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Practice

Is It Time for an “Engagement Check-up”?

By Guinevere Moore

At the beginning of every engagement, tax professionals perform a series of checks to determine whether they can take on a new matter:

1. Am I competent to take on this matter? In other words, does the professional possess the legal knowledge and skill required, and if not, can the lawyer get competent?
2. Would taking this matter result in a conflict of interest with a current client? A former client? A future client?
3. Do I as the lawyer, CPA, or Enrolled Agent have a financial interest that would materially limit my ability to zealously represent this client?
4. Are my fees reasonable for the work that will need to be performed?
5. Do I believe that the claims the client wants me to advance have merit?

These are just some of the considerations that attorneys and other tax professionals weigh when determining whether to accept or decline new representation. All too often, however, after a client relationship has been formed, professionals forget to re-run through the same checklist to consider whether the representation is still viable and in the best interest of the professional or, more importantly, the client. Professionals should take care to reevaluate representation on at least an annual basis to consider whether the representation should continue. Failure to take a fresh look at engagements will likely result in negative consequences for both the tax professional and the client. This column examines two of the most important factors that tax professionals should re-evaluate on at least an annual basis to ensure that all representations are appropriate: competence and conflicts of interest.

Competence

All tax professionals are charged with a duty to be competent in the work being performed.

The American Bar Association Model Rules (“Model Rules”) provide: “A lawyer shall provide competent representation to a client. Competent representation requires legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.”¹

AICPA Code of Professional Conduct (“AICPA Code”) Provides: “Competence is derived from a synthesis of education and experience. ... The maintenance

of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements ... each member should undertake to achieve a level of competence that will assure that the quality of the member's services meets the high level of professionalism required by these Principles."² "If a member is unable to gain sufficient competence, the member should suggest, in fairness to the client and public, the engagement of a competent person to perform the needed professional service, either independently or as an associate."³

Professionals should take care to reevaluate representation on at least an annual basis to consider whether the representation should continue. Failure to take a fresh look at engagements will likely result in negative consequences for both the tax professional and the client.

Regulations promulgated under Title 31 of the United States Code section 330 governing practice before the Service are published in the Code of Federal Regulations and in pamphlet form as Treasury Department Circular No. 230 ("Circular 230") provide: "A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. A practitioner may become competent for the matter for which the practitioner has been engaged through various methods, such as consulting with experts in the relevant area of studying the relevant law."⁴

Each of three relevant ethical guidelines have a baseline competence requirement that must be met for a tax engagement. Practically speaking, before a client relationship is formed it may be easy to know what skills are required and whether the professional possesses them. But after the engagement is under way, and after

it changes, it becomes more difficult. Nonetheless, tax professionals should carefully consider whether they are or could become reasonably competent to handle their clients' tax matters as the skills needed for those matters evolve.

Suppose CPA Jane has a client who she has represented for over seven years. In year seven, the client develops a new product that takes off and now has factories in London and Zurich. Does Jane have the knowledge and skills to continue representing this client? It may be that Jane can "get competent" on the requirements for reporting the foreign income, as suggested in both the AICPA Rules and Circular 230, as well as in the comments to the ABA Model Rule. But should she? If Jane has no experience in foreign reporting, even if she can achieve competence by reasonable preparation and study, she should inform her client that she has no relevant experience.⁵ Similarly, an attorney representing a client whose needs require skills and experience that would require the lawyer to become competent should inform the client of this key fact.⁶ Perhaps the client values Jane's manner of handling tax matters so much that the client won't mind that Jane is learning foreign reporting as she goes. Without question, continuity and institutional knowledge provide real benefits to both the client and the tax professional. A CPA or other tax professional who has a long standing relationship with a client will almost always be more cost effective. However, when the skills required to fully advise the client are not skills that the current tax professional has developed, the tax professional should candidly discuss options with the client. Both the tax professional and the client will be better served by the tax professional's candor on matters of competence.

Tax Professionals should perform annual "competency" check-ups on their matters. Doing so will prevent getting deeper and deeper into a situation in which the clients' needs require a level of skill and knowledge that the practitioner cannot deliver.

Conflicts of Interest

A conflict of interest check at the beginning of a new client relationship is not only routine, it is absolutely vital to taking on any engagement. Most firms have stringent procedures in place to ensure a thorough conflicts of interest check is completed before a new matter is opened, and with good reason. Conflicts of interest are prohibited by most governing bodies unless the conflict is one that can

be waived, and has been waived with informed consent by the client.

