Chapter 2
Professionalizing the Tax Accounting Profession: Fulfilling Public-Interest Reporting Responsibilities

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2.1 Introduction

In the next chapter, Tim Fogarty provides compelling evidence that accounting is in the process of deprofessionalizing; that is, accounting is losing its claim to professional status. One of the reasons for this deprofessionalization is that the accounting profession has lost its focus on public interest responsibilities. The focus on public interest responsibilities means placing societal interest ahead of self-interest when these interests are in conflict. Accounting has an inherent public interest role and both practitioners and accounting academics should be concerned about the erosion of this role. Although the public interest role is often associated with the auditing profession, it is equally important in the tax profession. Tax accountants walk a fine line between promoting the interests of their clients as part of their tax advocacy role and protecting the integrity of the tax system as part of their role as tax professionals. Recently, however, the former has dominated almost exclusively.

In this chapter, we present suggestions for forwarding and improving the professional status of tax accounting. Ultimately, this requires changing current values that have permeated the profession. This is not an easy process. Fogarty (2014) concludes that we need to understand how values become embedded in social practices. Our goal is to understand this process and, based on such an understanding, to make suggestions for change. To achieve our goal, we draw on the sociology literature. This literature provides a foundation for understanding how structures (like professions) arise and how they change over time. Specifically, we use the Barley and Tolbert (1997) model that provides a helpful pattern for understanding why structures tend to persist through time and how they can change. We use this

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model to understand both the current status of our profession and to identify ways for reversing the current trajectory.

The remainder of the chapter is organized as follows. First, we outline an ideal state of the tax profession. Suggestions for change are only meaningful if there is a clear goal toward which we are working. Second, we examine the distance between the ideal state (the goal) and the current state of the profession. We use the fraud triangle as means of understanding this distance. Third, we examine the Barley and Tolbert (1997) model from the sociology literature as a mechanism for understanding structural change. Essentially, the model helps us understand how we might move from the current structure toward the ideal structure. Finally, we conclude by proposing a path to change based on the Barley and Tolbert model.

2.2 The Normative Professional Ideal (The Goal)

2.2.1 A General Reporting Model

The tax profession is a specialized example of a more general reporting environment. Figure 2.1 presents an ideal general reporting model. Three parties are involved: the reporter, reportee, and report user(s).

The reporter issues a report based on an assessment of reportee performance. The report serves two general purposes. First it accurately measures and substantively reflects reportee performance. Second, it communicates information about

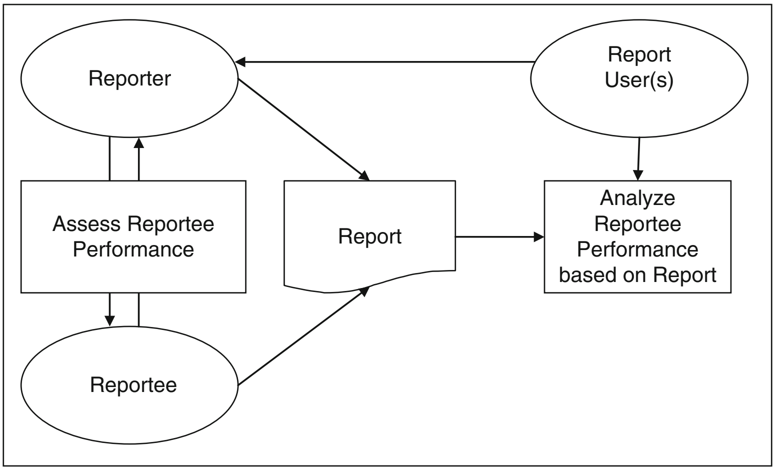

Fig. 2.1 A general reporting system

the reportee's performance to users who rely on this information for analysis and decision making. Because reporters control both what and how information is reported in the system's reports, they play a critically important public interest role. In essence, reporters have a dual obligation: they must balance the needs of the reportee (who wants to present its operations in the best possible light) against the public interest (protecting the users of the report). Reporters fulfill and satisfy these dual public interest responsibilities and build trust in a healthy, functioning reporting system by reporting truthful, accurate information. Meeting these public interest reporting responsibilities is the foundation of a sustainable, functioning reporting system. Report users and reportees communicate with reporters in a feedback loop on how well reporters are meeting their public interest reporting responsibilities.

