!

More so than ever before, now is the time to demonstrate the strength of your character as a proud member of the tax profession. Many highly credentialed tax practitioners have recently been named in criminal indictments emanating from the Southern District of New York. If convicted, these practitioners are facing many, many years of potential incarceration. The indictments assert, in part, that 19 tax practitioners (which included 17 former employees of KPMG, a former Brown and Wood lawyer and an investment advisor) and other “unindicted co-conspirators” conspired to do some or all of the following:

1. prepare false and fraudulent tax returns;
2. prepare false and fraudulent factual representations as part of the underlying documentation and issuing tax opinions based on those representations;
3. conceal listed transactions from the IRS by failing to register them; and
4. impede IRS examinations by knowingly failing to produce summonsed documents.

On August 11, 2005, a former New York-based

executive of the HVB Group of Germany pled guilty to charges of conspiracy, fraud and tax evasion in connection with the sales of certain structured transactions. On March 27, 2006, a former KPMG Partner in San Diego pled guilty to charges of conspiracy and tax evasion, and agreed to cooperate with the government in a widening inquiry into other accounting firms, banks, law firms and others involved in the creation and marketing of structured transactions in the late 1990s and early 2000s.

How did we get to the indictment of otherwise highly qualified tax practitioners, some of whom rose to highly visible positions of authority and responsibility? More importantly, how do we restore public confidence in the reputations and abilities of practitioners in general? The interactions of every practitioner with each client, government representative, judge and colleague is vitally important to the process of restoring the credibility and integrity of our profession. You can make a difference with a bit of effort and a lot of care and concern for your reputation while representing others.

The IRS has significantly enhanced its enforcement efforts since being attacked by Senator Roth and others in 1997-1998. The tax gap is comprised of under-reporting of income, underpayment of taxes and the nonfiling of returns. The IRS's most recent estimates, based on returns for tax year 2001, indicate that the gross tax gap is between \$312 and \$353 billion dollars annually. These amounts are reduced for late voluntary payments or as a result of IRS collection activity, resulting in a net tax gap of between \$257 and \$298 billion dollars annually (representing a noncompliance rate of 15–16 percent). Since the IRS receives approximately 130 million individual income tax returns each year, the average return includes a “surtax” of about \$2,000 to make up for tax revenues lost to noncompliance.

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The IRS currently is placing a priority on combating corporate tax shelters and abusive schemes used by high- individual taxpayers. The direct revenue gains from a single audit are much higher for these taxpayers than for “Mom and Pop.” Based on the updated tax gap data, however, the IRS must develop a longer-term focus, particularly with respect to the cash economy. Abusive transactions have largely been eliminated. As such, tax revenues from abusive transactions will be similarly eliminated within the next few years. The IRS must enhance its focus on the various elements of the tax gap. Approximately 67 percent of the tax gap is attributable to self-employed individuals. Underreporting by self-employed individuals represents approximately 43 percent of the gross tax gap. Approximately 80 percent of this underreporting is attributable to understated income, rather than overstated deductions.¹ Self-employed

individuals and other cash economy participants tend to understate their income, which is not subject to withholding or information reporting. IRS research indicates that taxpayers whose wages are subject to withholding report about 99 percent of their income. Similarly, taxpayers report about 96 percent of their income that is subject to information reporting. In contrast, taxpayers whose income is not subject to withholding or information reporting report about 68 percent of their income. This percentage drops to about 20 percent for sole proprietors operating within the national arena, such as street vendors, door-to-door sales persons, contractors and others.²

For years, longevity and career enhancement within the IRS have been based on a system of information flow that mirrors the comments and desires of current leadership. While practitioners have historically been characterized as the pillars of the system of taxation, some within IRS leadership believe that practitioners have actually become the “architects of its circumvention” through the erosion of professional standards within the practitioner community. IRS Commissioner Mark Everson has brought a “laser-like focus” to tax enforcement and, in particular, tax practitioners. Be careful, be a credible professional and operate with a high degree of integrity and be cognizant of the relative lines of reasonableness with

respect to each and every position you take on behalf of your client and yourself.

The “kinder, gentler” IRS of the late 1990s led to an unprecedented decline in IRS enforcement. Declining enforcement relies on a strong voluntary compliant constituency. Increased penalties do *not* increase compliance; increased tax enforcement increases compliance. Increased penalties only increase penalties on a smaller class of taxpayers actually discovered by a relatively ineffective taxing agency. A low examination rate may only encourage certain taxpayers and practitioners to push the compliance

envelope, since a low risk of detection could then be deemed worthwhile.

The enforcement decline following the IRS Restructuring and Reform Act of 1998³ has been obliterated. Audits, collections and criminal investigations have all improved significantly. However, the IRS con-

tinues to be resource-challenged. It must maintain an appropriate presence in each taxpayer and professional neighborhood—not only in the high-rent district. Initiatives administered without strong detection and enforcement efforts will not likely succeed. However, perceptions as to detection and enforcement are keys to an effective compliance response. The strategic placement of an empty police car will have a more significant impact than a motorcycle officer hiding in the bushes

Included within the IRS strategic enforcement priorities for the five-year period concluding in 2009 is a “laser-like focus” on professional responsibility to assure that attorneys, accountants and other tax practitioners adhere to professional standards and follow the law. There is a strong belief that the integrity of the system of taxation must rely on practitioners “doing the right thing.” These enforcement priorities have obviously been enhanced by well-targeted criminal investigations of practitioners and taxpayers, designed to generate sufficient publicity as a means of deterring others from following down the same or similar path.

In the current enforcement environment, how much disclosure is actually enough? If a government agent fails to ask the right question, does a practitioner have a duty to provide “all” the facts? Can assertion of a

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valid privilege somehow constitute the obstruction of justice? Should a practitioner only take a position when specifically authorized by the Internal Revenue Code, or can they pursue the position when there is nothing in the Code to prevent it? Should Congressional intent be taken into consideration when attempting to analyze the application of a relevant statute to a particular set of facts? Does “ethical” merely mean that it’s legal, or that it passes a risk/reward analysis? When does good, strong taxpayer representation become tax evasion, conspiracy or the obstruction of justice?

It is the practitioner’s responsibility to make sure the clients follow the law and observe appropriate standards. Our system of tax administration depends upon the integrity of the practitioners. We must lead the way for our colleagues, clients and others. Leadership stresses correctness—personal integrity is frequently the cornerstone of a leader’s success. “Leaders are not born, they are made; and they are made just like anything else, through hard work.”

(Vince Lombardi). Set high standards, create a plan, follow it, and accomplish your goals.

What is the future of the tax profession? The future will depend on each of us. Now is the time to step up to the plate, be a professional, and help the profession. Do not allow the alleged actions of others to impeach the historical reputation of the profession for credibility and integrity. Continue to operate under your personal “best practices” code and be a proud member of the tax community! Reputations are earned (and lost) everyday . . . Do what you can to help your clients, yourself and your profession! You can make a difference!

ENDNOTES

- ¹ Internal Revenue Service National Headquarters Office of Research, Tax Gap Map for Year 2001 (June 7, 2005).
- ² Written statement of Nina E. Olson, National Taxpayer Advocate, before the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, United States Senate, October 26, 2005.
- ³ IRS Restructuring and Reform Act of 1998 (P.L. 105-206).

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