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INCOME TAX PRACTICE AND CERTIFIED PUBLIC ACCOUNTANTS: 
THE CASE FOR A STATUS BASED EXEMPTION FROM STATE 
UNAUTHORIZED PRACTICE OF LAW RULES

by

MATTHEW A. MELONE*

The law is not a profession so easily acquired.
- Sir Walter Scott, Journal, April 30, 1828

Most lawyers are conservative. That’s what’s wrong with them. They 
seem to have a vested interest in not changing the law.
- Lord Denning, Sunday Times, Aug. 1, 1982

I. INTRODUCTION

The purpose of this article is to examine the application of unauthorized 
practice of law restrictions to certified public accountants engaged in income 
tax practice. Prior to my admission to the bar, I had been a practicing certi-
fied public accountant and, like many of my colleagues, did not believe that 
the scope of my profession’s services in tax matters was subject to serious 
dispute. However, exposure to attorneys, particularly those not in tax prac-
tice, has led me to conclude that the bar has not come to any universally agreed 
upon conclusions about the role that certified public accountants may pro-
perly play in tax matters. Recent events have supported my conclusion.¹

Accountants and lawyers have struggled for some time in their attempts 
to reach a consensus concerning their respective roles in income tax 
practice.² In 1944 the National Conference of Lawyers and Certified Public

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1. The American Bar Association has been studying the practice of accounting firms using
in-house lawyers to practice before the Tax Court. See Deborah Lohse, Tax Report, WALL ST.
J., May 18, 1994, at A1. Non-lawyers are authorized, pursuant to Tax Court Rules, to practice
before the Tax Court. See infra note 31. Moreover, in 1992 a comprehensive set of
‘unauthorized practice of law’ rules was submitted to the Supreme Court of South Carolina
for adoption. These proposed rules, if adopted, would have restricted the ability of certified
public accountants to practice in certain tax related areas. See infra notes 146-48 and
accompanying text.
2. Disputes among the two professions began to surface in the early 1930s. As an opening
salvo, several bar associations were proposing or supporting legislation at the state and federal
levels, that would have restricted the rights of accountants to practice before administrative
agencies. See 2 JOHN L. CAREY, THE RISE OF THE ACCOUNTING PROFESSION: TO
RESPONSIBILITY AND AUTHORITY 204-05 (AICPA 1970).
Accountants was formed. This group, comprised of members of both professions, sought to resolve issues of mutual interest in a cooperative manner.\textsuperscript{3} Much of the case law with respect to this issue is old. After 1966, with the apparent settlement of the federal preemption issue, the volume of case law dropped significantly.\textsuperscript{4} However, this seeming tranquility has masked continuing doubt about the proper parameters of certified public accountants' practices.

Several factors may cause this controversy to achieve greater prominence in the near future. Technological advances are drastically reducing the clerical and mechanical aspects of tax return preparation thereby freeing up time for the accountant to pursue other types of work. Competitive pressures within the accounting profession also point to aggressive courting of clients for additional services — as evidenced by Arthur Andersen's decision to litigate cases before the Tax Court.\textsuperscript{5} Finally, the ever increasing complexity of the tax law exerts a pressure toward specialization resulting, consequently, in the concomitant offering of more specialized services.

This article posits that unauthorized practice of law restrictions should have no application to income tax practice by certified public accountants.\textsuperscript{6} I have not resorted to federal preemption, due process, or other constitutional grounds to support this position. Instead, I believe that certified public accountants should be granted special status, by virtue of their professional designation, to practice in the income tax field. This conclusion is based on an examination of the rationales for unauthorized practice restrictions. In the case of certified public accountants such restrictions are not necessary. The displayed competency of certified public accountants in income tax matters, the strict code of conduct to which they must adhere, and the existence of

\textsuperscript{3} For the historical background to the formation of the National Conference as well as the role it played in attempts to forge a consensus among the two professions see id. at 206-57. The bar has also participated in national groups with professional groups other than certified public accountants. See Deborah L. Rhode, Policing the Professional Monopoly: A Constitutional and Empirical Analysis of Unauthorized Practice Prohibitions, 34 STAN. L. REV. 1, 9 (1981).

\textsuperscript{4} Professor Rhode summarized inquiries, investigations, and complaints directed against laypersons in 1979 by type of practice. In terms of frequency disputes concerning Rhode, tax practice was not on the list. See id. at 28-29.

\textsuperscript{5} See supra note 1, at A1.

\textsuperscript{6} Almost all jurisdictions have grandfather rules for various classes of accountants who are not certified, for example, public accountants, licensed public accountants, or registered public accountants. Moreover, 14 states have a continuing class of licensed accountants in addition to certified public accountants. See DIGEST OF STATE ACCOUNTANCY LAWS AND STATE BOARD REGULATIONS 97-98 (AICPA, NASBA 1992) [hereinafter DIGEST OF STATE ACCOUNTANCY LAWS ]. Because my analysis depends, in part, on the ethical duties and qualifications of certified public accountants my conclusions are limited to that class of accountants.
adequate remedial schemes to enforce proper professional conduct support this conclusion.

I have focused my analysis on income tax practice. I believe that the nature of the income tax laws and the skills required to practice in this area present the clearest case for removal of all state unauthorized practice restrictions. However, the analysis presented should be applicable to other tax practice areas — for example, estate and inheritance tax or pension planning. Any difference in the allocation of work among the legal and accounting professions between these areas and income tax practice should be driven more from pragmatic concerns than doctrinal differences.7

This article does not address Tax Court practice or practice before any other judicial forum. A reasoned analysis of this area of practice requires a detailed analysis of the rules of attorney-client and work product privileges8 as well as the issue of whether certified public accountants can effectively circumnavigate the applicable rules of procedure.9 Moreover, the effect of certified public accountants' inability to practice before the Federal courts must be examined.10 Such analysis is beyond the scope of this work.

Part II of this article provides a brief discussion of unauthorized practice restrictions in general. Particular emphasis is given to the asserted reasons for such restrictions. In Part III, a detailed analysis of the federal preemption issue is presented and the scope of services that such preemption protects from state law restrictions is examined. Part IV presents a detailed

7. See infra note 137.


9. It is possible that conflict of interests will exist, to a greater degree, for certified public accountants because they are more likely to have been engaged to prepare the tax returns at issue or to have performed other services that could create a conflict. Moreover, because certified public accountants are not eligible to practice before the federal courts, the decision on where to litigate may itself be subject to a conflict. See infra note 10 and accompanying text.

10. A taxpayer has the ability to forum shop in federal tax matters. The Tax Court has jurisdiction over deficiency judgments. See I.R.C. § 6213(a) (CCH 1994). Alternatively, the taxpayer may pay the tax in dispute and sue for refund in federal district court or in the United States Claims Court. Unless otherwise noted all references to the I.R.C. are to the Internal Revenue Code of 1986, as amended and available in the Internal Revenue Code volumes of the Stand. Fed. Tax Rep. (CCH).
analysis and critique of the leading cases dealing with the issue of tax practice as the unauthorized practice of law.

Part V presents the arguments for an unfettered role in income tax practice for certified public accountants. I support this argument, on competency grounds, by focusing on the unique character of the income tax laws and, by way of example, using tax return practice as evidence of competence in a broader practice sense. Finally, the regulatory scheme to which certified public accountants are subject is examined.

II. UNAUTHORIZED PRACTICE OF LAW: IN GENERAL

Restrictions on the practice of law by the laity have been in existence for quite some time.11 In several instances, the strictures predate the birth of the accounting profession.12 Various mechanisms are in place to enforce these restrictions. Courts have traditionally asserted their inherent power over those persons that practice before them, and have punished the unauthorized practice of law as contempt of court.13 A substantial majority of states prescribe misdemeanor penalties for the unauthorized practice of law.14 Enforcement of existing prohibitions is undertaken by state bar organizations, unauthorized practice committees of a state, county, or local bar organization, and state attorneys general or local district attorneys.15


12. According to Barlow Christensen, the origin of legislation in five states can be traced to the mid-1800s and in several other states legislation predates 1920. See id. at 180. The status of accounting as a profession is a relatively recent development. The first legislation creating the professional designation “Certified Public Accountant” was enacted on April 17, 1896 in New York. The period between 1913, the year the Sixteenth Amendment to the United States Constitution was enacted, and 1934, after passage of the federal securities legislation, marked the growth and establishment of accountancy as a profession. See generally JAMES DON EDWARDS, HISTORY OF PUBLIC ACCOUNTING IN THE UNITED STATES (1960). See also infra note 172 and accompanying text.


14. See Rhode, supra note 3, at 11-12 n.39 (compiling citations to statutes of 37 jurisdictions).

15. See Rhode, supra note 3, at 11-21. Based on her empirical study Professor Rhode asserts that, in the vast majority of states, bar committees are the only active enforcer of the restrictions on law practice. Rhode, supra note 3, at 19. Professor Rhode points out that seven states, principally due to antitrust concerns, do not have unauthorized practice committees nor any agency active in enforcement of unauthorized practice prohibitions. Rhode,
Restrictions placed upon the laity are justified by two broad arguments. The first argument advanced is that regulation of law practice serves to maintain judicial integrity. Proponents of this theory assert that regulation is needed to preserve courtroom decorum and as an aid in disciplining miscreant attorneys.

Secondly, and more importantly, unauthorized practice restrictions are necessary in order to prevent an unfettered market for legal services from harming consumers. Several rationales support this conclusion. First, consumer protection is required to protect the public from incompetent practitioners — the competency rationale. A second rationale supporting this theory — the motivational rationale — is rooted in the notion that attorneys,

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16. A third, and often unspoken, rationale for regulation of legal service providers is economic protectionism. Although this theory may be equated with pure and simple economic rent seeking it is often meant to express the notion that unfettered competition from lay persons would be disastrous to the legal profession. This is because the legal profession is hampered by restrictions that do not apply to the laity. Consequently, in addition to placing members of the bar at a competitive disadvantage, the vices that professional standards were meant to avoid would, in all probability, be imputed upon the profession in any event. See Andrews, supra note 15, at 616 (quoting REPORT OF THE CONFERENCE OF DELEGATES OF BAR ASSOCIATIONS (1920)). For a detailed analysis of professional regulation of lawyers and legal services from a market dominance perspective see RICHARD L. ABEL, AMERICAN LAWYERS (1989). This rationale, rarely made explicit, is occasionally denied. See Chicago Bar Ass'n v. United Taxpayers of America, 38 N.E.2d 349, 351 (Ill. App. Ct. 1941) (citing People v. Alfani, 125 N.E. 671 (N.Y. 1919) for the statement that practice restrictions are “not for the purpose of creating a monopoly in the legal profession nor for its protection . . . ”).


18. This is the predominate theme that runs through the case law dealing with accountants rendering tax services. See, e.g., Gardner v. Conway, 48 N.W.2d 788, 794 (Minn. 1951) (stating that the purpose of practice restrictions is "to protect the public from the intolerable evils which are brought upon people by those who assume to practice law without having the proper qualification"); In re New York County Lawyers Ass'n, 78 N.Y.S.2d 209, 218-19 (N.Y. App. Div. 1948) (holding that accountants do not have "the orientation" to qualify as tax attorneys). The increase in malpractice claims against attorneys in recent years may call this rationale into question. See ABEL, supra note 16, at 154. However, because I am concerned with the role of certified public accountants in tax practice, a challenge to the competency rationale would require a comparison of malpractice litigation between these groups - which I did not obtain. In any event, my goal is to establish the competency of certified public accountants in tax practice and not to discredit tax attorneys.
in conducting their professional affairs, operate in a fundamentally different fashion than lay persons. Invariably, these putative differences operate to the benefit of the consumers. For example, lawyers, in the minds of some people, are not motivated, to the same extent as others, by profit.\textsuperscript{19} Moreover, lay persons would be subject to less restrictions in advertising and soliciting for clients.\textsuperscript{20} Trends in the market for legal services that began in the late 1970s may have completely discredited this theory.\textsuperscript{21}

A third rationale underpinning the consumer protection theory is the remedial rationale. Lawyers are subject to court supervision and sanction for failure to comply with professional standards. Moreover, the existence of professional standards themselves serve to distinguish attorneys from the laity.\textsuperscript{22} Of course, the importance of this distinguishing feature correlates positively with the extent to which ethical prescriptions are heeded and, when breached, punishment ensues.\textsuperscript{23}

Although all states prescribe sanctions for the unauthorized practice of law, the states are far from uniform in their attempt to define, with precision,
just what activities constitute law practice. Professor Rhode categorized the existing statutes into three genres. The first type of statute makes no attempt to define the practice of law. The second type of statute provides a circular definition that, in essence, defines law as "what lawyers do." The third category of statute provides a list of activities that constitute the practice of law. However, the lists provided fail, invariably, to delineate with reasonable clarity the boundaries that the laity may not cross.

The practice of law is not confined to the conduct of cases in court. The rendering of legal advice, representation before administrative agencies, and preparation of legal instruments have all been held to constitute the practice of law. Moreover, the activities that are commonly put forth — whether by statute or by the courts — as constituting the practice of law are phrased in general, oftentimes vague, terms. As a result, these restrictions have

24. Rhode, supra note 3, at 45 & n.135.
25. Rhode, supra note 3, at 45 & n.136. As Professor Rhode points out, this is the approach taken by the ABA Model Code of Professional Responsibility. See Model Code Of Professional Responsibility EC 3-5 (1980) (stating that "the practice of law relates to the rendition of services for others that call for the professional judgment of a lawyer"). The ABA Model Rules do not attempt to define the practice of law. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.5 cmt. (1983).
26. See Rhode, supra note 3, at 46 & nn.140-44.
27. In unusual cases a statute will be very specific as to what activity or activities are reserved exclusively for members of the bar. See, e.g., infra note 133 and accompanying text (inquiring a New Jersey statute that was very specific in delineating what services may not performed by non-lawyers). Uncertainty as to where the line of demarcation between proper and unauthorized services is drawn is exacerbated by some courts through separation of powers disputes. For example, in Chicago Bar Ass'n v. United Taxpayers of America, 38 N.E.2d 349 (Ill. App. Ct. 1941), the court held void a rule promulgated by the state Department of Finance, pursuant to statutory authority, that allowed certified public accountants to represent taxpayers at hearings before the department. The court stated that "[t]he General Assembly has no authority to grant a layman the right to practice law .... Nor can the General Assembly lawfully declare not to be the practice of law, those activities the performance of which the judicial department may determine to be the practice of law." Id. at 351 (quoting People ex rel. Chicago Bar Ass'n v. Goodman, 8 N.E.2d 941, 945 (Ill. 1937)). The question of comity among the legislative and judicial branches arises frequently with respect to rules governing administrative practice. See infra note 122 and accompanying text.
29. See, e.g., Jemo Assoc., Inc. v. Lindley, 415 N.E.2d 292, 296 (Ohio 1980)(stating that, in addition to other enumerated activities, “action taken . . . in matters connected with the law” constitutes the practice of law) (quoting Land Title Abstract & Trust Co. v. Dworken, 193 N.E. 650 (Ohio 1934)); Bump v. District Court of Polk County, 5 N.W.2d 914, 918 (Iowa 1942) (including as the practice of law, the carrying on of “the business of an attorney”). For an analysis of due process issues raised, inter alia, by the vagueness of the restrictions
spawned a tremendous amount of litigation.30

III. FEDERAL PREEMPTION: THE SPERRY DOCTRINE

Before undertaking a detailed analysis of the case law involving tax practice two questions need to be answered. First, to what extent has federal law preempted state law in this area? Second, assuming that federal law has preempted state law to a significant extent, does the subject matter that survives preemption warrant significant attention?

A certified public accountant may, pursuant to statutory authority, represent a person before the Internal Revenue Service.31 Moreover, the Treasury Department is authorized to impose standards of conduct for individuals who practice before it.32 Regulations have been issued by the Secretary of the Treasury pursuant to this authority.33 These regulations, commonly referred to as Circular 230, govern practice before the Internal Revenue Service.

see Rhode, supra note 3, at 45-55. Occasionally, however, a court will provide detailed guidance. See, e.g., In re The Florida Bar, 355 So. 2d 766, (Fla. App. 1978) (listing, among 21 separately enumerated conclusions of law, various activities performed in pension planning that the court considered to be the practice of law). Note that The Florida Bar was decided on a stipulated record and upon facts that occurred prior to the enactment of federal legislation that now occupies the field of most employee benefits. Consequently, The Florida Bar is of little relevance in the pension field. See The Florida Bar Re: Advisory Opinion-Nonlawyer Preparation of Pension Plans, 571 So. 2d 430, 433 (Fla. 1990).

30. An analysis, or even a summary, of the case law in this area is beyond the scope of this work. For a compilation and overview of the case law dealing with unauthorized practice of law issues see 7 AM. JUR. 2D Attorneys at Law § 101 (1980 & Supp. 1994); 7 C.J.S. Attorney & Client § 29 (1980 & Supp. 1994); R.E. Heinselman, Annotation, What Amounts to Practice of Law, 111 A.L.R. 19 (1937); Annotation, What Amounts to Practice of Law, 125 A.L.R. 1173 (1940). See also UNAUTHORIZED PRACTICE HANDBOOK (J. Fischer & D. Lachmann eds. 1972).