We can apply this general model to the tax accounting profession. Professional tax accountants (reporters) prepare tax returns (reports) on tax client (reportee) performance for the taxing authority such as the IRS (report users). Tax accounting professionals fill the critical tax reporting role by reporting truthful accurate information to satisfy the reporting public interest responsibilities to clients and the tax system and help create a healthy, functioning, trusted tax system. What complicates matters is that tax accountants also provide tax planning advice to clients which ultimately impacts the amounts reported.

2.2.2 The Tax Accounting Professional's Public Interest Foundation and Resulting Tensions

Serving public interest responsibilities is integral to the notion of profession. Although the concept of profession has been widely debated in the literature, two key characteristics of professions appear to be consistently and widely accepted within the literature (May 2001; Toren 1975). First, there is an intellectual dimension. A profession is marked by "a body of theoretical and technical knowledge" (Toren 1975, 325). Second, there is a moral dimension which requires "a service orientation" (Toren 1975, 325). This public interest role is the distinctive basis for all professions (Scott 1965; Hall 1967, 1968) including the accounting profession (Wilkerson 2010; Cohen and Holder-Webb 2006, 26; Almer et al. 2005, 5; Puxty et al. 1994, 77–78; Dillard 2008).

The AICPA explicitly recognizes the tax professional's dual obligations to the client to act as a client advocate and to the tax system (AICPA 2009) to foster integrity in the tax system by honestly and fairly administering tax laws. It is not sufficient to merely represent private interests. A CPA must place the public interest ahead of those of the client and self-interests. Client advocacy is an acceptable standard in tax practice, but objectivity should not be sacrificed along the way. Similarly, the IRS has repeatedly emphasized the obligations of the tax professional to the tax system and the need for balance. For example, Shapiro (1986) notes:

> The [public interest] responsibility is of pervasive importance…In the normal practitioner-client relationship, both duties are recognized and carried out. However, there are situations in which this is difficult. In those situations, the practitioner is required to decide which obligation prevails and, in so doing, may correctly conclude that *the obligation to the tax system is paramount…The IRS relies on tax practitioners to assist it in administering the tax laws* by being fair and honest in their dealings with the Service and by fostering confidence…in the integrity of the tax system. (136, 139, emphasis added)

In a similar vein, Pickard (2005) states:

> We can't administer the tax system alone. We rely on the work of accountants and attorneys to make sure people get good advice and take the proper tax positions….Individual and business taxpayers rely on their CPAs to give them answers that are correct under the law without causing them to pay more than they have to. It's a delicate balance, and one that requires integrity. (Pickard 2005, 31)

An ideal, healthy, functioning tax system relies on tax accountants who build trust in the tax system by fulfilling their public interest responsibility. This responsibility requires practitioners to balance the commercial, self-interested incentives they face with their responsibilities to clients and the tax system. If tax practitioners focus on commercial interests to the exclusion of the public interest, they risk loss of professional status and self-regulation privileges. Failing to meet public interest reporting responsibilities invites external regulation to curb inappropriate behavior and protect the public interest[1].