The ABA Model Rules Provide:

- (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
 - (1) The representation of one client will be directly adverse to another client; or
 - (2) There is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.
- (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
 - (1) The lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
 - (2) The representation is not prohibited by law;
 - (3) The representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
 - (4) Each affected client gives informed consent, confirmed in writing.⁷

The AICPA Code of Conduct Provides:

- A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the Integrity and Objectivity rules when, for example, the member provides a professional service related to a particular matter involving two or more clients whose interests with respect to that matter are in conflict. (1.110.010.02)
- A conflict of interest may arise when a member is representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership. (1.110.010.04)
- The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a member is asked to conduct an engagement for a client in a situation that may become adversarial with respect to another client or the member or member's firm, even though the parties who engage the member may not initially be involved in a dispute. A member should

remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest. (1.110.010.06)

Circular 230 Provides:

- A practitioner shall not represent a client before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if—
 - The representation of one client will be directly adverse to another client, or
 - There is a significant risk that the representation of one client 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.⁸

Just as there are significant benefits for the client to have continuity in representation before the IRS in tax preparation, so too are there significant benefits from continuity in having the same person who prepared a tax return represent the taxpayer in an IRS examination, having the attorney who executed a transaction defend the transaction, or having the estate planner defend the estate tax return.

For tax professionals, the most serious danger of a conflict of interest arising is not from a new representation, when the conflicts checks are most often performed. Instead, many conflicts arise after the engagement has gone on for some time.

Conflicts Between Clients

Tax professionals often represent multiple clients without incident or conflict. But conflicts can arise from multiple client representation. For example, a tax professional who prepares returns for a business and its executives may discover that one of the executives has embezzled

funds. The tax professional must carefully check all relevant ethical rules regarding what the next step is. If the tax professional is an attorney, then ABA Model Rule 1.13 requires the attorney to safeguard “the best interest of the organization” above all else. Circular 230 §10.29 prohibits representation of a client before the IRS when representation of one would be adverse to another. Not every potential conflict that arises after representation is underway is so starkly obvious as a case of an embezzling executive. Many conflicts that arise in tax practice include:

- Spouses who file jointly and then are examined, and one spouse has the option of requesting innocent spouse relief under Code Sec. 6015;
- Representation involving multiple shareholders or partners of an entity when the interested parties cannot agree on how to report to the IRS, how to defend against an IRS examination, or how to proceed in litigation in U.S. Tax Court, Federal District Court, or Court of Claims; or
- Representation of multiple clients who have similar issues before the IRS who want to take opposing positions and defend those positions.

When a tax practitioner encounters one of these or other similar situations, they should take step back to consider whether he or she can continue the representation *at all*, and if so, inform the client of the potential conflict of interest and obtain informed consent in writing before continuing the representation.

Conflicts Between Client and the Tax Professional

Another conflict issue that frequently arises *after* a tax matter is well underway is a conflict between the client and the tax professional. Tax professionals who advise clients on reporting or tax consequences may be in conflict with their clients if an IRS examination is initiated. First and foremost, tax professionals must consider whether their client has the ability to request reasonable cause abatement of any applicable penalties due to reliance on professional advice. If so, then the tax professional’s applicable obligations under Circular 230, AICPA Rules, and the ABA Model Rules are all triggered: There is significant risk that the interest of the client may be limited by the personal interest of the practitioner.⁹

Just as there are significant benefits for the client to have continuity in representation before the IRS in tax preparation, so too are there significant benefits from continuity in having the same person who prepared a tax return represent the taxpayer in an IRS examination, having the attorney who executed a transaction defend the transaction, or having the estate planner defend the estate tax return. But there comes a time during each IRS examination when tax professionals who participated in planning and advised their clients regarding what needed to be reported, how, when and why should carefully consider during an IRS examination whether a conflict of interest has arisen and act accordingly.

ENDNOTES

¹ ABA Model Rule 1.1.

² AICPA Rule 0.0300.060.03.

³ AICPA Rule 1.300.010.04.

⁴ Circular 230 §10.35.

⁵ See, e.g., AICPA Code at Article III on Integrity. “Integrity requires a member to be, among other

things, honest and candid” Rule 102 and section 54, 0.02.

⁶ See, e.g., ABA Model Rule 1.4(b), which provides “A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.”

⁷ ABA Model Rule 1.7.

⁸ Circular 230 §10.29(a).

⁹ Circular 230 §10.29(a); ABA Model Rule 1.7(a)(2); AICPA Rule 1.110.010.06.

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