31. 5 U.S.C. § 500(c) (1988). Certified public accountants may also be admitted to practice before the Tax Court. However, unlike Circular 230, certified public accountants are not eligible for admission by virtue of their professional status. Instead, they, like any other nonlawyer, must qualify by submitting to a written examination and, if the Tax Court so requires, an oral examination. Failure of the written examination three times precludes the taking of further examinations. See T.C.R. 200(a)(3). Attorneys are admitted to practice before the Tax Court upon showing membership in good standing of the Bar of the Supreme Court of the United States or the highest court of any state, the District of Columbia, or any commonwealth, territory, or possession of the United States. See T.C.R. 200(a)(2). Note that I.R.C. § 7452 precludes the denial of admission to practice before the Tax Court to any person because of that person's failure to be a member of any profession or calling.


Attorneys and certified public accountants are authorized to practice before the Internal Revenue Service by virtue of their professional status.\textsuperscript{34} However, section 10.32 of Circular 230 provides that “[n]othing in the regulations in this part shall be construed as authorizing persons not members of the bar to practice law.” If “practice before the Internal Revenue Service” encompasses activities that fall within the definition of law practice then the regulations seemingly contain an internal inconsistency.

Circular 230 defines “practice before the Internal Revenue Service” very broadly.\textsuperscript{35} It is beyond dispute that the definition of “practice before the Internal Revenue Service” includes activities that have traditionally been considered the practice of law.\textsuperscript{36} Prior to 1963 state courts had held that the language in Circular 230 disclaiming any grant of authority to laypersons to practice law applied to limit the scope of permissible activities before the Internal Revenue Service.\textsuperscript{37} In essence, the courts held that state law governing the unauthorized practice of law was expressly preserved by Circular 230.

\textsuperscript{34} See Circular 230, § 10.3(a)-(b). Enrolled actuaries are granted similar privileges with respect to certain practice areas. Id. § 10.3(d). All other persons seeking to practice before the Internal Revenue Service must enroll as an agent, which requires, in most cases, the passing of a written examination administered by the Internal Revenue Service. See id. § 10.4. In order to practice before the Internal Revenue Service the attorney or certified public accountant in question must not currently be under suspension or disbarment from such practice and must file a written declaration that she is currently qualified as an attorney or certified public accountant, as the case may be, and is authorized to represent the particular party on whose behalf he acts. Id. § 10.3(a)-(b). Circular 230 relegates the determination of whether an individual is duly qualified as an attorney to state law. See Circular 230, § 10.2(b)-(c). The automatic qualification of attorneys and certified public accountants is pursuant to Pub. L. No. 89-332, 79 Stat. 1282 (1965). Attorneys are authorized to represent others before any agency while the authorization granted to certified public accountants is limited to representation of others before the Internal Revenue Service. Id. § 1(a)-(b). Note that, pursuant to other authority, certified public accountants are authorized to practice before other federal agencies. See, e.g., 4 C.F.R. § 11.1 (1993) (authorizing persons other than lawyers to practice before the General Accounting Office); 12 C.F.R. § 623.3(a)(2) (1993) (authorizing accountants to practice before the Farm Credit Administration).

\textsuperscript{35} Circular 230, § 10.2(e) provides that:

\textit{Practice before the Internal Revenue Service} comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a client’s rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include preparing and filing necessary documents, corresponding and communicating with the Internal Revenue Service, and representing a client at conferences, hearings, and meetings.

\textsuperscript{36} See supra note 28 and accompanying text.

In 1963 the United States Supreme Court decided *Sperry v. Florida*. At issue in *Sperry* was whether the state of Florida could prohibit a layperson from practicing before the United States Patent Office pursuant to regulations issued by the Commissioner of Patents with the approval of the Secretary of Commerce. The state of Florida had argued that the authorization granted by the federal regulations should be construed to co-exist with state unauthorized practice law, relying on language in the regulations that limited the authority conferred to practice before the Patent Office. The Court did not question the state’s determination that preparation and prosecution of patents applications constituted the practice of law. Instead, the Court held for the petitioner on Supremacy Clause grounds stating that “‘the law of the State... must yield’ when incompatible with federal legislation.”

The *Sperry* rationale has been applied to practice before the Internal Revenue Service. Although the *Sperry* preemption doctrine has been applied to federal tax practice the status of state unauthorized practice law retains importance. On a broad level, the notion that certified public accountants are authorized to practice in the tax field simply because the federal government has chosen to allow them to do so serves to diminish the stature of the accounting profession. Such a view tends to place the law profession in a position of tolerating an encroacher on its turf. Moreover, in a more practical sense, state law will

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39. The regulation in question provided that “[r]egistration in the Patent Office... shall only entitle the persons registered to practice before the Patent Office.” *Id.* at 386 (quoting 37 C.F.R. § 1.341). A predecessor provision contained broader language similar to that found in § 10.32 of Circular 230. The Court found that “the progression to more circumscribed language” tended to indicate that the limitation in question merely precluded general patent law practice. *Id.* The Court did not, however, indicate whether, under the language of the predecessor provision, state law could apply. However, the Court did note that the regulations governing trademark cases, unlike the patent regulation at issue, expressly preserved the applicability of state unauthorized practice law. *See id.*

40. *Id.* at 383.

41. *Id.* at 384 (quoting Gibbons v. Ogden, 9 U.S. (1 Wheat.) 211 (1824)).

42. *See The Florida Bar re Advisory Opinion-Nonlawyer Preparation of Pension Plans, 571 So. 2d 430 (Fla. 1990); Grace v. Allen, 407 S.W.2d 321 (Tex. Civ. App. 1966). See also Boris I. Bittker, Does Tax Practice by Accountants Constitute the Unauthorized Practice of Law?, 25 J. TAX’N. 184 (1966); BERNARD WOLFMAN, ET AL., 2 STANDARDS OF TAX PRACTICE ¶805.02 (CCH Tax Trans. Lib. 1992). The application of *Sperry* in the federal tax context has generated some doubt. In his article, Professor Bittker asserts that the enactment of Pub. L. No. 89-332, 79 Stat. 1281 (1965), actually weakens the *Sperry* preemption argument but concludes that the *Sperry* rationale should still apply. Professor Bittker based his conclusion, in part, on the fact that Pub. L. No. 89-332 did not alter the status of enrolled practitioners who are neither attorneys nor certified public accountants and, consequently, it would be unlikely that the courts would impose state law restrictions on certified public accountants. *See Bittker, supra note 42, at 185-86. Moreover, the regulatory language in question in *Sperry* differed from that found in Circular 230. *See supra note 39.*
continue to have applicability in several contexts. First, and quite obviously, state law will continue to have vitality in the state and local tax context — an increasingly important practice area for tax professionals. Secondly, Circular 230 practice authority extends only to practice before the Internal Revenue Service. The reach of the Sperry doctrine to federal tax practice will depend upon how broadly “practice before the Internal Revenue Service” is defined.

Section 10.2(e) of Circular 230 paints with a broad brush and provides a blurry line of demarcation between “practice before the Internal Revenue Service” and other services in the federal tax field. In order for a person to be “practicing before the Internal Revenue Service” the services performed by such person must be “connected with [presentations] to the Internal Revenue Service.” The construction of the term “connected with” is critical. For example, tax return preparation is considered “practice before the Internal Revenue Service.” Is tax advice concerning a pending transaction “connected with” the preparation of a tax return? A plausible argument may be made that such advice is connected with the preparation of a tax return because the transaction or the effect of the transaction will be reported on a return.

43. The Sperry doctrine presumably would also apply to the Tax Court Rules. These Rules provide for non-lawyer practice before the Tax Court in certain circumstances. See supra note 31.

44. The potential for recurring disputes, despite Sperry, is highlighted by the Rules Governing the Unauthorized Practice of Law in the State of South Carolina proposed by the South Carolina Bar Association in 1992. Comments to Proposed Rule 6 appear to have incorporated both the Bercu and Gardner tests by stating that “a non-lawyer . . . may not hold himself out as qualified to deal with difficult and involved questions of tax law, wholly apart from any engagement to prepare tax returns or practice before the Internal Revenue Service.” The Supreme Court of South Carolina did not adopt the proposed rules. See infra notes 146-48 and accompanying text.

45. Circular 230, § 10.2(e).

46. Tax return preparers are excluded from the general eligibility requirements of Circular 230. Circular 230, § 10.7. Prior to 1984, tax return preparation was specifically excluded from the definition of practice before the Internal Revenue Service. As part of the 1984 amendments to Circular 230 this exclusion was deleted and the above exception for tax return preparers was added. See Bernard Wolfman, et al., 1 Standards of Tax Practice ¶ 117.011 (CCH Tax Trans. Lib. 1992).

47. One can muddy the waters quite easily by inquiring as to the purpose of the advice. Should it matter that the advice was rendered specifically to determine how to report a pending transaction on a return; whether such advice was given to achieve a particular tax result regardless of how it is to be reported; or whether the advice was given for a non-tax purpose altogether, such as its effect on earnings per share? Note that the regulations defining tax return preparer include a person that renders advice pertaining to events that have occurred and directly relevant to the making of an entry on a return or claim for refund. See infra note 48.
A better approach is to take a more circumscribed view of "practice before the Internal Revenue Service." First, although Circular 230 does not delineate the scope of services constituting tax return preparation, the regulations defining a tax return preparer do, and expressly exclude a person that gives advice on a prospective transaction from the definition of a tax return preparer. Moreover, because section 10.7 of Circular 230 exempts tax return preparers from the general eligibility requirements of practice before the Internal Revenue Service, a broad construction of what services are connected with tax return preparation would invite unlicensed and unregulated individuals to seek solace in federal preemption from state attempts to regulate them. Secondly, Circular 230 by its terms, envisions direct contact, either through a filing or some form of communication with the Internal Revenue Service. Therefore, assuming that a prospective transaction is not


A person who only gives advice on specific issues of law shall not be considered an income tax return preparer, unless —

(i) The advice is given with respect to events which have occurred at the time the advice is rendered and is not given with respect to the consequences of contemplated actions; and

(ii) The advice is directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim for refund. For example, if a lawyer gives an opinion on a transaction which a corporation has consummated, solely to satisfy an accountant (not at the time a preparer of the corporation's return) who is attempting to determine whether the reserve for taxes set forth in the corporation's financial statement is reasonable, the lawyer shall not be considered a tax return preparer solely by reason of rendering such opinion.

49. See supra note 46. Unenrolled tax return preparers may not, however, represent a client during an examination unless they have personally signed the return as preparer. See I.R.S. Announcement 65-2, I.R.B. 1965-2, 14.

50. In defining who may practice before the Internal Revenue Service, Circular 230 states that an attorney or certified public accountant must file a written declaration that he is qualified as an attorney or certified public accountant and is authorized to represent the particular party on whose behalf he acts. See Circular 230, §§ 10.3(a)-(b), 10.5.

Circular 230 also provides requirements that a practitioner must comply with in rendering tax shelter opinions. See id. § 10.33. It is arguable that, by promulgating standards with respect to third party opinions, Circular 230 has broadened the potential scope of the Sperry doctrine. This was the position taken by petitioners in their brief challenging the proposed unauthorized practice rules by the South Carolina Bar, discussed infra at notes 147-48 and accompanying text. However, § 10.33 does not provide a positive grant of authority to practitioners to render such opinions. Instead, it provides guidance to those that render such opinions. Because a practitioner, for purposes of § 10.33, is defined to include anyone eligible to practice before the Internal Revenue Service it is questionable, both as a matter of interpretation and policy, whether an otherwise unlicensed and unregulated individual should be allowed to perform all the activities that are required in rendering tax shelter opinions. See Circular 230, § 10.33(a)(1)-(6) & (c)(1). Moreover, in light of § 10.33, it is possible that certified public accountants may be precluded, under state law, from rendering such opinions.
the subject of a ruling request, then advice on structuring such transactions should not be considered to be “practice before the Internal Revenue Service.”

IV. CASE LAW: ANALYSIS AND CRITIQUE

This section presents an analysis of the leading cases that have been decided involving tax practice as the unauthorized practice of law. Many of these cases involve accountants who were not certified and, in some cases, practitioners who were not accountants at all. The courts seemingly placed no emphasis on the status of the person performing the disputed services — except the fact that they were not members of the bar — and consequently, these cases provide useful insight into the courts’ view of tax practice. The cases that follow involve the rendering of traditional tax services, such as tax return preparation and tax advice. Laypersons, including accountants, have, of course, been the subject of proceedings that involve services or practices that clearly breach any line of demarcation between appropriate professional practice and unauthorized practice of law. In some of these cases tax matters form part of the factual backdrop. Because my analysis is limited to tax practice an analysis of the law pertinent to such practices is beyond the scope of this work.

The courts have tended to test the practices of laypersons in income tax matters using two tests — one based on the form of service delivery and the other based on the difficulty of the services delivered. The discussion that

51. In some cases the court failed to mention whether the accountant was certified or not.
52. See, e.g., Lowe v. Presley, 71 S.E.2d 730 (Ga. Ct. App. 1952) (holding that a layperson rendering advice to individuals under indictment for willful evasion of federal income tax constituted the unauthorized practice of law). In Lowe, the defendant advised his clients of the nature of charges against them and as to the making of a plea of guilty or not guilty. Id. at 733. Ironically, in this case the defendant was also found to be unqualified to perform accounting and auditing services necessary to provide information for the client’s defense. See also The Florida Bar v. Town, 174 So. 2d 395, 397 (Fla. 1965) (enjoining the accountant-respondent from “preparation of corporate charters, bylaws, resolutions, and other documents incidental to the contractual rights of the corporation, its incorporators, and stockholders”); In re The Florida Bar, 317 So. 2d 754 (Fla. 1975) (enjoining the respondent from advertising as an attorney at law, specializing in tax matters, when she was, in fact, not a licensed attorney); DeLeon v. Saldana, 745 S.W.2d 55 (Tex. Ct. App. 1987) (assuming that, in an action for quantum meruit, the jury considered only tax related work and not services rendered in preparing articles of dissolution, corporate minutes, and other documents that plaintiff accountant conceded as unauthorized legal work). The inconsistency of the courts’ view of tax practice is highlighted in the dicta of DeLeon and Town. In DeLeon the court did not disturb the trial court’s holding that the plaintiff could proceed with his quantum meruit claim for tax advice in connection with corporate dissolution. See DeLeon, 745 S.W.2d at 57. However, in Town, one of the considerations that the court factored into its conclusion that the respondent was practicing law was “the interest of federal taxing authorities in corporate financing.” See Town, 174 So. 2d at 397.
follows analyzes the cases that have applied these tests and presents several recent cases that have evidenced a progression toward discarding these tests.

**A. Incidental Services Test**

The incidental services test has been applied in a variety of practice areas. This test is a pragmatic response to the reality that many fields of endeavor involve, to varying degrees, the application of legal principles to particular factual circumstances. The leading case that applied the incidental services test to tax practice is *In re New York County Lawyers Ass’n*, referred to as the *Bercu* case. The petitioner brought a contempt proceeding.

53. See 7 AM. JUR. 2D, supra note 30, § 101.


55. The issue of whether tax practice constitutes the practice of law generally arises in the context of contempt, injunction, and disciplinary proceedings or actions to enforce a contract. Occasionally, the issue arises in other contexts. For example, in Goldenberg v. Comm’r, 65 T.C.M. (CCH) 2338 (1993), a similar issue arose, ironically, in the context of substantive tax law. At issue was whether a licensed attorney and certified public accountant could deduct the cost of a graduate law degree in taxation as a trade or business expense pursuant to I.R.C. § 162. Section 162 requires, *inter alia*, that, in order to be deductible, expenses must be paid or incurred in carrying on any trade or business. See I.R.C. § 162(a). The petitioner was not engaged in the practice of law at the time he was pursuing his graduate law degree but did practice law as a law firm associate after receiving his degree. *See Goldenberg*, 65 T.C.M. (CCH) at 2339. The petitioner asserted that he was engaged in the practice of law prior to entering graduate school as a result of his prior employment with the Internal Revenue Service. The court acknowledged that a person may be carrying on trade or business while unemployed if that person previously carried on such business and intended to return to it. However, the court held that prior employment as an Internal Revenue Service revenue agent, appeals officer, or as a certified public accountant did not constitute the practice of law. *Id.* at 2340. *See also* Bancroft v. Indem. Ins. Co., 203 F. Supp. 49 (W.D. La. 1962) (holding that accountant’s malpractice insurance policy covered liability for negligently rendered tax opinions in the face of the insurer’s assertion that the insured was engaged in the unauthorized practice of law).

An interesting issue was raised in *Goldenberg*. The petitioner argued, alternatively, that the educational expenses should be allowed as a deduction because he was carrying on the business of tax accounting. The court, assuming *arguendo*, that the a layperson could deduct graduate legal studies, held that the taxpayer failed to prove his intention to return to the practice of tax accounting. *See Goldenberg*, 65 T.C.M. (CCH) at 2340-41. If the reasoning of *Bercu* or *Gardner* were followed it is somewhat difficult to comprehend the utility of a graduate law degree in taxation to an accountant. In order to deduct educational expenses a taxpayer must, *inter alia*, incur those expenses in order to maintain or improve skills required by his employer or by law or regulations. *See* Treas. Reg. § 1.162-5(a)(1)(1967). Alternatively, such expenses could be incurred to meet the express requirements of an employer or applicable law or regulation. *See* Treas. Reg. § 1.162-5(a)(2) (1967). Consequently, if tax services were limited either to those performed incidentally in connection with the performance of other services or those of a simple nature it is questionable whether an advanced education in taxation could qualify under these standards — especially taking into account the courts’ view of tax return preparation.
and sought to enjoin the respondent from pursuing certain activities that, petitioner alleged, constituted the practice of law. The respondent was an accountant. The proceeding arose out of an action brought by the respondent against his client to recover fees for services rendered.