There are numerous examples where tax practitioners have ignored their obligation to the tax system. One pertinent example is the use of abusive tax shelters to create artificial losses via mechanisms that serve no business purpose. According to media reports one of the Jenkens and Gilchrist attorneys who pleaded guilty to tax fraud admitted that “she wrote false opinion letters designed to justify complex financial transactions that reduced the potential taxes to be paid by the firm's clients. The overall scheme created more than $400 million in false tax losses” (Bray 2012). It would appear that the accountants who developed these shelters failed to take into account their public interest obligation. Similarly, Henchman (2008) reports on the Sale-in-Lease-out (SILO) transactions in which private corporations (who could use depreciation deductions) “purchased” public transit assets from public authorities (who could not take advantage of depreciation deductions). The private corporations involved immediately leased them back to the public entities and eventually sell them back at the end of the lease term. Again, there is a legitimate question as to whether the accountants who developed and promoted these artificial schemes to move deductions out of the hands of public entities and into the hands of corporations, without any legitimate business change or purpose, simply abandoned their public interest obligations in the interests of profit making.

[1] One example of this might be seen in the role of the PCAOB which serves to limit the professional autonomy of professional accounting firms.

2.3 De-professional Erosion (The Current State): A Fraud Triangle Analysis

As noted in the previous chapter (Fogarty 2014), recent developments in the accounting profession suggest that there has been a shift from professional public interest ideals to self-interested business pursuits. Beginning in the mid-1960s, the accounting profession gradually shifted from professionalism to commercialism (Zeff 2003a, b). Big firms transformed from organizations strongly imbued with professional values to ones strongly pursuing commercial and business goals placing added pressure on partners to generate fees and placate clients. Numerous other authors have noted this development among the major accounting firms not only in the US but globally (Sikka 2008; Hanlon 1994). Sikka (2008) cites comments made by former SEC chief accountant Lynn Turner in a PBS interview as follows:

> Today they [major firms] are a business firm, and the CEOs and culture at the top of these firms is, "What can we do [to] make our business more profitable?". (p. 277)

The fraud triangle (Cressey 1953) provides a helpful and well-established framework for analyzing this shift in the tax profession. A fraud, or "trust violation" in Cressey's (1953) terminology, generally involves three elements depicted in Fig. 2.2 below: opportunity, incentives, and rationalization. We use the fraud triangle to analyze the illegal tax shelters that became a significant part of the tax environment in the 1980s and 1990s. We focus on tax shelters because they provide an example of the way the tax profession sacrificed its public interest responsibility in pursuit of commercial gain and each of the Big Four public accounting firms played a widespread, extensive and dominant role in the tax shelter industry (Wang 2003). Understanding this drift helps us to determine ways to restore the public interest focus and thus reverse the deprofessionalization trend.

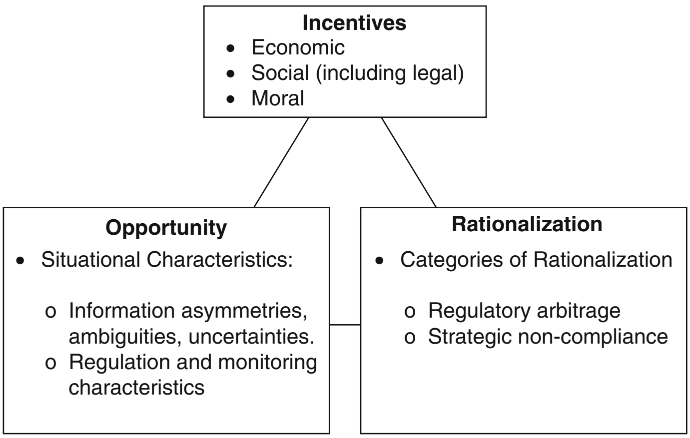

Fig. 2.2 Fraud triangle model—factors contributing to tax reporting frauds

2.3.1 Opportunity[2]

Opportunities for fraud arise from information asymmetries, uncertainty, or ambiguity combined with absent or inadequate monitoring and enforcement mechanisms. Reporters and reportees have an informational advantage over report users because they control the information reported (creating opportunity). The IRS lacks the resources to monitor all tax reporting activity and is often at an informational disadvantage in the tax reporting environment (Smith 2004). "Gray" areas in the tax law require judgment and create opportunities to aggressively exploit so-called loopholes to lower taxes but at the cost of sacrificing tax system integrity and the tax authority's trust in tax accountants.

One example of this tax-law ambiguity is the legal uncertainty surrounding abusive tax shelters and the resulting opportunities for commercial gain. The primary purpose behind abusive or illegal tax shelters is the avoidance or evasion of taxes in a manner not intended by the law (Permanent Subcommittee 2005). This distinction between abusive and legal shelters is not always clear in practice, and this ambiguity made it easier for the Big Four to find lawyers willing to support aggressive shelters (Wang 2003, 1259). Limited tax authority monitoring and enforcement further fueled the opportunity for the use of tax shelters (Wang 2003). The IRS lacked sufficient resources to monitor tax shelter activity (Smith 2004), and this increased the opportunity for fraud.

2.3.2 Incentives

It is well established that incentives influence judgment (Watts and Zimmerman 1986) and can motivate fraudulent tax reporting. Incentives take three primary forms: economic, social and moral (Levitt and Dubner 2005, 21). Economic incentives cause individuals to act in their own self-interest. They generally involve cost-benefit considerations and the prospect of financial gain or loss. For example, client fees, client acquisition, and client retention provide strong economic incentives for the tax practitioner. Counterbalancing these economic benefits are the corresponding potential economic risks, penalties, and fines from aggressive fraudulent activity.

In the abusive tax shelter example, economic incentives substantively dominated public interest responsibilities. The immediate economic gains and tax shelter earnings were substantial relative to inconsequential potential penalties (Smith 2004).

[2] We present the fraud triangle elements with opportunity first followed by incentives and rationalization. This maintains consistent parallels and symmetry with our proposed practical educational model in Sect. 2.5.1 and presented in Fig. 2.4. This is also consistent with Stuebs (2010) and Stuebs and Thomas (2011). We recognize that the auditing literature often presents the fraud triangle in a different order with incentives first followed by opportunity and rationalization.

Contingent fees elevated the potential return from aggressive tax shelter sales providing additional key economic incentives (Wang 2003). These economic incentives became more salient in an environment of competitive market forces. Contingent fees, market pressures, and other salient economic incentives played a key role in diverting accounting firms' attention away from steadfastly administering their entrusted client advocate and legal administrate responsibilities in favor of commercial gain (Permanent Subcommittee 2005, 88).

Social incentives involve the aversion to being seen by others as engaging in wrongful behavior. They are similar to "subjective norms" or an individual's perception of social pressures in the Theory of Planned Behavior (Ajzen 1985) and can be either formal or informal. Obeying authority (Milgram 1963) and conforming to group norms (Asch 1958) are examples of common social incentives. Legal compliance is a powerful formal social incentive. In addition to pressures to comply, social incentives can also involve pressures to impress by meeting or exceeding perceived social norms and expectations. Social pressures reinforced the use of abusive tax shelters. For example, in the well-known KPMG tax shelter case, superiors placed intense pressure on subordinates to comply with and impress superiors by 'signing-off' on the merits of a proposed product even with serious questions about its legal compliance (Permanent Subcommittee 2005, 22; Minority Staff 2003, 7; Milgram 1963) reflecting strong social pressure to serve commercial interests over the public interest (Smith 2004).

Moral incentives involve individuals' aversion to something they consider wrong. Moral incentives focus on duties, responsibilities and obligations. For example, the tax accountant has dual responsibilities to advocate for the client and to serve the public by maintaining tax system integrity.

In the tax shelter case, there is evidence that firms used their reputations to give legitimacy to tax shelters that were highly questionable. For example, an illustrative internal KPMG e-mail stated: "Our reputation will be used to market the transaction" (Permanent Subcommittee 2005, 20). Essentially, senior executives in the firm were willing to use the firm's reputation (the belief that this firm would not support something unethical) in order to make commercial gain but in a way that was directly opposed to the factors that had created this positive reputation (selling tax shelters that were hard to understand and that were not consistent with basic ethical practices). Instead of being upheld, the public interest reputation of the profession was not only disregarded but used to pursue commercial gain.