The City of New York had claims against the Croft Company for retail sales taxes and compensating use taxes attributable to business done in the years 1935 through 1937. The Croft Company, an accrual basis taxpayer, earned no profits during those years and disputed the City's claims. In 1943 the company earned large profits and was subject to federal income tax at a very high marginal tax rate. The company was contemplating settling the dispute with the City and sought advice as to whether the amounts owed to the City would be deductible in the years to which the taxes related, or at the time the dispute was settled — 1943. The issue, therefore, was when an expense was properly deductible by an accrual basis taxpayer.

The company's regular accountant, who was also an attorney, advised the company that the deduction would have to be taken in the years to which the payments related — 1935 through 1937. At that point the president of the company sought the respondent's advice. The respondent performed no other services for the company at that time. The respondent, based upon his review of case law and a treasury decision, advised the company that the deduction could be taken in 1943. The court recognized that the application of legal knowledge is necessary in order for an accountant to properly discharge his duties but that the application of such knowledge is "only incidental to the accounting functions." In this case the respondent's advice was unconnected with accounting work.

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56. The court did not, in its opinion, mention whether the respondent was a certified public accountant.

57. In re New York County Lawyers' Ass'n, 78 N.Y.S.2d at 211.

58. Id. at 213. The court did not specify the nature of the Croft Company's dispute with the City with respect to the sales and use taxes in question. The court did, however, admonish the respondent for citing I.T. 3441, 1941-1 C.B. 208, a pronouncement that dealt with the issue of sales taxes only. The court believed that the respondent oversimplified and inadequately covered the issue he was faced with by failing to assimilate the use tax in his research. See New York County Lawyers' Ass'n, 78 N.Y.S.2d at 215.

59. The court stated that the company faced a minimum tax rate of 80% in 1943. Id. at 213. I did not examine the relevant statute in effect in 1943. However, because the year in question was a war year this confiscatory marginal rate appears accurate.

60. Id. at 216.

61. The court stated that an "accountant serves in setting up or auditing books, or advising with respect to the keeping of books and records, the making of entries therein and the handling of transactions for tax purposes and the preparation of tax returns." Id. The court did not define what it meant by the "handling of transactions for tax purposes."
The court rejected the notion that the tax law is mainly a matter of accounting. The court viewed the tax law as drawn from, and intimately connected with, various branches of law and held that an accountant, "regardless of specific tax knowledge, does not have the orientation even in tax law to qualify as a tax lawyer." Moreover, the court refused to adopt a case by case inquiry into the subjective qualifications of the accountant before it, holding that "[a]n objective line must be drawn, and the point at which it must be drawn... is where the accountant or non-lawyer undertakes to pass upon a legal question apart from the regular pursuit of his calling."

The court was concerned that a case by case determination of whether other branches of law were involved would prove impractical. The court's reasoning is somewhat contradictory, for if the tax law cannot be distinguished from other branches of law, then the need to determine whether other branches are involved is unnecessary. Ironically, the issue in this case involved a tax accounting concept — the timing of an expense deduction.

The respondent challenged the logical consistency of denying an accountant the right to advise a taxpayer on a tax question while recognizing his right to prepare tax returns. The respondent asserted that the court's approach would permit an accountant to advise on a tax issue if it arose during the preparation of the return but not if the identical issue was the subject of a separate engagement. The court's reasoning in response to the respondent's argument is unclear and less than satisfactory. The court merely reiterated its holding and stated that such a distinction is "altogether valid and desirable."

The court seemingly rooted the distinction on two grounds. First, the court appeared to view the tax preparation process as clerical, capable of being prepared from instructions prepared for lay consumption. Secondly, the court, despite its perceived threat to the public, appeared to be striking a balance between the law and accounting professions. It appears that the latter rational was predominant in influencing the court’s conclusion because

62. In fact, the court refused to accept the notion that taxation may be properly classified as a hybrid of law and accounting. See id. at 220.
63. Id. at 218-19. See infra note 170 and accompanying text for a discussion of specialization by members of the bar.
64. New York County Lawyers’ Ass’n, 78 N.Y.S.2d at 219.
65. See id. at 220.
66. Id. at 221.
67. Id. at 220.
68. The court stated “[i]t is a practical, reasonable and proper accommodation to business men and the accounting profession not only to permit accountants to prepare tax returns but to permit them, despite the risks involved, to assume jurisdiction of the incidental legal questions that may arise in connection with preparing tax returns.” Id. (emphasis added).
the court did not place any caveats on the difficulty of legal questions that may arise so long as they arise incidentally to the performance of accounting services.

The court, in Bercu, did not mention a relatively recent case that did not adopt the incidental services test. In that case the respondent, a subsidiary of Standard and Poor’s Corporation, provided payroll and social security statistical information to subscribers.69 The respondent expanded its services to include a variety of tax related services. Among the services offered were specific advice and opinions on compliance with existing tax laws and methods to achieve savings thereon based on subscriber specific information.70 In order to provide this service, the corporation interpreted and analyzed court decisions and government rulings. Moreover, the respondent undertook activities that were, by any definition, beyond the scope of accounting or tax services.71 In granting the petitioner’s application for a perpetual restraining order against the respondent, the court flatly rejected the adoption of an incidental services test. The court stated that the fact that “some part of the service rendered might be said to be fairly incidental to or within a lawful activity for non-lawyers and on that ground not improper . . . obviously cannot here be a sufficient justification or excuse.”72 The court did not provide a detailed rationale for this rejection other than its view that the respondent had clearly crossed the difficult to define boundary line between permissible and impermissible practice by accountants.73

69. In re New York County Lawyers’ Ass’n, 43 N.Y.S.2d 479 (N.Y. Sup. Ct. 1943). In a later case, High v. Trade Union Courier Publishing Corp., 69 N.Y.S.2d 526 (N.Y.S. Ct. 1946), involving an action for equitable relief, damages, and quantum meruit, the court did not rely on Bercu. The plaintiff entered into a contract with the defendant whereby the plaintiff, in exchange for a percentage of the amounts saved, would disclose to the defendant confidential information that would enable the defendant to secure an exemption from federal telephone excise taxes. Id. at 528. The confidential information, it turned out, was a provision of the Internal Revenue Code of 1939. Id. at 530. The defendant motioned the court to dismiss on the pleadings asserting, inter alia, that the transaction was unenforceable because it involved services that amounted to the unauthorized practice of law. The court denied the defendant’s motion to dismiss stating, without further elaboration, that the advice imparted could not be said to constitute the practice of law. Id. at 529. Although not clear from the court’s recitation of the facts it appears that the plaintiff did no more than provide a citation to the statute.

70. In re New York County Lawyers’ Ass’n, 43 N.Y.S.2d at 480.

71. The respondent, inter alia, prepared legal clauses for contracts, prepared forms for corporate resolutions, and reviewed internal documentation for purposes of determining their legality. See id.

72. Id. It is conceivable that this case may be read for the proposition that the incidental services test has no application in situations where the alleged unauthorized acts include activities that involve services that are not directly tax related such as drafting legal documents. However, the court did not condition its rejection of the incidental test on this ground and there appears to be no rational basis for refusing to test the individual practices separately.

73. Id. Ironically, one factor that the court considered important was that the information
In the context of income tax practice the incidental test is unworkable for several reasons. First, if protection of the public is, as the courts have expressed, the paramount concern underlying unauthorized practice restrictions then it difficult to conceive of a good argument supporting the notion that the public is protected by drawing distinctions based on how the disputed services are delivered. The form, as opposed to the substance, of the services is elevated to critical status. Moreover, assuming that this formal distinction represents a balancing of the benefits of allowing the public the full services of other professionals with the potential harm of allowing the laity to practice law, the courts have not provided any reasons why this balancing process should stop at the point they have chosen. 74

Secondly, the incidental test fails to comprehend the nature of tax accounting practice. As discussed subsequently in this article, the legal issues encountered in tax return preparation are not incidental to the preparation of the returns, but are the essence of this service. 75 It is conceivable that the incidental test could have continued vitality in the face of a proper understanding of the tax return process. However, this would require that the entire tax return preparation service be considered incidental to other services. For example, the tax return may be considered incidental to performance of an audit engagement. However, this would require the courts to ignore the fact that, once the tax return itself is considered a separate activity, it is easily severable from other activities thereby undermining the rationale for applying this test. Moreover, this view has the perverse effect of penalizing accountants specializing in taxation — those that ostensibly should pose less risk to the public.

B. Difficult v. Elemental Test

The incidental test was rejected in Gardner v. Conway. 76 In that case, the committee for the unauthorized and illegal practice of law of a county bar
association sought to have the defendant perpetually enjoined from holding himself out as an income tax expert, duly qualified to give advice and aid to the public in the making of income tax returns, and to hold him in contempt of court for so doing. The defendant had a grade-school education and practiced as a public accountant after serving for three years as United States deputy collector of internal revenue. The plaintiffs hired a private investigator to pose as a client. During the course of the meeting with the private investigator the defendant prepared an income tax return and gave advice with respect to several issues that arose in connection with the preparation of the return.

The court recognized the difficulty of defining the practice of law, and stated that:

[The development of any practical criterion, as well as its subsequent application, must be closely related to the purpose for which lawyers are licensed as the exclusive occupants of their field. That purpose is to protect the public from the intolerable evils which are brought upon people by those who assume to practice law without having the proper qualifications.]

With that goal in mind the court asserted that the privilege of practicing law is based on “the threefold requirements of Ability, Character, and Responsible supervision.” The court made clear that the third requirement was, if not paramount, at least distinguishing.

In the court’s view, the interest of the public would not be served by

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77. Id. at 791. For a discussion of the status of public accountants see supra note 6.
78. The defendant advised the client as to whether a partnership existed between he and his wife; whether he was entitled to an exemption for his wife; whether it was desirable to file a separate return; whether certain expenditures were capitalizable or deductible; and whether certain losses caused by flood and frost were deductible. Gardner, 48 N.W.2d at 791-92.
79. Id. at 794.
80. Id. at 795. The court also noted economic self-interest as a motivation for restrictions to the unauthorized practice of law. Without such restrictions “men of ability and character will find no inducement to undergo the years of training necessary to qualify them as lawyer.” Id.
81. The court stated:

The public welfare is safeguarded not merely by limiting law practice to individuals who are possessed of the requisite ability and character, but also by the further requirement that such practitioners shall henceforth be officers of the court and subject to its supervision. In consequence, lawyers are not merely bound by a high code of professional ethics, but as officers of the court they are subject to its inherent supervisory jurisdiction, which embraces the power to remove from the profession those practitioners who are unfaithful or incompetent in the discharge of their trust.

Id. at 794 (citations omitted).
drawing distinctions among services rendered based upon whether the services’ relationship to the objectives of the engagement were primary or incidental. The focus of inquiry should be on the nature of the service and whether difficult, as opposed to elementary, questions of law are implicated. The court did, however, hold that the regular practice of law, even if it involves elementary issues, is the practice of law nonetheless. In essence the court’s test is conjunctive. A lay person may resolve occasional and elementary questions of law.

In applying this standard to tax practice, the court, despite recognizing the significant overlap of law and accounting, refused to categorize tax law as sui generis. Assuming the validity of taxation’s classification as a hybrid of law and accounting, the court held that “it does not follow that it is so wholly without the law that its legal activities may be pursued without proper qualifications and without court supervision.” The court appeared to ground its view in the broad training of the lawyer. Specifically, the court attached significance to knowledge of basic legal concepts, legal processes, and the interrelationships among different branches of the law. Lack of such knowledge

82. Id. at 795-96.

83. The status of tax services performed by a person regularly engaged in the practice of law was at issue in State v. Willenson, 123 N.W.2d 452 (Wis. 1963). In that case an attorney’s spouse, a non-lawyer, conducted an income tax preparation business within the physical confines of the attorney spouse’s office. The defendant had an interest in the business but took no supervisory or other responsibility for the work performed. Among the issues presented in the case was whether a sign advertising the income tax practice was unprofessional conduct. Id. at 453. The defendant argued that, since his spouse was conducting a business that was properly performed by a layperson, he is free to advertise that business without regard to professional restrictions on lawyer advertising. The court held that “[o]ne who seeks assistance from a lawyer in what appears to him the simplest sort of income-tax problem has a right to have the lawyer live up to all professional standards in furnishing such assistance.” Id. at 454. Moreover, the court felt the spirit of the ethical rules in question would be violated because a collateral business, “when engaged in by a lawyer, constitutes the practice of law . . . .” Id. at 454 n.4 (emphasis added). The court did not, however, attempt to define the practice of law within the context of tax practice. It merely cited secondary sources for the proposition that returns of a simple nature are properly prepared by non-lawyers. See id. at 454 n.3 (citing 7 Am. Jur. 2D Attorneys at Law § 79 and R.F. Martin, Annotation, Services in Connection With Tax Matters As Practice of Law, 9 A.L.R.2d 797, 801). See also In re Larson, 485 N.W.2d 345 (N.D. 1992) (holding, in a disciplinary proceeding, that a tax preparation practice by a suspended attorney constituted the practice of law). The court in Larson, did not attempt to categorize tax return preparation work but implied that this type of work is properly performed by laypersons because the court held that its reasoning “should not prevent [a suspended attorney] from engaging in tax accounting elsewhere, someplace that the person is not known as a lawyer.” Id. at 350.

84. In a sense the court adopted a form of the incidental test. However, the test would appear to applied by examining the entire practice of the person in question as opposed to each individual service performed.

85. Gardner, 48 N.W.2d at 796.
was deemed, by the court, as narrow specialization of a dangerous kind. 86

What standard is to be used in determining whether a legal question is
difficult or elemental? The court held that such a determination is to be made
through the understanding “possessed by a reasonably intelligent layman who
is reasonably familiar with similar transactions.” 87 The test is applied based
on the facts and circumstances of the particular case. 88 The court did not
distinguish between laypersons, apparently dividing the universe into lawyers
and non-lawyers. 89

Although it refrained from providing a bright line test, the court provided
some inkling as to the line of demarcation in tax practice.

Matters in this field, as in other statutory subjects, will at times involve
difficult questions of statutory interpretation of statute or court decision,
and the validity of regulations or statute; they will also involve doubtful
questions of non-tax law on which tax issues may depend . . . . Such
questions, in general, are the kind for which lawyers are equipped by train-
ing and practice. 90

The court then specified areas where the accountant may play a key role, such
as inventory accounting methods, accrual issues, depreciation, carryovers and
 carrybacks, and consolidated return issues. 91

The reasoning of the Gardner court has been followed in California. In
Agran v. Shapiro, 92 an action to recover for accounting services rendered, the
respondent performed three distinct services for the appellant. First, the re-
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86. See id. The court cited In re New York County Lawyers Ass’n, 78 N.Y.S.2d 209 (N.Y.
App. Div. 1948) and Albright v. United States, 173 F.2d 339 (8th Cir. 1949) as evidence of
the danger of narrow specialization and the benefit of broad legal training, respectively. One
is left to wonder how much of an effort was made to find case law going the other way.
87. Gardner, 48 N.W.2d at 796.
88. Id. at 796-97.
89. In fact, the court held that “[a] layman, whether he is or is not an accountant, may not
hold himself out to the public as a tax consultant or a tax expert, or describe himself by any
similar phrase which implies that he has a knowledge of tax law.” Id. at 798.
90. Id. at 797 (citing Maurice Austin, Relations Between Lawyers and Certified Public
Accountants in Income Tax Practice, 36 IOWA L. REV. 227, 228 (1951)).
91. Id.
was the relationship between federal legislation and regulations and state unauthorized practice
of law rules and whether the former displaces the latter. The court held that state law is not
preempted by the federal rules. See id. at 628-30. Of course, this case was decided prior to
Sperry. For a discussion of the Sperry preemption doctrine see supra notes 31-50 and
accompanying text.
93. Agran, 273 P.2d at 621.
prepared an application for tentative carryback adjustment of a loss incurred by the appellant in 1948 to the years 1946 and 1947. Finally, the loss carryback was challenged upon audit and the appellant researched the issues raised by the revenue agent and held several conferences with the agent. The principle point of contention was whether the loss incurred in 1948, and carried back to 1946 and 1947, and forward to 1949, was incurred in a trade or business, a necessary condition to the allowance of a carryback. The respondent was successful in his negotiations with the Internal Revenue Service.

The court, finding that the law and accounting are “inextricably intermingled” in the field of taxation, held that, in preparing the tax returns, the respondent was not engaging in the practice of law. The court, in reaching its conclusion, looked to the nature of the taxpayer’s return and, in effect, adopted the Gardner difficult versus elemental test. The court noted that it had generally been conceded that the preparation of federal income tax returns is within the proper function of a public accountant, “except perhaps in those instances where substantial questions of law” are involved. In light of the taxpayers limited sources of income and the routine nature of their business operations, the court found the returns to be of “simple character such that an ordinary layman without legal or accounting training might have prepared them in the first instance.”