2.3.3 Rationalization

Rationalization involves the individual's internal response to external opportunities and reconciles an individual's moral incentives with economic and social incentives. It involves an erosion of public interest responsibilities in the presence of incentives and occurs when tax preparers justify on a post hoc basis predetermined, aggressive reporting behaviors that fail to meet professional public interest responsibilities.

Since rationalizations respond to incentives, we categorize economically motivated rationalizations, and legally motivated rationalizations. The behavior of firms in the tax shelter example was rationalized with economic concerns and incentives. For example, KPMG increased fees to reflect the increased risk from dubious tax products (Permanent Subcommittee 2005). The economic benefits provided the primary ad hoc rationale for creating and marketing the tax shelters (Permanent Subcommittee 2005, 57–58).

Bratton (2003) identifies two primary legally motivated rationalizations to eliminate the difference between what legally should be done and what is done. Regulatory arbitrage involves "the practice of structuring an inappropriate transaction so it stays within the bounds set by a rule" (Bratton 2003, 1044). In other words, the tax professional modifies the characteristics of the actual transaction to meet the tax law's technical requirements and rationalize *technical* compliance.

In contrast, strategic noncompliance takes advantage of opportunities to exercise judgment in applying tax laws to modify the interpretation and application of tax law to fit the desired transaction. It involves an "action under an interpretation of the law in conflict with the stated interpretation of the regulator" (Bratton 2003, 1044). Although the original intent of the law may not always be clear, strategic noncompliance implies an aggressive use of judgment such that the practitioner distorts the underlying spirit of the law in order to achieve a positive tax result for the client. Accounting firms were aware of the questionable and precarious legality of their tax shelters (Permanent Subcommittee 2005) and often justified actions on the basis that the structures adhered to the technical "letter of the law". For example, KPMG's tax shelters complied with the literal form of the tax law but not the intended substance[3] and even though KPMG staff had identified serious questions about the technical validity of these shelters, they proceeded to market them (Permanent Subcommittee 2005, 1). It is very difficult to see how the tax professionals at KPMG acted in a way that was consistent with their duty to the public interest when they actively promoted a transaction with no economic substance and that internal staff had expressly regarded as being technically questionable.

[3] One example of the way that a transaction complied with the letter of the law but not the spirit of the law can be seen in the bond linked issue premium structures (BLIPS) that were sold by KPMG. Hosmer (2008) provides a detailed overview of the way that these transactions operated. Essentially, the taxpayer would take a $50 million 7 year loan with a very high interest rate. As compensation for the excessively high interest rate, the investment bank would provide an offsetting "premium" of $20 million. The benefit of the premium arrangement was that it was classed as equity rather than a liability (because it was not strictly speaking a loan) but at the same time the taxpayer avoided treating it as income because of the risk of forfeiture. Ultimately, when the taxpayer terminated the 7-year $50 million loan, the bank required repayment of the $20 million premium. This resulted in the taxpayer being able to claim a loss of $20 million. There is little doubt that the loss is a paper loss only and that the transaction lacks economic substance. The only real cost is to the tax system. Accordingly, it is difficult to see that the professionals who developed and sold such products were acting in a manner consistent with their public interest obligations.

2.3.4 Results: Deprofessionalization and a Loss of Trust

Although aggressive tax shelters initially resulted in economic benefits, significant costs accrued to the profession and society as a whole. Aggressive tax shelters signaled a shift from professionalism to commercialism (Permanent Subcommittee 2005) consistent with the commercialization trend within the broader public accounting profession (see for example Fogarty et al. 2006). Firms emphasized customer-driven commercialism and client service rather than public-service responsibilities (Hanlon 1994). Pursuit of financial rewards eclipsed traditional values (Sikka and Hampton 2005; Smith 2004).

This shift from professionalism to commercialism signals a shift from “service interest” to “self-interest” (Toren 1975, 326). For example, self-interested revenue potential received primary consideration and often trumped service-interested ethical considerations relegating them to secondary, ancillary consideration in KPMG’s tax shelter approval process (Permanent Subcommittee 2005). KPMG’s aggressive marketing tactics also signaled a move away from service-interested professionalism to self-interested commercialism. Tax shelter services were no longer client specific. Instead, generic tax shelters were developed and then methodically and aggressively sold (Wang 2003, 1251) with the goal of creating and encouraging an aggressive sales culture (Permanent Subcommittee 2005, 36, 42). KPMG turned tax professionals into tax product salespersons, pressured tax professionals to meet revenue targets, and used questionable marketing tactics (Permanent Subcommittee 2005, 33). KPMG’s own internal documents recommended deceptive hard-sell tactics like using misleading statements to convince uninterested or hesitant clients (Permanent Subcommittee 2005, 42). Instead of serving clients and the tax system, accountants like KPMG used clients and their position in the tax system to further personal gains and increase commercialization in the tax profession.

The tax shelter industry ultimately undermines the public confidence in the tax system and in the tax profession. By placing pursuit of personal gain ahead of client advocate and public interest responsibilities, firms lost the trust of clients, employees, and the public (Smith 2004). Although profitable, the primary consequence of the tax shelter abuses was a loss of public trust. Ultimately, the root of the problem lies in the loss of understanding and subversion of the profession’s primary public interest reporting role and responsibilities.

2.3.5 The International Dimension

The loss of public interest focus and associated problems are not contained to the domestic sphere. Numerous international issues also exist. Sikka (2008) makes reference to the engagement of Big Four accounting firms in schemes to avoid sales tax in the UK, income splitting schemes using trusts in Australia and tax evasion in Russia.

Among others, international tax evasion schemes that have direct implications for the US include the use offshore credit/debit cards, offshore banking secrecy and the role of tax havens.

Ostrander (2003) provides a helpful review of the offshore credit card schemes which entailed hiding income in financial institutions located in tax haven countries and then using credit or debit cards to draw on those funds. Ostrander notes that:

> To engage in an offshore scheme, the individual in the US will *find an offshore professional* to assist in the development of an overall offshore plan. … Once the offshore structure is created, the next step is devising methods to transfer funds or assets … These funds or assets may represent profits the US person seeks to hide from US tax authorities. The last step in the process is using techniques to access such funds … Payment cards are common and at the time were promoted as a purportedly non-traceable method of accessing offshore funds. (emphasis added, p. 114)

These complex structures could not have been developed without the assistance of accounting and legal experts (the professionals). It is apparent that these professionals disregarded the public interest obligations imposed on them by their respective professions.

Tax havens and banking secrecy laws have long been a recognized international tax problem. There is widespread evidence of corporations using offshore tax havens to substantially reduce their worldwide effective tax rates. In a compelling article, Drucker (2010) documented the way that Google was able to secure a 2.4 % effective tax rate via manipulations such as the "Dutch Sandwich" and the "Double Irish." Although the Organization for Economic Cooperation and Development (OECD) countries have primarily taken the lead in fighting tax haven abuses, the OECD (2010) points out that "These issues face not only OECD and G20 jurisdictions, but also those in the developing world, where the goal of self-sustaining growth depends in large part on securing a stable stream of tax revenue" (p. 21).

2.4 Achieving Change: A Structural Change Model

The previous two sections established a normative ideal for the tax profession and contrasted it with the current state of the profession. The comparison makes clear how far the current state deviates from the normative ideal. This is consistent with Fogarty's (2014) analysis concerning the deprofessionalization of accounting more generally. Moving our profession from its current state to its ideal state necessitates understanding how institutions change. In this section, we turn our attention to the sociology literature and the possibilities of structural change.