The court did not, in addressing the preparation of the tax returns, provide any insights into the standard or standards to be used in measuring the difficulty or substantiality of legal issues. However, the court did elaborate on this point in dealing with the issue of whether the other two services performed by the respondent resulted in the unauthorized practice of law.

With respect to the filing of the tentative carryback claims and the related negotiations with the revenue agent, the court found these services to constitute the practice of law. The court reasoned that, because the fact that the loss occurred and the manner in which it arose were not disputed, the only issue that remained in order to determine whether it qualified for carryback

94. Id.
95. A portion of the 1948 was not absorbed in the carryback years of 1946 and 1947 and, therefore, was carried forward to 1949. Id. at 622.
96. Id. at 623.
97. Id. at 622.
98. Id. at 623.
99. Id.
100. Id. Presumably, the court’s reference to accounting training was merely to embellish the court's opinion that the returns were simple. It would seem most odd to adopt a test for determining whether a return is simple enough for an accountant by requiring that accounting training is unnecessary.
treatment was whether it was incurred in a trade or business, as required by statute. In holding that the issue in question was one of law, the court looked to whether the issue was one that properly resided with a jury to decide. 101

Moreover, the court clearly adopted the Gardner standard after determining that the issue was a legal one, by inquiring whether the legal question presented was a difficult or doubtful one. In holding that issue was, in fact, a difficult one, the court placed reliance on the frequency the issue had been litigated or ruled upon by the Treasury Department, and the time and effort expended by the respondent in researching the issue. 102 Additionally, the court went on to expressly reject the incidental test, quoting extensively from Gardner. 103 The court, however, did not make clear whether it adopted the Gardner reasonable layman test to determine whether a legal issue is a difficult one. Instead, the court looked to the effort expended by the tax advisor in researching the dispute and the relevant historical antecedents.

In Zelkin v. Caruso Discount Corp., 104 the court had occasion to apply the reasoning of Agran but, in a decision that highlighted the unworkability of the Gardner test, found that the case before it was distinguishable from Agran. The plaintiff, a certified public accountant, 105 represented taxpayers in negotiating with the Internal Revenue Service. This type of service represented the plaintiff's primary line of business. The defendant engaged the plaintiff to represent it to contest certain deficiency assessments proposed by the Treasury Department. 106 The most significant tax issue present was whether the defendant, a cash basis taxpayer, was in constructive receipt of funds held by a commercial finance company in reserve. 107 The plaintiff testified that he had

101. The court stated “[w]e think that on this proof, no question of fact was presented for submission to the jury. The undisputed proof made it a question of law for the court.” Agran, 273 P.2d at 623-24, (citing Wilson v Eisner, 282 F. 38, 41 (2d Cir. 1922))(a case that dealt with the issue of whether an activity was engaged in for profit or for pleasure). Moreover, the court, after citing case law holding that the issue of whether a loss or expense has been incurred in a trade or business is a factual issue to be resolved on a case by case basis, relied on an Eighth Circuit case that made the issue subject to de novo court review. Id. at 624 (citing Washburn v. Comm'r, 51 F.2d 949, 951 (8th Cir. 1931)).

102. Id.

103. Id. at 624-26.


105. The plaintiff also had obtained a law degree but, apparently, was not licensed to practice law. See id. at 222.

106. Id.

107. Id. at 222-23. The defendant corporation sold conditional sales contracts to Commercial Credit Corp. As security for the purchase Commercial Credit Corp. was entitled by contract, to withhold a percentage of the purchase price as a reserve. The original contract, calling for a five percent retention, was modified to take into account the quality of the paper purchased, market conditions, and general business activity. Id. at 223. The relevant tax issue concerned
performed research at two law libraries and reviewed the original reserve agreement. The plaintiff contended, however, that his research was directed toward a determination of proper accounting methods employed by taxpayers in similar factual settings.

The defendant, citing *Agran*, asserted that the plaintiff’s services constituted the unauthorized practice of law. The court distinguished this case from *Agran*. The court placed its emphasis, in part, on the volume of research undertaken by the layperson when it stated that “[t]he Agran case is, however, clearly distinguishable from the instant matter, for the accountant there testified that he cited numerous cases . . . and that he ‘spent approximately four days in reading and reviewing over one hundred cases on the proposition of law involved.’” Moreover, it appears the court attempted to divorce tax accounting from its legal underpinnings. The court held that the plaintiff “could be said to have been practicing law only if on the face of the problem which he was negotiating no discussion of that problem would be possible without reference to legal issues and no persuasive argument could be made which did not include a discussion of legal principles.”

In *Lowell Bar Ass’n v. Loeb*, the Supreme Judicial Court of Massachusetts had before it a petition brought by a local bar association to enjoin the respondents from giving legal advice in connection with liability to pay income tax and the preparation of income tax returns. The respondents included an attorney who, while devoting little time to the business in question, owned American Tax Services, an unincorporated business engaged in preparing individual income tax returns on a high volume basis — a sort of predecessor to H.R. Block. Other respondents included the wife of the owner, who devoted all her time to the business, and a general manager. Only the general manager was an accountant.

The court declined to enunciate any broad principles that were not necessary in deciding the case. However, the court provided insight into its view of the prevailing law. First, the court appeared to sanction the

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109. *Id.*
110. *Id.* at 224.
111. *Id.*
112. *Id.*
113. 52 N.E.2d 27 (Mass. 1943).
114. *Id.* at 30.
incidental test. The court stated:

The proposition cannot be maintained, that whenever, for compensation, one person gives to another advice that involves some element of law, or performs for another some service that requires some knowledge of law, or drafts for another some document that has legal effect, he is practicing law. All these things are done in the usual course of the work of occupations that are universally recognized as distinct from the practice of law. There is authority for the proposition that the drafting of documents, when merely incidental to the work of a distinct occupation, is not the practice of law, although the documents have legal consequences. We cite the cases for that principle, and not to approve the application of that principle to the particular facts of the cases cited. 115

The court went on to discuss the drafting of documents incident to other professions and occupations, such as architecture, insurance and brokerage. 116 The court, however, expressly reserved opining on the application of the incidental test where the issues presented are complex. 117

Secondly, in the context of tax practice, the court appeared to draw a bright line with respect to certain practices. The commencement of legal proceedings in court in cases related to taxes is exclusively reserved to lawyers. 118 Moreover, the court stated that:

[d]oubtless the examination of statutes, judicial decisions, and departmental rulings, for the purpose of advising upon a question of law relative to taxation, and the rendering to an client of an opinion thereon, are likewise part of the practice of law in which only members of the bar may engage. 119

Finally, the court decided the case at hand based on the simplicity of the returns prepared by the respondents. "[W]e find the respondents engaged in the business of making out income tax returns of the least difficult kind. . . . The forms. . . . can readily be filled out by any intelligent taxpayer. . . . who has the patience to study the instructions." 120 The court rejected the notion that

115. Id. at 31.
116. Id. at 31-32.
117. Id. at 34.
118. Id. at 32-33.
119. Id. at 33. In Groninger v. Fletcher Trust Co., 41 N.E.2d 140 (Ind. 1942), the court held that the furnishing of pamphlets to customers describing the tax law, illustrating tax liability under different circumstances, and describing the proper method of making returns could not "be seriously contended . . . [as constituting] an unlawful practice of law." Id. at 142. Generally, the sale of printed material, even when purporting to explain legal practices to the public, has not been held to be the practice of law. The courts are divided, however, on the question of whether the sale of "how to" kits constitutes the practice of law. See generally 7 A.M. Jur. 2d, supra note 30, § 102 (1980).
120. Lowell Bar Ass'n, 52 N.E.2d at 34. In Rhode Island Bar Ass'n. v Libutti, 100 A.2d
there are no real differences between simple and complex legal issues, and drew on the practices of the community.

Somewhat related to the *Gardner* line of cases are those that deal with the issue of accountant representation of taxpayers before state or local administrative agencies. The outcome of these cases typically turns on whether the services rendered constitute the practice of law — which, invariably, they do. 121 Once that determination is made, the courts have tended to resolve the issue by examining the rules of the agencies in question and applying a separation of powers analysis. 122 The courts have not applied the incidental test. 123 By implication, these cases stand for the proposition that these services involve inherently “difficult” matters of law or involve services that are the exclusive province of attorneys, regardless of their difficulty. Little or no analysis is performed with respect to the subject matter of the issues that are before the administrative body in question.

406 (R.I. 1953) the state bar association sought to enjoin a public accountant from preparing income tax returns. The injunction was sought on two grounds. First, the accountant, not a certified public accountant nor a member of the American Institute of Accountants, was precluded by statute from preparing income tax returns. The statute in question limited return preparers to members of the bar, certified public accountants, or members of the American Institute of Accountants. *Id.* at 406-07. Secondly, the accountant, in preparing returns other than those of taxpayers whose income is less than $5,000, entirely subject to withholding, and who claim the standard deduction, was engaged in the unauthorized practice of law. *Id.* at 407. The court decided the case on the statutory grounds and did not reach the issue of whether preparation of these more complex returns was the practice of law. *Id.* at 407-08. Note that one court has held that statutory provisions restricting the class of persons eligible to prepare income tax returns for compensation to certified public accountants and attorneys were violative of the Fourteenth Amendment. See Moore v. Grillis, 39 So. 2d 505, 512 (Miss. 1949) (en banc).

121. But see Tanenbaum v. Higgins, 180 N.Y.S. 738 (N.Y. Sup. Ct. 1920) (distinguishing between administrative and judicial bodies and holding that the Tax Department of the City of New York was not a judicial body and, consequently, practice before it was not the practice of law).


123. See, e.g., Kentucky State Bar Ass’n v. Bailey, 409 S.W.2d 530 (Ky. 1966) (holding that the filing of petitions with the Kentucky Board of Tax Appeals for review of adverse rulings entered by the Department of Revenue constituted the practice of law); Chicago Bar Ass’n v. United Taxpayers of America, 38 N.E.2d 349 (Ill. App. Ct. 1941) (holding that the preparation and presentation of claims for refund of Illinois Occupational taxes to the Illinois Department of Finance constituted the practice of law); Mandelbaum, 290 N.Y.S. at 464
The problem of attempting to resolve unauthorized practice of law issues by resorting to a difficult, elemental dichotomy should be apparent. First, the determination of just what is a difficult question itself leads the courts down a slippery slope. The court in *Gardner* used a reasonably intelligent layperson as the standard with which to gauge the difficulty of a legal issue. However, the court did not attempt to distinguish among laypersons. Laypersons familiar with similar transactions obtain their familiarity from different perspectives. For example, an executive negotiating a transaction will have a distinct base of knowledge and framework in dealing with such transactions from the certified public accountant who must report upon it or the banker who must decide whether to finance the transaction.

The courts in *Agran* and *Zelkin* looked to the amount of research undertaken in determining whether the question at issue was a difficult one. This reasoning is perverse for two reasons. First, it penalizes diligence. A more germane question would have been how much research was necessary. Secondly, because of the factual intensity of many issues, as well as the fact that tax practitioners are prone to hyperlexis, a significant body of law has developed with respect to almost all issues. Using research effort as a proxy for difficulty ignores the fact that a well developed body of law actually diminishes the difficulty of solving particular problems. The impracticality of this test was evidenced by two courts holding, in essence, that an accountant may properly undertake to perform services for which an accountant was not needed at all.

(Stating that the rendering of an opinion used in the application of tax refunds, as to the meaning of a New York statute, constituted the practice of law). In *Mandelbaum* the court implied that practice before the administrative agency in question would be proper, assuming that the agency's rules permitted lay representation. Id. In *Chicago Bar Ass'n* the defendant did raise the defense that the practices in dispute were incidental to the exercise of his rights as a certified public accountant. See *Chicago Bar Ass'n*, 38 N.E.2d at 350. The court did not squarely address this issue. See id.

Issues of lay practice before administrative agencies have arisen with respect to other professions and occupations. In these cases the courts have similarly failed to examine the underlying nature of the dispute or apply the incidental services test. See, e.g., *Stack v. P.G. Garage, Inc.*, 80 A.2d 545 (N.J. 1951) (holding that the appeal of real estate taxes to the county tax board by a licensed realtor amounted to the practice of law); *People ex rel. Trojan Realty Co. v. Purdy*, 162 N.Y.S. 56 (N.Y. App. Div. 1916) (holding that a corporation that appealed real estate tax assessments before the tax board, a quasi judicial body, was engaged in the practice of law).

124. See *Gardner v. Conway*, 48 N.W.2d 788, 796 (Minn. 1951).


126. See infra note 168 and accompanying text.

Secondly, the courts have not made clear whether the difficulty of the issue may arise from the tax law itself, or whether the difficulty must have its genesis in a branch of non-tax law. The courts have refused to accept the notion that the tax law is *sui generis*. Therefore, it would appear that the courts would not limit the source of difficulty to non-tax law. Consequently, assuming a proper understanding of the tax return process, the entire tax return process would be off-limits to accountants — a position that belies eighty years of experience and one that no court has ever entertained.\(^{128}\) If non-tax law must be the root of the difficulty then this distinction among the branches of law impliedly treats the tax law as *sui generis*.\(^{129}\) As discussed subsequently in this article, the interrelationship of tax law and other branches of law should pose no special difficulty for certified public accountants because existing professional standards will require the assistance of specialists, when needed.\(^{130}\)

C. Progress Toward Special Status

Three recent decisions have, to varying degrees, recognized the unique professional status of certified public accountants, and have rejected arbitrary distinctions. Ironically, none of the cases directly involve income tax practice.

The New Jersey Supreme Court has relatively recently had occasion to weigh in on the propriety of accountants preparing inheritance tax returns.\(^{131}\) In 1972 the Committee on the Unauthorized Practice of Law issued Opinion No. 10. In that Opinion, the Committee concluded that the preparation of a New Jersey Inheritance Tax Return by a non-lawyer acting for another would constitute the unauthorized practice of law.\(^{132}\) New Jersey had, by statute, created a line of demarcation between accounting and law as it related to the filing of inheritance tax returns.\(^{133}\) The Committee's conclusion

\(^{128}\) See infra notes 151-54 and accompanying text.

\(^{129}\) The conceptual confusion generated by this test is evident in *Zelkin*. In that case the court either implied that non-tax law must be the source of the difficulty or was operating with a fundamental misunderstanding of tax accounting. The court held that the plaintiff "could be said to have been practicing law only if on the face of the problem which he was negotiating no discussion of that problem would be possible without reference to legal issues and no persuasive argument could be made which did not include a discussion of legal principles." *Zelkin*, 9 Cal. Rptr. at 224. Every tax accounting issue requires a discussion of legal principles for tax accounting is a statutory creation. Therefore, either the court failed to see this or was limiting the legal issues to which it was referring to non-tax legal issues.

\(^{130}\) See infra notes 155-71 and accompanying text.


\(^{132}\) *Id.* at 712.

\(^{133}\) The statute provided, *inter alia*, that no Inheritance Tax report will be accepted unless
was rooted in the belief that the preparation of an inheritance tax return "requires the application of a gamut of legal principles." 134 In 1984 The New Jersey Society of Certified Public Accountants (NJCPA) challenged Opinion No. 10 and the New Jersey Supreme Court granted the petition for review. 135

The court, highlighting the difficulty in drawing a clear line between the two professions with respect to tax practice, held that certified public accountants may prepare inheritance tax returns, but that their clients must be notified in writing, before commencing work on the return, that review of the return by a qualified attorney may be desirable. 136 Thus, the court gave express recognition to a special status for certified public accountants. However, the scope of this special status was mitigated by the notice requirement imposed by the court.

The court reviewed the nature of the Inheritance Tax and concluded that the "preparation of an Inheritance Tax Return is, in general, so dependent on

the estate is represented by an attorney at law of the State of New Jersey, the personal representative of the estate, or certain testate or intestate successors of the decedent. See id. at 713 n.2. The statute further provides that "[n]othings herein is intended to preclude the discussion of accounting problems which may arise in the course of an audit of a New Jersey Inheritance Tax report, with a Certified Public Accountant . . . . Under no circumstances may a C.P.A. enter into discussions regarding any question of law." Id. (emphasis added). This statute had its genesis in regulations promulgated after the issuance of Formal Opinion No. 19 by the Attorney General. See infra note 134.

134. In re New Jersey Soc'y of Certified Pub. Accountants, 507 A.2d at 712. The Committee's conclusion was supported by a formal opinion of the Attorney General. The Attorney General had previously ruled that preparation of inheritance tax returns by a person not licensed to practice law and not acting as a representative of the estate would constitute the unauthorized practice of law. See 19 Op. Att'y Gen. 146 (1955). This opinion, issued in response to an inquiry from the State Treasurer, stated that inheritance tax returns prepared by non-lawyers should not be accepted, effectively removing the State Treasurer's discretion to accept such returns. See id. at 146-49. Formal Opinion No. 19 relied upon the general statutory prohibition to the unauthorized practice of law and held that the State Treasurer, in addition to the express authority to adopt rules to efficiently administer the Department of Treasury, had the implied power to regulate the filing of returns so as to prevent such unauthorized practice of law. See id.