The notion of structure is well developed in the sociology literature and encompasses "the tendency of patterns of relations to be reproduced, even when actors engaging in the relations are unaware of the patterns or do not desire their reproduction" (Sewell 1992, 3). We can view the tax profession as a form of structure that shapes the behaviors of the professionals within it. The structural shift in thinking from professionalism to commercialism in the tax profession has become so

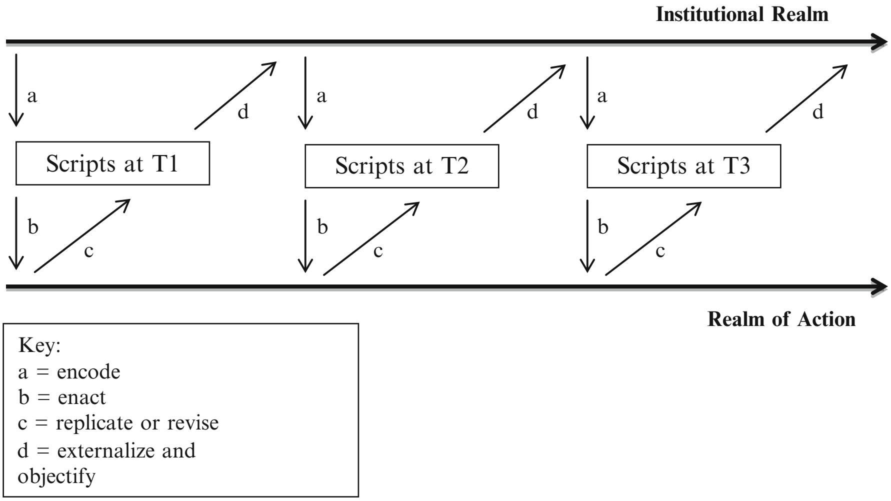

Fig. 2.3 Barley and Tolbert's (1997) institutional change model (*Source*: Barley and Tolbert 1997)

entrenched that new generations of tax preparers simply follow without challenging the status quo. In other words, patterns of behavior are reproduced over time perpetuating a commercialism status quo.

On one level, this entrenched behavior is discouraging and seems to offer little hope for change. On another level, however, the notion of structure provides the very hope of change. Giddens' suggests that not only does structure place constraints on human behavior but it also enables human behavior (Giddens 1976). Essentially, structure both regulates how people behave but it also provides those same people with the authority and opportunity to achieve certain goals and ends. Sewell (1992) articulates this most clearly in his comment that "if enough people or even a few people who are powerful enough act in innovative ways, their action may have the consequence of transforming the very structures that gave them the capacity to act" (p. 4). In the professional accounting context, the profession restricts certain behaviors but at the same time being a part of the profession gives meaning and power to individuals who are then positioned to make changes to the profession. This gives us hope that change is a legitimate possibility.

The next question then is: how might change be achieved? We focus on the change model developed in the sociology literature by Barley and Tolbert (1997). They depict the structuration process as one which operates continuously. In this model, there are constraints imposed on the action of individual actors, but the behaviors of the actors then serve to reinforce the existing structure or promote change. Their model is shown in Fig. 2.3 and consists of four moments or stages.

In the first stage, institutional principles are encoded into specific "scripts". Barley and Tolbert (1997) define scripts as "behavioral regularities." One possible current institutional script is that commercial gain is the highest priority of the tax professional and that the public interest is secondary. Another example can be seen in the abusive tax shelter industry where a critical script was that compliance was an economic cost-benefit decision. The comments from an internal KPMG memo typify this script: “Are we being paid enough to offset the risks of potential litigation resulting from the transaction?” (Permanent Subcommittee 2005, 20)[4].