135. See In re New Jersey Soc'y Certified Pub. Accountants, 507 A.2d 711 (N.J. 1986). Several years earlier the New Jersey Society of Certified Public Accountants had requested the Attorney General to review the statute at issue Formal opinion No. 19 but their request was denied. See id. at 713.

136. Id. at 717. The court noted that such notification may be required by a certified public accountant in order to meet her standard duty of care. In light of this duty of care it is difficult to ascertain what the court has accomplished by setting out a notification requirement other than precluding oral notification and use of professional discretion by certified public accountants in determining whether an attorney's review is, in fact, desirable. Given the court's assumption that "certified public accountants will be aware of the boundaries of their own professional skills and will recommend consultation with counsel whenever . . . legal advice is desirable" a rigid notification requirement appears unnecessary. See id.
the correct application of legal principles as to require this Court to exercise its supervisory jurisdiction over the practice of law." 137 However, the court also focused on the purpose of regulating the practice of law. The court refused to "impose needlessly restrictive conditions that disserve the public interest." 138 The court, in reaching its conclusion, appeared to be influenced by several factors. First, the court noted the elaborate certification, admission, and regulatory mechanisms in place that govern certified public accountants practicing in New Jersey. Secondly, the court recognized that "the skills possessed by a substantial number of certified public accountants" qualifies them to prepare and file the returns in question. 139

The court did not provide a workable distinction between law and accounting practice with respect to tax return preparation. The court did not address petitioner's contention that the preparation of a return is an accounting function. 140 The court did find the notion that accounting "merely involves the setting down of figures" as overly simplistic 141 but did not attempt to precisely determine what tax accounting entails.

In *The Florida Bar Re: Advisory Opinion – Nonlawyer Preparation of Pension Plans,* 142 the unauthorized practice of law committee of the Florida Bar Association petitioned the Supreme Court of Florida to approve a formal advisory opinion concerning non-lawyer preparation of employee pension

137. *Id.* at 716. Inheritance tax, like the federal estate tax, is levied on a tax base that is balance sheet oriented. In other words, the tax base is defined with reference to property that exists at a given point or points in time. Income tax is based on the activity of a taxpayer as opposed to property holdings at a particular point in time. Consequently, the importance of accounting issues is diminished. However, without undertaking a detailed analysis, it would appear that the issues facing the tax practitioner in this area, from a doctrinal standpoint, are within the expertise of the certified public accountant. Advice rendered must consider, *inter alia,* the present and future financial impact upon the taxpayer and beneficiaries. Moreover, traditional accounting skills such as the summarization, classification, recordkeeping, and application of present value concepts will be involved. As a practical matter, because the planning process often requires the drafting of documents attorneys are better positioned to provide these services. Moreover, because the tax issues presented are unique to this area attorneys drafting documents are more likely to be more familiar with the relevant tax issues than attorneys drafting commercial documents. *See generally Lawyers and Certified Public Accountants: A Study of Interprofessional Relations,* 36 *Tax Law* 26, 35-36 (1982) (reprinting Statement on Estate Planning issued by the National Conference of Lawyers and Certified Public Accountants in 1981).


139. *Id.* at 717.

140. *See id.* at 715. The petitioners also put forth their right to practice before the Treasury Department and the United States Tax Court as support for their position. *Id.* The court did not address this issue. *See supra* notes 31-50 and accompanying text for a discussion of the federal preemption issue.


142. 571 So. 2d 430 (Fla. 1990).
INCOME TAX PRACTICE AND CPAs

plans. The proposed opinion categorized the various functions of pension planning into those which may be performed by non-lawyers and those that may not. The court declined to approve the opinion. The court relied primarily on Sperry federal preemption grounds. Nevertheless, the court cited approvingly to In re New Jersey Soc'y. of Certified Pub. Accountants.

The Supreme Court of South Carolina has recently examined the proper scope of certified public accountants' services. The South Carolina Bar had submitted, through a special subcommittee of its Unauthorized Practice of Law Committee, a comprehensive set of proposed rules governing the unauthorized practice of law. The proposed rules would have restricted the ability of laypersons, including certified public accountants, to practice before state agencies and the Probate Court.

The court refused to adopt the proposed rules, expressing its preference for resolution of such issues on a case by case basis and not through enforcement of a comprehensive set of rules. Moreover, in the strongest statement to date regarding the status of certified public accountants, the court stated:

[O]ur respect for the rigorous professional training, certification and licensing procedures, continuing professional education requirements, and ethical code required of Certified Public Accountants (CPAs) convinces us that they are entitled to recognition of their unique status. . . . We are confident that allowing CPAs to practice in their areas of expertise, subject to their own professional regulation, will best serve to both protect and promote the public interest.

V. ARGUMENTS FAVORING REMOVAL OF PRACTICE RESTRICTIONS

The necessity for consumer protection, the principle justification supporting the law of unauthorized practice is based on three rationales — competence, motivational, and remedial rationales. The motivational rationale, in my opinion, warrants no further discussion. This section will address

143. Id. at 432.
145. The Florida Bar Re: Advisory Opinion, 571 So. 2d at 433.
146. The proposed rules also would have imposed restrictions upon certified public accountants engaged in federal income tax practice.
148. Id. at 124-25.
149. See supra notes 18-23 and accompanying text.
150. See supra note 21 and accompanying text.
whether restrictions on the practice of certified public accountants in the income tax field are justified by the competence and remedial rationales.

A. Competence Rationale

Limitations on tax practice by certified public accountants cannot be justified on competency grounds for two reasons. First, the tax law is, in several respects, well suited for certified public accountants to master and apply to client factual situations. In a sense, it may properly be viewed as *sui generis*. Secondly, the historical role of certified public accountants in the tax return preparation process provides ample evidence that an unfettered role in tax practice is justified.

1. Tax Law as *Sui Generis*

The tax law, contrary to the position taken by the courts, is different than other areas of law. It is similar to other law in that it is subject to the same interpretive, analytical, and reasoning processes that lawyers use in other areas of the law. However, it is distinguishable from other areas of law because its subject matter makes attempts to segregate accounting and legal issues unworkable. The tax law concerns itself with issues that, in the words of one authority, "revolve[] around timing and character."\(^{151}\)

Income tax laws, by their very nature, define a tax base. In so doing, the classification, measurement, and summarization processes cannot be divorced from the law that makes these processes necessary. Moreover, in most cases, it is the law that establishes the methodologies that are employed in performing these processes.\(^{152}\) The futility of efforts to draw clear borders between the professions is evidenced by the inconsistent criteria employed to demarcate the professions' respective roles in tax practice.

Existing attempts to define the role of lawyers and accountants are unworkable because they allocate the respective spheres of expertise using inconsistent criteria. Accountants are assigned a role based on their substantive


knowledge — a substantive criteria — while attorneys are assigned a role based on their familiarity with the process of law — a procedural criteria.\(^{153}\)

For example, particular types of tax problems are oftentimes considered within the accountants’ area of expertise.\(^{154}\) “The lawyer’s domain becomes exclusive when issues of non-tax law or difficult issues of interpretation come into play. While reserving issues of non-tax law to the lawyer is, in my opinion, appropriate and desirable, the reservation of interpretive difficulties inherent in the tax law to the bar is problematic. This position necessarily implies that the substantive areas that are generally considered within the accountant’s domain involve no interpretative difficulty. However, as the tax return illustrations presented below highlight, a familiarity with the relevant statutes in the areas involved evidences that this assertion goes too far.

a. The problem of non-tax law

Admittedly, as the courts have recognized, the tax law is not a neat self-contained body of law.\(^{155}\) Much of the tax law will turn on legal relationships and consequences that are determined by the application of non-tax federal or state law. Although lawyer exclusivity over matters of non-tax law has not been subject to serious challenge, the respective role of lawyers and accountants needs to be clarified in the event an issue of non-tax law presents itself in an income tax context.

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153. Procedural based criteria are also used to describe a certified public accountant’s role. Generally, such a role is deemed to encompass significant issues of classification and summarization. However, it is difficult to reconcile this approach with the substance — procedure approach described above. This difficulty arises because the tax law itself provides the rules for such processes and, consequently, the procedurally defined scope is either subsumed by the lawyer’s role or a resort to substantive areas must be made.

154. See Austin, supra note 90, at 228-29 (stating that the determination of income may present issues with respect to inventory pricing, accrual and installment accounting, depreciation, and consolidated returns, among others). The Gardner court cited this article for the proposition that certain issues are properly resolved by accountants. See supra note 90 and accompanying text. The National Conference of Lawyers and Certified Public Accountants have also resorted to a similar method of reasoning. In attempting to define the roles of the two professions with respect to federal income tax advice the Joint Statement issued by the conferees asserts that problems raising “uncertainties as to the interpretation of law, or uncertainties as to the application of law to the transaction involved...” may be best referred to an attorney. The Joint Statement goes on to state that difficult issues of “classifying and summarizing the transaction” are best handled by the certified public accountant. See Lawyers and Certified Public Accountants: A Study of Interprofessional Relations, supra note 137, at 34 (reprinting the National Conference’s Statement on Practice in the Field of Federal Income Taxation). Professor Bittker has, however, recognized the problem of determining the proper role of the accountant by reference to particular types of issues. See Bittker, supra note 42, at 186-87.

155. See Gardner v. Conway, 48 N.W.2d 788, 796 (Minn. 1951).
An issue of non-tax law may present itself in one of two ways. First, the transaction in question may involve issues that implicate non-tax law and these issues have relevance separate and apart from the tax consequences. For example, for tax purposes it may be desirable to liquidate a subsidiary tax-free into its parent pursuant to I.R.C. section 332.156 Because, for purposes of I.R.C. section 332, a merger of a subsidiary into its parent is treated in the same manner as a liquidation157 the choice between a state law merger and liquidation will turn on factors separate and distinct from the tax consequences. This scenario presents a clear case for lawyer exclusivity.158

Consider, however, an example involving recently enacted I.R.C. section 197.159 This provision provides that a taxpayer is permitted an amortization deduction for any amortizable section 197 intangible.160 Amortization is determined by recovering the adjusted basis of the section 197 ratably over a fifteen-year period.161 Excluded from the definition of amortizable section 197 intangibles are, inter alia, interests in land162—a term the statute leaves undefined.163 Until such time as regulations, rulings, or court decisions provide guidance the exact scope of this term will depend on state law and other federal law. For example, the determination of whether restrictive covenants or equitable servitudes are interests in land for purposes of section 197 may depend on state property law or analogy to other federal law such as bankruptcy law.164 Other examples requiring resort to non-tax law

156. I.R.C. § 332 applies to liquidations of 80% or more owned subsidiaries. See I.R.C. § 332(b)(1).
158. Other issues may involve a combination of tax and non-tax alternative outcomes—for example, the decision to incorporate a business. These issues are analogous to those tax issues that can only be resolved with recourse to non-tax law. See infra notes 159-65 and accompanying text.
160. I.R.C. § 197(a).
161. Id.
162. I.R.C. § 197(e)(2).
164. Courts have had to resolve similar issues in the context of 11 U.S.C. § 365 (1988). This provision provided a debtor in possession with the option to reject executory contracts. The courts have had to determine whether certain types of covenants are executory contracts, subject to rejection, or are real property interests that may not be rejected. See, e.g., In re Case, 91 B.R. 102 (Bankr. D. Colo. 1988) (holding a covenant that “runs with the land” to be a real property interest).
are easily found.165

This example, and others like it, represent the situation where the application of tax law is dependent upon interpretation or analysis of non-tax law. Clearly, the resolution of the non-tax issue is beyond the training of the certified public accountant. However, nowhere has it been clearly stated just where the accountant’s role ends. When faced with such an issue, must the accountant relinquish her role in resolving the underlying tax issue or, alternatively, may the accountant seek legal advice on the non-tax issue while retaining responsibility for the ultimate tax decision? It would appear that no reason exists to require the accountant to relinquish her role entirely with respect to the tax issue. The resolution of the non-tax matter may be seen as analogous to the situation requiring the retention of an expert in other fields, such as an appraiser or actuary. Moreover, the inability of certified public accountants to draft documents serves to ensure that a lawyer will have input as to whether the tax advice given creates new, or exacerbates existing problems.

Professor Bittker has raised a more troublesome issue. He has had concerns with respect to non-lawyers’ ability to recognize that a non-tax issue exists. Although recognizing that accountants and lawyers have advantages over each other in certain areas, this problem is peculiar to accountants. Professor Bittker put forth three examples of issues whose resolution would turn on non-tax principles of law not mentioned in the tax literature.166 Admittedly, if this is a pervasive problem, then the certified public accountant’s role in the tax process may be properly circumscribed. However, I believe this type of problem to be exceptional. Most interpretive difficulties arise from the application of the tax law itself — pure tax law complexity. Secondly, many issues of non-tax law are readily ascertainable. That is, the statute, regulations, or decisional law will expressly reference the non-tax matter whose resolution will determine the tax consequences. Burke and Treas. Reg. § 1.468B are two such examples.167 In fact, some commentators have posited that the tremendous complexity facing tax practitioners is a result of too much guidance.168

165. For example, after United States v. Burke, 112 S. Ct. 1867 (1992), the excludability of damages awarded pursuant to certain federal antidiscrimination statutes under I.R.C. § 104 will depend, in part, on the remedial scheme employed by the statutes under which the claim is made. See generally Arthur W. Andrews, The Taxation of Title VII Victims After the Civil Rights Act of 1991, 46 TAX LAW. 755 (1993). See also Treas. Reg. § 1.468B-1(c)(2) (1994) (providing that the use of a qualified settlement fund is limited to liabilities from claims taking a particular form or arising under a particular statutory scheme).

166. See Bittker, supra note 42, at 187-88.

167. See supra note 165 and accompanying text. For example, Burke is amply discussed in the tax services. See [1994] 2 Stand. Fed. Tax Rep. (CCH) ¶ 6662.03.

168. See, e.g., Richard M. Lipton, "We Have Met the Enemy and He Is Us": More Thoughts
Moreover, it is unclear whether lawyers, in general, have the breadth of knowledge, at least to the degree that has been assumed, to recognize such issues consistently. The practice of law has gone in the direction of increasing specialization and, in the case of tax law, subspecialization. This tendency to narrow the scope of one's professional expertise undermines, to an extent, the argument that, relative to attorneys, accountants lack the necessary breadth to do the job. Because I believe the recognition problem to be atypical and, given the specialization of most tax attorneys, any advantage accruing to attorneys in this respect is marginal.

On Hyperlexis, 47 TAX LAW. 1 (1993) (decrying the tendency of tax practitioners to demand guidance from the Internal Revenue Service and the Treasury as to the tax consequences of virtually any transaction). Hyperlexis is a term defined by Bayless Manning in 1977 as a "pathological condition caused by an overactive lawmaking gland." See id. at 2.

169. Professor Bittker has suggested, assuming that accountants continue to apply legal principles and the appropriate professional organizations and the Treasury do not work to change this practice, that accountants' training include a larger element of legal education. See Bittker, supra note 42, at 188. The Uniform Certified Public Accountant Examination includes a section on law related topics. This section tests knowledge in a variety of business law areas including among others, contracts, sales, bankruptcy, agency, corporations, and partnerships. See MARK E. ROZKOWSKI, BUSINESS LAW FOR THE CPA CANDIDATE vii - viii (1992). Moreover, most undergraduate accounting curriculums require at least one business law course to be completed in order to earn a degree in accounting. My previous experience as a practicing certified public accountant leads me to believe that non-tax law courses, with respect to training a tax practitioner, are of marginal benefit to a person who has not attended law school. This is because these courses are intended to provide a general level of knowledge with respect to the nature and function of law and its relationship to business. In my opinion, graduate courses in tax law provide far greater exposure to the legal subtleties that one will encounter in tax practice.

170. On November 9, 1992 The American Bar Association adopted the American Bar Association Standards For Accreditation Of Specialty Certification Programs For Lawyers. These standards establish the authority to grant and withdraw accreditation of specialty certification programs for lawyers in particular fields of law. Moreover, the standards require that accrediting organizations demonstrate that lawyers certified by them possess enhanced level of skill and expertise and involvement in a specialty area. As of July 1993 sixteen states had adopted certification plans and an additional two states provide for specialist designation. See SPECIALIZATION DESK BOOK 11-1 to 11-13 (A.B.A. 1993). Of these states, 7 recognize tax law as a specialty. In Louisiana tax law is the only specialty recognized. Recognition of practice specialties began in earnest in the 1970s in response to the de facto specialization that had already taken place. See id. at 1-1. The actual and potential effects of increased specialization by the bar has produced much literature. See, e.g., Norman Bowie, The Law: From a Profession to a Business, 41 VAND. L. REV. 741, 743-44 (1988); Marc Galanter and Thomas M. Palay, Why the Big Get Bigger: The Promotion-To-Partner Tournament and the Growth of Large Law Firms, 76 VA. L. REV. 747, 806-11 (1990). See also REPORT OF THE AMERICAN BAR ASSOCIATION TASK FORCE ON THE GENERAL PRACTITIONER AND THE ORGANIZED BAR 18-19 (July 1984). For an interesting view of the changing nature of tax law practice see M. Bernard Aidinoff, et. al., Tax Lawyering: A Changing Profession, 46 TAX LAW. 665 (1993) (collecting several short essays).

171. This is not to argue that real advantages do not exist to clients in retaining tax lawyers that have such expertise. As in any field of endeavor, let alone law, not all practitioners are created equally. Professor Bittker's views reflect, no doubt, his particular experiences and
2. Tax Return Preparation as Evidence of Competency

The certified public accountant’s role in the preparation of tax returns has generated relatively little controversy. In fact, the accountant’s role in preparing income tax returns was a contributing factor in the growth of the accounting profession in the twentieth century. At the federal level, it appears well settled that Circular 230 has provided an imprimatur immune on Supremacy Clause grounds to any state law challenge. In attempting to define the boundaries between the legal and accounting professions, the courts have not placed much evidentiary weight on the fact that certified public accountants have been engaged in tax return preparation practice since the founding of the profession. This reticence may be explained by the manner in which the courts have viewed the tax return preparation process.

The discussion that follows posits that the courts operate under a fundamental misconception concerning the preparation of tax returns. Once the nature and scope of the tax return preparation process is understood it becomes apparent that a prohibition on the rendering of tax advice, unconnected to the rendering of other services, cannot be rooted in competency grounds. Moreover, if the level of complexity is the criteria for drawing a line of demarcation between the professions, a proper understanding of the tax return level of expertise. He is a recognized giant in the field of federal income taxation. See generally Elias Clark, Boris I. Bittker: Colleague and Friend, 93 YALE L.J. 199 (1983) (paying tribute to Professor Bittker for a remarkable career).

172. The ratification of the Sixteenth Amendment to the United States Constitution by the necessary number of states by the end of February 1913 is generally credited with ushering in a period of unprecedented growth for the accounting profession. The Sixteenth Amendment made possible the enactment of a broad based income tax in October of 1913, effective to March 1, 1913, with the passage of the Revenue Act of 1913, Pub. L. No. 16, 38 Stat. 114 (1913). A national franchise tax on corporations, using cash receipts as a base, enacted in 1909 also increased the need for accountant’s services. See JAMES D. EDWARDS, HISTORY OF PUBLIC ACCOUNTING IN THE UNITED STATES 93-104 (1960). See also 1 JOHN L. CAREY, THE RISE OF THE ACCOUNTING PROFESSION, 67-71 (AICPA 1969); MARK STEVENS, THE BIG EIGHT 139-140 (1984). The first federal income tax was enacted in 1862 in an effort to finance the Civil War. MICHAEL J. GRAETZ, FEDERAL INCOME TAXATION 2 (1988). Federal tax legislation was also passed in 1864, 1870, and 1894. Id. For a brief discussion of the history of the federal income tax see Graetz, at 2-6. The latter legislation was held unconstitutional by the Supreme Court in Pollock v. Farmers’ Loan & Trust Co., 157 U.S. 429 (1895), (prompting efforts to amend the constitution), overruled by South Carolina v. Baker, 485 U.S. 505 (1988). Relatively few persons were subject to tax by these early statutes.

173. See supra notes 31-50 and accompanying text.

174. Using tax return preparation practice as evidence of a broad level of competency in tax law presupposes that the tax returns are being prepared competently. I have not engaged in any empirical research concerning the quality of tax returns prepared by certified public accountants as compared to those prepared by attorneys or other professional group. However, I know of no studies or literature that would tend to dispel the fact that certified public accountants have prepared returns competently over the years.
preparation process would result in almost all income tax returns of business enterprises being considered complex, and consequently, not within the accountant’s proper scope of services. This assertion belies historical experience and accepted business practices.175

Courts in cases presenting unauthorized practice of law issues176 have generally categorized tax return preparation as clerical in nature.177 This view, simplistic to say the least, is not the result of any reasoned examination of the

175. Moreover, it is possible that tax return preparation is a service most attorneys would rather not engage in. See Rhode, supra note 3, at 36 (reporting a consensus among attorneys that unauthorized law practice is not perceived as an economic threat because, inter alia, much of the work is that which attorneys do not want).

176. The nature of the tax preparation process has also been the expounded upon in cases dealing with the attorney-client privilege. Several circuits have held that the attorney-client privilege does not attach to communications incident to the preparation of tax returns because the nature of the tax return preparation service is not a legal service but clerical one. See, e.g., In re Grand jury Investigation of Glen J. Schroeder, Jr., 842 F.2d 1223 (11th Cir. 1987) (holding that preparation of a tax return is not a legal service); United States v. Davis, 636 F.2d 1028, 1043 (5th Cir. 1981), cert denied, 454 U.S. 862 (1981) (holding that, although some knowledge of the law is required, preparation of a tax return is primarily an accounting service); United States v. Gurtner, 474 F.2d 297, 298 (9th Cir. 1973) (holding that consultations with an attorney for the purpose of preparing tax returns are not privileged and, by its choice of citation, implicitly equating tax return preparation with the preparation of a net worth statement). Canaday v. United States, 354 F.2d 849, 857 (8th Cir. 1966) (adopting the reasoning of the trial court that filling out tax returns is scrivener’s work). Cf. Colton v. United States, 306 F.2d 633 (2d Cir. 1962), cert denied, 371 U.S. 951 (1963); United States v. Merrell, 303 F. Supp. 490 (N.D.N.Y. 1969); United States v. Summe, 208 F. Supp. 925 (E.D. Ky. 1962). In Summe, the court clearly refused to accept the notion that tax return matters were somehow less demanding than other legal matters faced by attorneys. This is important because it tends to dispel any question that the court’s view was premised on a Gardner type analysis. For a detailed analysis of attorney-client privilege in the tax return context see Bruce Graves, Attorney Client Privilege in Preparation of Income Tax Returns: What Every Attorney-Preparer Should Know, 42 TAX LAW. 577 (1989).

177. See, e.g., In re New York County Lawyers Ass’n, 78 N.Y.S.2d 209, 220 (N.Y. App. Div. 1948) (stating that preparation of the return was clerical process); In re Larson, 485 N.W.2d 345, 350 (N.D. 1992) (stating, without providing any reasoning, that a suspended attorney may prepare tax returns, which the court considered a “tax accounting” service, in a location where the suspended attorney is not known as a lawyer); In Agran v. Shapiro, 273 P.2d 619 (Cal. App. Dep’t Super. Ct. 1954), the court conceded that preparation of tax returns is within the accountant’s domain but then retreated from providing a categorical treatment of tax returns by stating that a possible exception exists where substantial questions of law are involved. Presumably, this is a form of the Gardner test applied to tax return preparation. Other courts have drawn a distinction between simple and complex returns, either expressly or by implication. The fact that the courts would make such a distinction would appear to imply that the courts regard certain tax returns as involving more than scrivener or clerical work. Unfortunately, no analysis was provided to highlight the courts’ insight into the nature of the tax return process. See, e.g., State v. Willenson, 123 N.W.2d 452, 454 n.3 (Wis. 1963) (citing secondary sources for the proposition that tax returns of a simple nature are within the domain of laypersons); Lowell Bar Ass’n v. Loeb, 52 N.E.2d 27, 34 (Mass. 1943) (holding that, based on the simplicity of the tax returns in question, the respondent was not engaged in the practice of law).
tax return process but is posited in a conclusory fashion. One could reason-
ably conclude that this view of the tax return process stems from the same type of circular reasoning that is found in certain definitions of law practice. That is, because they are typically prepared by accountants tax returns do not in-
volve difficult questions of law.178

Some courts, particularly those that have adopted the Gardner test, have expressed the notion that there is a distinction among tax returns. This distinc-
tion is based on the difficulty of preparing the returns in question.179 However, in these cases the courts appear to treat the complex return as the exceptional or unusual case, which, in my opinion, evidences a failure to understand the nature of the tax return process.180 Moreover, the courts, in giving weight to the complexity of the tax return at issue, are implicitly subscribing to the notion that only simple returns may be prepared by accountants.

Any attempt to categorize services rendered in connection with tax return preparation as legal or accounting in nature will lead, at best, to a conclu-
sory opinion as to what services are best performed, or should be per-
formed, by each profession. The nature of the tax return preparation process, inextricably meshing law and accounting, may be illustrated by two examples. The examples chosen are the procedures necessary to determine tax deprecia-
tion and amortization deductions and liabilities properly accrued for tax purposes.

1. Illustration of the Tax Return Process

I have chosen the two items referred to above for purposes of illustration because they are ubiquitous in the preparation of income tax returns. These

178. Treas. Reg. § 301.7701-15(a)(1)(1980) contradicts this view of the tax return preparation process. This provision provides that a tax return preparer includes anyone who furnishes information and advice “so that completion of the return . . . is largely a mechanical or clerical matter.” Moreover, Treas. Reg. § 301.7701-15(d)(1) categorically excludes persons providing typing, reproduction, or other mechanical assistance from the definition of a tax return preparer. Therefore, the “mere scrivener” categorization is expressly rejected by the Treasury Department.

179. See supra note 120.

180. Whether the determination of whether a return is complex is made by examining whether substantial questions of law exist or by some other factor that correlates with complexity, the courts have failed to consider that all but a fraction of non-individual returns and many individual returns will be complex. A thorough understanding of the process would highlight the futility of such an approach.

181. Depreciation is often used to refer to the periodic cost recovery of tangible assets. Amortization is often used to refer to the periodic cost recovery of intangible assets. For purposes of this article I use the word depreciation to describe the cost recovery of both tangible and intangible assets.
examples are representative of situations that confront the certified public accountant consistently in a tax return preparation practice. They are not atypical. These issues, and others presenting similar difficulties, are pervasive in the preparation of an income tax return of a business entity of any substance. As discussed subsequently, the tax return preparer encounters six distinct types of problems in preparing tax returns. The variety of skills necessary to resolve these problems should provide comfort to those questioning the competency of tax return preparers to venture into other areas of tax practice.

Labeling tax return preparation as mechanical, clerical, or some other such term is grossly inaccurate. It is based on the image of a tax return as a finished product with its numbers representing a taxable years worth of activity neatly summarized. However, "[t]he danger of images lies not in the information they carry but rather in our propensity to believe . . . that we have seen the whole picture." Perhaps this view of the process is grounded, in part, on stereotypical notions about the role of accountants. A better explanation may be found in the distinction between tax planning and compliance work.

182. Moreover, this article does not present, by way of example, issues attendant to broad areas of the tax law that have no counterpart whatsoever in generally accepted accounting principles. For example, the taxation of partnerships and foreign subsidiaries owned by United States persons present issues and concepts that are completely irrelevant from a financial accounting perspective. Because a partnership is not a taxing entity much of the complexity inherent in this area stems from rules that affect the allocation of items to the partners. For example, the rules dealing with the allocation of income and losses to partners and the allocation of partnership debt among the partners for basis purposes are lengthy and, in some parts, of byzantine complexity. See generally Treas. Reg. §§ 1.704-1 & 1.704-2 (1991); Temp. Treas. Reg. § 1.704-1T (1991); Treas. Reg. §§ 1.752-0 - 1.752-5 (1993).

For financial accounting purposes these issues are largely irrelevant. For financial accounting purposes the domicile of an entity is irrelevant to whether it is consolidated with its affiliates. Geography is relevant only insofar as it may affect segment reporting or currency translation. For tax purposes, a veritable maze of rules exist to determine when the income of a foreign entity is subject to United States taxation. See, e.g., I.R.C. §§ 551-558 (dealing with the taxation of foreign personal holding companies); I.R.C. §§ 951-964 (providing the taxing scheme for controlled foreign corporations); I.R.C. §§ 1291-1297 (dealing with the taxation of passive foreign investment companies). Moreover, very complex rules exist to mitigate the potential of multiple taxation due to the multiple jurisdictions that may have claim to the earnings of the entity. See generally I.R.C. §§ 901-908 (providing detailed rules with respect to the foreign tax credit). For a general overview of the United States taxation of foreign entities and the foreign tax credit see JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION, B2-1 to B3-159, B4-1 to B4-287 (WG&L 1992).


184. The illusion that tax return preparation is principally a clerical process may be rooted, historically, to the early years of the accounting profession before the complexity of the income tax laws increased exponentially. Moreover, prior to the advent of the personal computer and its embrace by the profession, a good deal of time was, perhaps, spent in gathering, summarizing, and classifying data.
Tax compliance, or tax return work, is performed *ex post*. The transactions that must be reported have already taken place. If the assumption is made that most tax issues are resolved *ex ante* then the clerical, mechanical view of tax return preparation may be justified. However, most issues are not resolved *ex ante*. There are several reasons for this. Many transactions, for example, do not warrant examination *ex ante* because the expense of doing so is preclusive. Alternatively, certain expenditures may be necessary despite the tax consequences. Moreover, significant transactions that have been examined *ex ante* are often resolved at a macro level. For example, a transaction may be examined to assure it qualifies as a tax free reorganization or that certain provisions do or do not apply. The detailed application of the relevant statutes and regulations is often left to the tax return preparer.

a. Depreciation

Depreciation is, I venture to say, an area that most tax practitioners would consider to be within the accountant’s sphere of expertise — perhaps exclusively so. In order to properly report depreciation deductions, a process of aggregation, classification, and calculation will be necessary — activities well within the traditional role of a certified public accountant. Moreover, in opining upon the financial statements, a similar process has already taken place.\(^{185}\) However, a description or analysis of the tax return preparation process cannot conclude at this point.

The process of aggregating, classifying, and calculating incident to a determination of the tax return depreciation deduction is very similar, as a process, to the procedures required to determine depreciation expense for financial accounting purposes. The substantive work, however, depends to a great extent on obtaining a working knowledge of a bewildering array of statutes, regulations, administrative pronouncements, and case law.\(^{186}\) By substantive work, I mean the reasons why transactions are aggregated and classified in a particular manner and the methodology employed in calculating a final result. It is beyond the scope of this work to provide a discussion, or even

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185. The amount of work performed during the course of an audit with respect to any given account or group of accounts will depend on the scope of the audit procedures employed and the level of assistance given by the client’s personnel. Statistical sampling is often employed and, in cases where such techniques are employed, as few as 5% of transactions may be examined. For a detailed discussion of statistical sampling in an audit context see AICPA PROFESSIONAL STANDARDS (CCH) AU ¶¶ 350.03 - 350.47 (1985). Moreover, even in cases where extensive analysis of an account or group of accounts are made generally accepted accounting principles may differ from tax accounting rules.

186. A partial listing of the I.R.C. provisions that may be implicated include §§ 162, 163, 167, 168, 197, 263, 263A & 1274.
a listing of all the issues that may arise with respect to depreciation.  

A sampling of the issues that frequently arise, however, will highlight the futility of attempts to categorize the entire tax preparation process into one nice neat category.

The tax return preparer will confront six broad types of problems in deriving a tax depreciation figure. The types of problems to which I am referring are categorized using a process oriented typography. In other words, the focus of attention will be placed on the type of skills necessary to solve particular substantive tax issues, and not on the substantive tax issues themselves. The skills required to properly solve these problems are varied. The problems that confront the tax preparer should fall within the Gardner court's definition of difficult and, moreover, belie any notion that the application of legal principles is incidental to the preparation of tax returns.

The first set of problems involves the data gathering, summarization, and classification. The procedures incident to completing these tasks involved at this stage are well suited for the accountant to perform. The exact procedures that are necessary will vary from enterprise to enterprise but examples of typical procedures would include an analysis of general ledger activity within certain accounts and an examination of source documentation such as invoices, requisitions, and the like.

The second type of problem encountered is the application of a simple legal concept whose resolution is heavily fact intensive. I call this the simple legal — factually complex type of problem. The classic presentation of this issue is the question of whether an expenditure is properly expensed or capitalized.  

Section 263(a) denies a deduction for amounts that are properly chargeable to a capital account. Included within ambit of section 263(a) are amounts expended for the acquisition of "new buildings or for permanent improvements or betterments made to increase the value of any property or estate." In addition, amounts expended in restoring property or in making good the previously deducted exhaustion of that property must be capitalized. The Supreme Court has held that expenditures must be capitalized if they either create a separate and distinct asset or if they provide a significant long-term benefit.

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187. For a comprehensive treatment of depreciation see Depreciation: MACRS and ACRS, 531 Tax Mgmt. (BNA) (1994); Depreciation: General Concepts; Non-ACRS Rules, 530 Tax Mgmt. (BNA).
188. This issue is also present for financial statement purposes and, in the easy cases, will resolve itself at this stage.
The concept is simple.\textsuperscript{192} Has a separate and distinct asset been acquired or created or does the expenditure have future utility? Ironically, at its core this issue is one of the most basic of accounting issues and, in a sense, is analogous to the situation presented in \textit{Zelkin}, where the constructive receipt doctrine was involved.\textsuperscript{193} The easy cases — those involving the acquisition of an identifiable or distinct tangible asset — pose little difficulty. The tough cases involve expenditures that, at first glance, appear to be properly classified as a repair or maintenance expense. The question that must be answered with respect to these expenditures is whether they have future utility. An answer to this question will require a close examination of all the facts surrounding the expenditure and a thorough knowledge of how the Internal Revenue Service has ruled and what the courts have held in situations presenting similar fact patterns.\textsuperscript{194}

\textsuperscript{192} Statutory complexity does arise with respect to this issue due to the application of the uniform capitalization rules imposed by I.R.C. § 263A. Closely related to the expense versus capitalization issue, these rules provide for the capitalization of certain direct and indirect costs to inventory produced or acquired and certain other property produced by the taxpayer. The application of these rules requires a two step process. First, capitalizable costs must be identified. Second, these costs must be allocated to the ending inventory or other property at issue. The first step involves the application of basic cost accounting principles, although the costs that must be capitalized are defined by regulation rather than by full absorption accounting theory. Cost accounting is, by its nature, mechanically complex. \textit{See generally L. Gayle Rayburn, Cost Accounting} (5th ed. 1993). However, these regulations provide an additional layer of complexity. This additional complexity is caused by the various methods of allocation that are available to a taxpayer with no counterpart in generally accepted accounting principles. For an analysis of the uniform capitalization rules see \textit{Uniform Capitalization Rules}, 2-2nd Tax Mgmt. (BNA) (1992).

\textsuperscript{193} \textit{See supra} notes 104-12 and accompanying text.

\textsuperscript{194} Certain patterns or themes have emerged from the multitude of rulings and court holdings dealing with this issue. For example, expenditures incurred to make property suitable for a new use must be capitalized. \textit{See, e.g.}, United States v. Wehrli, 400 F.2d 686 (10th Cir. 1968) (holding that expenditures incurred as a part of a general plan to adapt property for a new use must be capitalized); California Casket Co. v. Comm'r, 19 T.C. 32 (1952) (requiring that costs incurred to convert a warehouse to a factory be capitalized). Likewise, expenditures that materially enhance the useful life of an asset or increase its fair market value must be capitalized. \textit{See, e.g.}, Pacific Fruit Express Co. v. Comm'r, 60 T.C. 640 (1973) (holding that the cost to repair railroad cars must be capitalized because the expenditures in question served to increase the useful lives of the cars); Hudlow v. Comm'r, 30 T.C.M (CCH) 894 (1971) (requiring that forklift repair costs be capitalized because the repairs performed extended the useful life of the trucks and increased their market value). Whether an expenditure increases the value of an asset or extends its useful life is determined by comparing the value or life of the asset before the event or events that necessitated the repairs occurred with its post repair value or useful life. \textit{See Plainfield-Union Water Co. v. Comm'r}, 39 T.C. 333 (1962). Otherwise, any routine maintenance work would be captured by this test. Moreover, expenditures that individually would fail to meet this test for capitalization may nevertheless be capitalized if they are part of an overall plan of renovation or rehabilitation. \textit{See Ruttenberg v. Comm'r}, 52 T.C.M. (CCH) 370 (1986). For a thorough analysis of the repair versus capital expenditure issue see \textit{Deductions Limitations: General}, 504 Tax Mgmt. A-43 - A-59 (BNA) (1993).
Accounting theory, while useful to obtaining a grasp on the issue, will prove relatively useless in resolving the difficult cases. This is because for purposes of applying generally accepted accounting principles, the determination of whether an expenditure should be capitalized will be influenced by the matching principle and the concept of conservatism.\textsuperscript{195} For tax purposes the matching principle, while relevant, is not a necessary condition for capitalization treatment\textsuperscript{196} and the conservatism concept is irrelevant, if not diametrically opposed to bedrock tax principles.\textsuperscript{197} This lack of congruence between accounting and tax principles is underscored by the uncertainty generated by \textit{INDOPCO}. The second prong of the \textit{INDOPCO} test — whether an expenditure has future utility — is a classic matching concept issue. Ironically, however, it is this issue that has caused the greatest consternation and anxiety among tax practitioners.\textsuperscript{198} The tax preparer may well be guided by accounting theory, but may be on firmer ground if she examined the issue with a touch of Holmesian realism and anticipate how the courts may decide the issue.\textsuperscript{199}

\textsuperscript{195} The matching principle is the term used for the principle that expenditures should be charged to income in the period or periods in which related revenue is generated. Expenditures that create an asset yield a benefit over several years and are recovered systematically through an allocation procedure - depreciation and amortization, for example. See \textit{FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS No. 6, ELEMENTS OF FINANCIAL STATEMENTS 50-52} (1985). Conservatism is a fundamental accounting concept that represents "a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered. Thus, if two estimates of amounts to be received or paid in the future are about equally likely, conservatism dictates using the less optimistic estimate . . . " \textit{FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS No. 2 QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION 40} (1980).

\textsuperscript{196} In Rev. Rul. 94-38, 1994-25 I.R.B. 4, the Internal Revenue Service ruled that expenditures incurred in connection groundwater and soil remediation activities not involving the construction of tangible property were currently deductible. This ruling expressly endorsed the matching principle but also asserted that I.R.C. § 263A applies in the case where tangible equipment is acquired despite the fact that the waste disposal practices that necessitated the remediation have been discontinued — circumstances where the matching principle would be violated. For a discussion of § 263A see \textit{supra} note 192.

\textsuperscript{197} In contrast to the principle of conservatism tax deductions are deemed a matter of legislative grace. See \textit{Interstate Transit Lines v. Comm'r}, 319 U.S. 590, 593 (1943); \textit{Helvering v. Indep. Life Ins. Co.}, 292 U.S. 371, 381 (1934).

\textsuperscript{198} The Internal Revenue Service has sent out mixed signals as to whether it will use the \textit{INDOPCO} precedent with a modicum of restraint or as a bludgeon to require capitalization of many expenditures heretofore treated as period costs. See, e.g., Rev. Rul. 92-80, 1992-C.B. 57 (ruling that \textit{INDOPCO} will not affect the treatment of advertising costs as deductible business expenses under § 162); Priv. Ltr. Rul. 92-400-04 (June 29, 1992) (ruling that asbestos removal costs had to capitalized because, \textit{inter alia}, of the future health benefits that would result). See also Peter L. Faber, \textit{Indopco: The Still Unsolved Riddle}, 47 TAX LAW. 607 (1994);\textsuperscript{199}

\textsuperscript{199} In attempting to answer the question "what constitutes the law" Holmes, viewing the
A third type of problem is presented by issues that, by their very nature, are complex. I call this type of issue the statutorily complex problem. Several examples of this type of problem are presented in connection with the calculation of tax depreciation. For instance, depreciation must be calculated for purposes of determining alternative minimum taxable income so that liability for the alternative minimum tax, if any, may be determined. In fact, in the case of corporations, two separate depreciation calculations must be made in order to calculate alternative minimum taxable income. The alternative minimum tax is, to a great extent, a tax imposed on a second tax base. The tax base is derived from taxable income and adjusted upward or downward by certain statutorily defined items and, increased by statutory items of tax preference. The alternative minimum tax scheme, contained in five I.R.C. sections, is fraught with definitions, percentage limitations and phase-outs, elections and its interstices are conceptually difficult to master.

law through the eyes of a bad man, dismissed the importance of axioms and deductions and stated that "[t]he prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by the law ..." Oliver Wendell Holmes, The Path of the Law, 10 HARV. L. REV. 457, 461 (1897).

For convenience I use the expression "statutorily complex" to include problems or issues rendered complex by regulation or administrative pronouncement in addition to those problems involving the application of a complex statute.

The alternative minimum tax scheme was enacted as part of the Tax Reform Act of 1986, § 701, Pub. L. No. 99-514, 100 Stat. 2320 (1986). A detailed analysis of the alternative minimum tax is beyond the scope of this work. For a thorough analysis and historical overview of the alternative minimum tax see Alternative Minimum Tax, 288-4th Tax Mgmt. (BNA) (1989).

All taxpayers are required to adjust taxable income for depreciation deductions in calculating alternative minimum taxable income. The adjustment is made by calculating depreciation under the alternative depreciation system of § 168(g) and substituting the 150% declining balance method for certain property. Certain elections available in calculating depreciation for regular tax purposes may affect the calculations necessary in determining depreciation for alternative minimum tax purposes. See I.R.C. § 56(a)(1). In the case of corporations a second calculation must be made for purposes of determining adjusted current earnings. In essence, a second tier adjustment is mandated. Depreciation is one of items that requires adjustment.

In addition, § 53 provides a credit against the regular tax liability for minimum tax liability paid in prior years attributable to certain adjustments. The credit is intended to allow a credit for minimum tax liability caused by timing differences between the two taxing systems but is somewhat broader in effect.

See I.R.C. §§ 55(c)(1); 56(d)-(e);

See I.R.C. §§ 55(d)(3); 56(d)(1)(A); 59(a)(2)(A).

See I.R.C. § 59(e).
A second example of a statutorily complex provision affecting depreciation is the restrictions applicable to listed property. Listed property is defined as any passenger automobile; other property used as means of transportation; property generally used for purposes of entertainment, recreation, or amusement; computers and peripherals; cellular telephones and similar equipment; and any other property specified by regulations.\(^{207}\) The significance of property being classified as listed property is that annual depreciation deductions for certain of such property is limited to an amount provided by statute\(^{208}\) and further limitations are placed on depreciation in cases where the business use of the asset fails to exceed 50 percent of total use.\(^{209}\) Moreover, detailed recordkeeping requirements are imposed upon taxpayers in order to support business usage of the asset in question.\(^{210}\) The regulations implementing section 280F are of Byzantine complexity. Various tables are provided in order to apply the rules to leased assets.\(^{211}\) It is noteworthy that these rules have no conceptual counterpart in the body of generally accepted accounting principles.

A fourth type of issue that confronts the tax return preparer is the ambiguous statute. In many cases it is just not clear what a statute means or whether it applies to a particular factual situation. Ambiguities will generally exist with respect to recently enacted provisions because the Internal Revenue Service and the courts have not had the opportunity to resolve, or provide guidance on, the issue or issues at hand.\(^{212}\) Section 197 provides several examples of ambiguity created by new legislation.

Section 197, enacted as part of the Omnibus Budget Reconciliation Act of 1993\(^{213}\), provides that a taxpayer is permitted an amortization deduction for any amortizable section 197 asset.\(^{214}\) The amortization deduction is deter-

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208. See I.R.C. § 280F(a)(1)(A) (providing limits on the annual depreciation deduction for passenger automobiles). The annual limitation is annually adjusted for inflation, as measured by the CPI automobile component. See I.R.C. § 280F(d)(7).
209. If property is not predominately used in a qualified business use then depreciation must be determined under the alternative depreciation system provided for under § 168(g). See I.R.C. § 280F(b).
211. See Temp. Treas. Reg. § 1.280F-5T (1993). The objective of these rules is to adjust a taxpayer's lease expense in order to place leased assets subject to § 280F in a rough parity with taxpayer owned assets.
212. Ambiguities are not, however, found exclusively in relatively recent provisions. See infra notes 237-39.
214. I.R.C. § 197(a). A detailed analysis of § 197 is beyond the scope of this work. For a thorough analysis and historical background see STATEMENT OF CONFERENCE MANAGERS FOR THE REVENUE PROVISIONS OF TITLE XIII OF THE OMNIBUS BUDGET RECONCILIATION
mined by amortizing the adjusted basis of the section 197 asset ratably over a period of fifteen years.\textsuperscript{215} Property subject to section 197 is treated, for all purposes of Chapter 1 of the Internal Revenue Code, as property which is of a character subject to depreciation under section 167.\textsuperscript{216} Included in the definition of amortizable section 197 assets are goodwill and going concern value.\textsuperscript{217} One of the purposes of the enactment of section 197 was to place goodwill and going concern value on equal footing with other intangible assets to eliminate the excessive litigation that had arisen prior to its enactment. However, various statutory and regulatory provisions, predating the enactment of section 197, identify goodwill and going concern value for special treatment, arguably contrary to the spirit of section 197 or the applicable provision in question.\textsuperscript{218}

The fifth type of issue involves questions that require the exercise of professional judgment. Judgment is an attribute that is required only where a choice among alternative courses of action is available. The various elections available to the taxpayer, made with the filing of the income tax return, with respect to depreciation are a good example of issues calling for the exercise of judgment.\textsuperscript{219} The decision whether to make a particular election will be influenced, \textit{inter alia}, by predictions concerning the future tax liabilities

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\textsuperscript{215} I.R.C. § 197(a).
\textsuperscript{216} I.R.C. § 197(f)(7).
\textsuperscript{217} I.R.C. § 197(d)(1)(A)-(B).
\textsuperscript{218} For example, I.R.C. § 1060 applies in certain cases only when goodwill and going concern value may attach to a group of assets. See Temp. Treas. Reg. § 1.1060-1T(b)(2) (1988). Because § 197 has separately defined various types of intangible assets, such as workforce in place or customer based intangibles, that have traditionally been subsumed within goodwill or going concern value it is questionable whether the application of § 1060 should be limited to acquisitions where goodwill and going concern may attach. Of course, this assertion is premised on the fact that goodwill and going concern value are similarly defined for purposes of §§ 197 and 1060 – a premise that is fraught with its own ambiguity. An analogous issue is presented by Treas. Reg. § 1.1031(a)-2(c)(2) (1991). This provision categorically denies like-kind exchange treatment for goodwill and going concern value.
\textsuperscript{219} See, e.g., I.R.C. § 59(e)(allowing the taxpayer the option to amortize certain expenditures over a 10 year period for alternative minimum tax purposes); I.R.C. § 168(b)(5) (providing for an election to use the straight-line method of depreciation for certain property); I.R.C. § 168(g)(7) (providing for an election to use the alternative depreciation system for regular tax purposes); Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13,261(g)(2)(A), 107 Stat. 312, 540 (1993) (providing the taxpayer with an election to early apply § 197). The importance and pervasiveness of elective provisions is evidenced by the fact that an entire treatise is devoted to them. See generally MICHAEL B. LANG & COLLEEN A. KHOURY, FEDERAL TAX ELECTIONS (WG&L 1991).
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of the client, administrative convenience, and effects on third parties.\footnote{220}{Finally, the last type of issue present is the actual calculation of the deduction. This is the most mechanical phase of the process. It should be apparent that the complexity that is an inevitable consequence of the volume of law in this area is in no way limited to arithmetic messiness. In fact, with the proliferation of tax preparation software, the arithmetic is usually the least of an accountant’s concern.\footnote{221}{b. Liability Accruals

The determination of whether liabilities should be accrued for tax purposes presents, like depreciation, issues that are generally thought of as accounting in nature.\footnote{222}{To be sure, the entire area is premised on the matching principle\footnote{223}{and a major portion of the preparation and examination of financial statements will involve accrued liabilities.\footnote{224}{Although the relative

\footnote{220}{For example, the election to adopt certain depreciation methods will be influenced by the fact that these methods may avoid the administrative expense of calculating depreciation under a second method. Moreover, certain elections will bind third parties to a particular tax treatment of certain items. For example, the election to apply § 197, discussed at \textit{supra} note 219, will bind all taxpayers under common control with the electing taxpayer to the same treatment. \textit{See} Omnibus Budget Reconciliation Act of 1993, \textit{supra} note 219, § 13,261(g)(2)(B).

\footnote{221}{The fact that much of “number crunching” is performed by tax preparation software does not, in any way diminish the need for a working knowledge of the present law. For example, the appropriate classification of property must be made by the preparer. Moreover, various elections are available to taxpayers. These elections will require analysis as to the probable tax consequences that will follow the making of an election or the failure to do so. \textit{See}, e.g., I.R.C. § 168(b)(5) (providing for an election to substitute the 150 percent declining balance method for the 200 percent declining balance on certain cases); I.R.C. § 168(f)(1) (allowing an election to exclude property from the modified accelerated depreciation system if depreciation would otherwise be properly calculated under a units of production or similar method); I.R.C. § 168(g)(7) (providing the taxpayer an option to elect the application of the Alternative Depreciation System for regular tax purposes). For a brief discussion of the computer usage in tax return preparation practice see Thomas W. Holgland & Sam A. Hicks, \textit{Computer Usage and Tax Software in a Tax Practice}; AICPA Tax Division Survey Results, 1994 \textit{TAX ADVISER} 446 (July 1994).

\footnote{222}{Most income tax returns prepared for business enterprises will be prepared on the accrual basis of accounting. Most corporations are prohibited from computing their income on the cash basis method of accounting. \textit{See} I.R.C. § 448(a)(1). Exceptions are made for certain qualified personal service corporations and corporations with less than $5,000,000 in average annual gross receipts during a predetermined base year period. \textit{See} I.R.C. §§ 448(b)(2), 448(c). Moreover, use of the cash basis method of accounting is precluded for any trade or business in which inventories are present. \textit{See} Treas. Reg. § 1.446-1(c)(2) (1992).

\footnote{223}{See \textit{supra} note 195.

\footnote{224}{The principle of conservatism places great emphasis, in an audit context, on the search for unrecorded liabilities — possibly as much or greater emphasis than is given to examining recorded liabilities. \textit{See} \textit{supra} note 195.}
importance or prevalence of the issues may vary, the same six types of issues will confront the tax preparer as she encountered in the depreciation context.225

The data gathering, summarization, and classification work related to the determination of tax accruals is relatively uncomplicated. An examination of financial accounting accruals will, typically, be the starting point in the process. Because of the conservatism principles much of the analysis will focus on whether liabilities accrued for financial reporting purposes should be similarly accrued for tax purposes.226

The second type of issue, the simple legal — factually complex problem, surfaces with respect to the all events test. The all events test requires that, before a liability is properly accrued, all the events have occurred that establish the fact of the liability and the amount of the liability may be determined with reasonable accuracy.227 The economic performance rules have, to an extent, minimized the importance of the all events test.228 However, the

225. The timing of tax accruals is relevant not only for purposes of determining the timing of deductions but also in determining whether an item is properly capitalized at a given point in time. See Treas. Reg. § 1.446-1(c)(1)(ii)(B) (1992). Conceptually, the determination of proper tax accruals is more difficult than the determination of tax depreciation. That is because the allowance of a deduction is fraught with exceptions and special rules depending upon the type of taxpayer that is involved or the nature of the expenditure. In essence, the relevance of when an item is incurred is dependent upon whether the item is deductible at all. The complexity inherent in this area is evidenced by the fact that 14 pages were required in one work to provide a table of contents. See Deductions: Overview and Conceptual Aspects, 503 Tax Mgmt. (BNA) (1994).

226. A major focus in the financial accounting process will include a search for unrecorded liabilities. Typically, the procedures performed in such a search will include a review of events and transactions occurring after the accrual date, review of various types of source documentation and inquiries of client personnel and outside advisors who may possess relevant information. For tax purposes, a review of these procedures could reveal liabilities that have not been accrued for accounting purposes but should be accrued for tax purposes.


228. The economic performance rules, contained in I.R.C. § 461(h), were enacted by Pub. L. No. 98-369, § 91(a), 98 Stat. 598 (1984). These rules do not displace the all events test but provide, in the case of certain liabilities, that the all events test shall not be met any earlier than the time economic performance occurs. See I.R.C. § 461(h)(1). The rules work, in general, to deny the accrual of a liability until certain events occur. The triggering events depend upon the nature of the liability in question. In general, the rules categorize liabilities as payment or service liabilities and require actual payment or the provision or receipt of services, respectively, before a liability may be accrued. See I.R.C. § 461(h)(2). Ironically, these rules require a major departure from generally accepted accounting principles with respect to payment liabilities — tort claims, for example — while at the same time providing for an exception for certain items that is based, in part, on the application of the matching principle. See I.R.C. § 461(h)(3)(A)(iv)(II).
former rules have not eliminated the application of the latter and, in many cases economic performance issues will substitute for those issues previously arising under the all events test.

The concept, relatively simple to understand, is closely related to the standards applied in a financial accounting context in order to determine whether a liability should be recorded. However, the all events test is much more rigid and formalistic. Whether the incurrence of a liability is probable is largely irrelevant. The focus, instead, is on the occurrence of a discrete event. Whether the test is met will depend on the facts and circumstances. Moreover, whether a liability may be estimated with reasonable accuracy is not always clear.

Statutory complexity — the third type of issue — also confronts the tax preparer with respect to the determination of tax accruals. An example that comes to mind is the original issue discount rules. The original issue discount rules, enacted in 1984, require the application of time value of money concepts to certain items. By their very nature these rules are complex. Moreover, the applicable statutes and regulations are laden with definitions and exceptions. Their application to contingent liabilities is illustrative of the complexity added by these rules.

Consideration given for the acquisition of assets often includes a contingent element based on the productivity of the business or particular assets acquired. The basis of the assets in question are not adjusted until such time as the contingent element becomes fixed. The original issue discount rules require that a portion of the contingent payment be recharacterized as interest by discounting the contingent payment back to the acquisition date.

229. For financial accounting purposes liabilities are defined as “probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.” FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS NO. 6 ELEMENTS OF FINANCIAL STATEMENTS, 13 (1985).

230. The Internal Revenue Service has taken the position that a liability cannot be determined with reasonable accuracy until all the necessary facts about the amount of the liability are known. See, e.g., Priv. Ltr. Rul. 78-31-003 (April 13, 1978) (ruling that liability for reclamation work could not be determined with reasonable accuracy because the taxpayer had not yet performed the work nor contracted with a third party to perform the work).


234. See Prop. Treas. Reg. § 1.1275-4(c)(3)(ii), 51 Fed. Reg. 12,022 (April 8, 1986). This result is generally favorable for the buyer because the interest portion of the payment will be deductible currently while the principal portion of the payment, allocated among the assets purchased, will be recovered over the remaining life or cost recovery period of the asset or assets in question.
Moreover, the amount not recharacterized as interest must then be allocated to the assets purchased as if the amount was incurred at the time of acquisition.\textsuperscript{235}

The fourth type of problem, ambiguity, is also prevalent with respect to the tax treatment of accrued liabilities. Several examples may be posited. In the case of the sale of a business, liabilities of the seller are often assumed by the buyer. The seller must determine whether, and at what point, the liabilities that have been assumed by the buyer are deductible. Existing guidance tends to conflict and leaves unanswered questions.\textsuperscript{236}

A very recent example of an ambiguous provision is provided by \textit{Albertson's, Inc. v. Comm'r.}\textsuperscript{237} One of the issues presented in that case was

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\item In general, allocation of the purchase price to the components of a group of acquired assets is performed using the residual method. The residual method segregates assets into four classes. The purchase price is allocated sequentially among the classes. Classes of assets are allocated purchase price only to the extent there remains amounts to allocate after previous classes have been allocated their share of the price, limited to the fair market value of the assets within the class. \textit{See} Temp. Treas. Reg. § 1.338(b)-2T (1986); Temp. Treas. Reg. § 1.1060-1IT(d) (1988). Contingent amounts are allocated as if they were incurred at the time of acquisition and will, therefore, require the reapplication of the residual method. If the asset or assets in question have been disposed of then the contingent amount that would have been allocated to such asset or assets may be written off. Temp. Treas. Reg. § 1.338(b)-3T(d) (1988); Temp. Treas. Reg. § 1.1060-1IT(f) (1988). If the allocation of contingent amounts results in an increase to the basis of assets subject to cost recovery under § 168 then the increase in basis is recoverable over the remaining years in the assets' recovery period. \textit{See} \textit{id.}; \textit{Prop. Treas. Reg. 1.168-2(d)(3), 49 Fed. Reg. 5940} (1984). An exception to the reapplication of the residual method exists for contingencies relating to specific income-producing intangible assets, such as patents and copyrights. Purchase price adjustments relating to these assets are made directly to the assets in question. Temp. Treas. Reg. § 1.1060-1IT(f)(4) (1988).
\item For example, in the case of nonqualified deferred compensation liability the seller is not entitled to a deduction for liabilities that have been assumed until such time as the employees include the payment in income although, apparently, the seller must include the liability assumption as part of the amount realized on the sale. \textit{See} Priv. Ltr. Rul. 89-39-002 (June 15, 1989). Liability for past service cost in a qualified plan setting, however, is not deductible at all by the seller nor is it included as part of the amount realized on the sale. \textit{See} Priv. Ltr. Rul. 84-36-002 (March 23, 1984); Priv. Ltr. Rul. 84-11-106 (Dec. 16, 1983). Presumably, I.R.C. § 404 overrides the assumed liability doctrine with respect to qualified plan liabilities. In the case of payment liabilities under the economic performance rules the seller would obtain an immediate deduction at the time of assumption provided these liabilities have been "expressly assume[d]." Treas. Reg. § 1.461-4(g)(1)(ii)(C) (1992). The regulations do not, however, make clear exactly what is required in order for a buyer to "expressly assume" a liability. Except for qualified plan liabilities, the buyer will generally treat the assumption of the liability as part of the purchase price of the assets purchased. The amount of the liabilities assumed should be allocated to the assets at the time the relevant tests for accruing liabilities are met. For an in depth analysis of these issues see MARTIN D. GINSBURG & JACK S. LEVIN, 1 MERGERS, ACQUISITIONS, AND LEVERAGED BUYOUTS §304 (CCH Tax Trans. Lib. 1993).
\item Albertson's, Inc. v. Comm'r., 95-1 U.S.T.C. (CCH) § 50,016 (9th Cir. 1993), \textit{aff'd}
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whether interest on deferred compensation was subject to the same deductibility restrictions as the deferred compensation on which the interest was accrued. The court, relying on the plain meaning of the statute and legislative history, held that interest accrued on deferred compensation is not subject to the deferred compensation rules. The court’s holding has been the subject of much debate and will not be the last word on this matter.

The exercise of professional judgment, the fifth type of issue, does not appear to play as great a role in this area. Of course, judgment plays a major part in resolving ambiguities, but I am referring here to the selection among alternative courses of action, each of which carries the same level of risk of error. Elections are available in certain cases, but whether a liability is accruable is generally not subject to choice, at least on an ex post basis. At that point, the decision confronting the tax preparer is whether to deduct or capitalize the item associated with the liability.

Finally, the mechanical aspects of liability accruals pose very little difficulty, except in cases where the original issue discount rules apply or in cases implicating specialized deductions such as insurance reserves. Unlike depreciation, however, the software necessary for these calculations is more specialized and not as easily accessible as standard off-the-shelf products.

B. Remedial Rationale

The other significant justification for prohibitions placed on the practice of law by the laity is the fact that attorneys are governed by an elaborate code of ethics and subject to sanction by the court for breaches of ethical duties. The existence of ethical duties and remedial schemes to redress their breach provide a layer of protection in addition to traditional tort remedies.
Extending this rationale to inhibit tax practice by certified public accountants is a non sequitur for two reasons. First, certified public accountants, like attorneys, are subject to regulation by virtue of their professional status. Second, certified public accountants engaged in tax practice are subject to an elaborate body of rules that govern professional conduct specific to tax practice.

1. Professional Regulation — In General

Certified public accountants are subject to the jurisdiction of state boards of accountancy. These boards are charged with enforcing and interpreting the statutory rules governing the licensing and regulation of certified public accountants. Every state, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands has a board of accountancy created by a public accountancy act. Every jurisdiction sets minimum requirements for licensing. Among the more common requirements, in addition to passing the Uniform CPA Examination, are those governing education, experience, and continuing professional education. In addition, a majority of jurisdictions require the passing of a special examination, or the taking of a special course in professional ethics. Moreover, every jurisdiction has established a disciplinary mechanism to deal with breaches of prescribed duties.

The American Institute of Certified Public Accountants (AICPA), the national trade association of certified public accountants, has promulgated a level of due care exhibited in a particular engagement fall below a reasonable level. See generally Joseph J. Portuondo, 

Malpractice Risks of Tax Practitioners, 46 N.Y.U. INST. ON FED. TAX, § 18 (1988). Moreover, in Hafried v. Comm’r, 162 F.2d 628, 634 (3d Cir. 1947), the court made clear that, for purposes of meeting the reasonable cause exception for certain tax penalties, a taxpayer will not be disadvantaged for relying on the advice of an accountant.

A summary of the various requirements by jurisdiction may be found in DIGEST OF STATE ACCOUNTANCY LAWS AND STATE BOARD REGULATIONS (AICPA, NASBA 1992) [hereinafter DIGEST OF STATE ACCOUNTANCY LAWS]. A baccalaureate degree is required in the vast majority of jurisdictions in order obtain a CPA certificate and license to practice. A small number of states allow certification without a baccalaureate degree. However, in such cases, the experience requirements that must be met are more stringent. See id. at 103-05. Effective in the year 2000 all new members of the AICPA will be required to have completed 150 semester hours of college. To date a majority of states have also adopted this requirement. See, e.g., I.L., ANN., STAT. ch. 2 25, para. 450/3 (Smith-Hurd Supp. 1994). Florida has had this requirement in effect since 1983. See Fla. STAT. ANN. § 473.306(2)(b)(2) (West 1991).

An element of dishonesty or fraud are grounds for revocation or suspension of the license to practice; DEL. CODE ANN. tit. 24, § 117 (1987) (containing rules similar to those of Pennsylvania cited above).
The AICPA Code of Professional Conduct is comprised of Principles that are broad aspirational guides for conduct and Rules that are specific and mandatory. The Rules prescribe minimum levels of conduct below which a certified public accountant may not fall without risking disciplinary action including loss of membership in the AICPA. The Rules, drafted in broad general terms, require, inter alia, integrity, objectivity, professional competence, the exercise of due care, adequate planning and supervision in the performance of professional services, and the maintenance of client confidences. Moreover, the Rules prohibit acts discreditable to the profession and provide restrictions on the use of contingent fee arrangements, commissions and referral fees, and advertising and solicitation.

2. Tax Practice Specific Regulation.

In addition to a professional code of conduct, certified public accountants engaged in tax practice are subject to a variety of standards specific to tax practice. The AICPA has issued Statements on Responsibility in Tax

247. CODE OF PROFESSIONAL CONDUCT (AICPA 1988).

248. A member of the AICPA engaged in the practice of public accounting is required to observe all the Rules of Conduct. The practice of public accounting, defined in rather circular fashion, as "holding out to be a CPA or public accountant and at the same time performing for a client one or more types of services rendered by public accountants" encompasses income tax practice. See id. at Introduction. A member not in public practice must observe Rule 102, governing integrity and objectivity, and Rule 501, prohibiting acts discreditable to the profession. Id.

249. Detailed guidance is issued in the form of Interpretations of the AICPA Rules of Conduct. These Interpretations are promulgated by the Executive Committee of the Professional Ethics Division of the AICPA. A summary of Interpretations promulgated under the various Rules of Conduct may be found in LARRY P. BAILEY, 1994 GAAS GUIDE 44.05-.44 (1994). Additional guidance may be found in the Rulings on Ethics issued by the Executive Committee of the AICPA. These Rulings apply the Rules of Conduct and Interpretations to a particular set of circumstances. A synopsis of the various Rulings, organized by Rule of Conduct, is available in id. at 44.44-62.

250. See CODE OF PROFESSIONAL CONDUCT, supra note 247 at Rules 102, 201, 301. Attempts to maintain minimum levels of quality services are not limited to the promulgation and enforcement of the Code of Professional Conduct. In January 1988 the membership of the AICPA voted to require members engaged in public accounting to participate in mandatory practice monitoring programs. These programs require CPA firms to either undergo a peer review or enroll in the AICPA quality review program. For a detailed discussion of these programs see HOWARD P. McMURRIAN, ET. AL., GUIDE TO QUALITY CONTROL (7th ed. Practitioners Publishing Co. 1994).

251. CODE OF PROFESSIONAL CONDUCT, supra note 247 at Rule 501.

252. Id. at Rule 302.

253. Id. at Rule 503.

254. Id. at Rule 502.
Practice. These Statements — eight in all — establish standards for tax practice and define the responsibility of the certified public accountant to the client, the public, and the government. The Standards provide guidance on a broad range of issues including the taking of tax return positions, departure from administrative rulings or court decisions, knowledge of errors, and the provision of tax advice. Unlike the Code of Professional Conduct, these Standards will not trigger sanction for their breach. However, they may be indirectly enforced by the Internal Revenue Service, the courts, or state agencies.

Moreover, in federal practice, the tax practitioner must contend with a plethora of statutory and administrative provisions designed to maintain the integrity of a predominately self-assessed system of taxation. Circular 230 imposes a number of duties and restrictions on persons practicing before the Internal Revenue Service. Moreover, the Treasury Department has the authority to suspend or disbar a person from practicing before it for, inter alia, incompetence, disreputable conduct, or violation of statutes or regulations. One court has expressly noted that administrative control over practitioners diminishes the need for independent measures designed to protect the public.

An additional source of control over tax practitioners is exercised by the

255. Eleven Statements were issued between 1964 and 1977. In 1988 these Statements were significantly revised and reissued in the form of eight Statements.


258. See Circular 230, § 10.21-10.33.

259. 31 U.S.C. § 330(b) (1988); Circular 230, § 10.50. Disreputable conduct is defined in § 10.51 of Circular 230. A willful violation of Circular 230, in addition to the acts enumerated in § 10.51, may also be grounds for suspension or disbarment. Id. § 10.51. For a discussion of certain procedural aspects of Circular 230 disciplinary actions see Wolfman, Et Al., supra note 46, ¶¶ 117.0152-0153. No attempt was made to compile the duties imposed on tax practitioners by state or local tax authorities. The threat of sanctions at the federal level should provide an ample deterrent because, notwithstanding the increasing importance of state and local tax burdens, the inability to practice at the federal level would, in most cases, prove to be a death sentence for a tax practice.

Internal Revenue Code’s penalty scheme. In addition to taxpayer penalties the Internal Revenue Code contains several provisions aimed directly at tax practitioners. These penalties are not limited to tax return preparers but also cover tax shelter activity and aiding and abetting taxpayers in the understatement of tax liability.

V. CONCLUSION

Admittedly, in terms of expertise in tax matters, there are differences between the law and accounting professions. However, these differences relate, in the main, to the type of tax work best performed by each profession. With that said, blanket generalizations, although potentially accurate at a macro level, fail to consider the individual case. Certified public accountants should be judged individually and their expertise subjected to existing professional standards. We do not expect all lawyers to be tax experts as the price for allowing lawyers to be engaged in tax practice. Let’s grant the same courtesy to certified public accountants. The tax law is a complex, fluid body of law. The public is best served by allowing the marketplace to decide how and among whom services will be divided.

261. See, e.g., I.R.C. § 6694 (providing monetary penalties on return preparers where any part of an understatement of tax is due to a position for which there was not a realistic possibility of success); I.R.C. § 6695 (providing monetary penalties for failure to provide certain information to a client or the Internal Revenue Service). For a comparison of the realistic possibility of success standard of § 6694 with the ABA and AICPA standards see WOLFMAN, ET AL., supra note 46, ¶ 214.

262. See I.R.C. §§ 6700-6701. In addition to monetary penalties the Internal Revenue Service may seek injunctive relief, in appropriate circumstances, under I.R.C. §§ 7407 & 7408.