In the second stage, actors translate the scripts into actions. In essence, they put into practice the institutional principles conveyed to them. Barley and Tolbert (1997) are careful to note that this may not be a conscious choice; that is, in many cases actors merely follow along and “behave according to their perception of the way things are” (p. 102). In the current setting, we might interpret this as accountants routinely putting into practice the script that commercial gain is the priority and public interest issues are irrelevant. Because superiors model this behavior, accountants operate as employees seeking to maximize the return to the firm. Similarly, in the abusive tax shelter industry example, lower-level employees in the firms blindly followed the commercial-interest-over-public-interest script that had been established at the higher levels of the firms involved. As long as the expected gain exceeded the expected costs, they were willing to pursue transactions irrespective of the cost to the integrity of the tax system.

The third stage involves either replication of or revision to the original scripts. Individual actors either seek out new scripts (revision) or they continue with the current scripts (replication). Replication, however, increases the entrenched nature of the script. Barley and Tolbert (1997) note that actors tend not to seek out new scripts unless there has been some exogenous influence. Such external influences can include technological change, economic crises, changes in regulations, and cross-cultural contacts (Burns 1961; Ranson et al. 1980). Absent such external influences, actors are more likely to follow along with the existing scripts.

In the fourth and final stage, the behaviors of the actors are objectified. Essentially, “the patterns acquire a normative, ‘factual’ quality and their relationship to the existing interests of different actors becomes obscured” (Barley and Tolbert 1997, p. 103). In essence, when scripts are repeated over and over, people begin to see them as an objective reality of the way things work. The current status of the profession is consistent with this phenomenon. Fogarty’s (2014) deprofessionalizaton arguments highlight the fact that there is little understanding among tax professionals of their public interest obligation. Few tax accountants see their role as being any different to other commercial service providers. They believe in a reality that entails getting the best result for the client irrespective of any public interest implications because that is what they are hired to do. This perception of an objective reality then drives the development of scripts in the next iteration, highlighting the dynamic

[4]Although it is true that all pricing invariably takes into account future risks, we suggest that there is a difference between pricing in legitimate risk (that the IRS and firm positions may differ, resulting in some loss) and pricing in risk associated with being caught for engaging in practices that were known ex ante to be highly suspect from a legal standpoint. The latter represents an ‘audit lottery’ type of thinking; that is, there’s a risk we’ll get caught but we’re making so much that it’s worth taking the risk. This type of thinking is contrary to the standards for tax practice prescribed by the AICPA (2009).

nature of the process. It also explains why there is limited concern outside the halls of academia for the current lack of public interest focus in the tax profession: the new normal is that public accounting is simply another form of commerce with no notion of professional responsibilities.

2.5 Professionalization and a Return to Public Interest Responsibilities: Applying the Change Model to the Tax Profession

The relevant conclusion for the accounting profession from this sociology literature is that external shocks can provide the impetus and opportunity to affect needed change. Change is unlikely to occur without such external shocks. The recent accounting scandals (e.g., Enron and WorldCom) including the tax shelter scandal represent systemic failures that had the potential to precipitate significant change. Unfortunately, however, the changes they precipitated were not internal but have tended to be external to the system; that is; most of these changes have been regulatory changes. The problem with such changes, however, is that they perpetuate an illusion of control (Rosanas and Velilla 2005) without necessarily inducing real change. Accordingly, there is potentially no internal change but rather a mere accommodating of the external change, which ultimately leads to further failures. In this case, the new regulation simply increases the costs of engaging in tax shelters and thus makes this specific behavior less attractive. However, absent a change in the underlying thought processes or central *scripts* of professional tax accountants that underpinned the tax shelter phenomenon, there are likely to be further failures in other areas. The regulation may fix the tax shelter problem but it won't prevent similarly bad practices in other areas.

We suggest that real change will occur only if practitioners establish and secure a foundational script of the public interest reporting role and responsibilities of the tax profession. Consistent with Barley and Tolbert's (1997) comments, change will need to be intentional and driven by actors with the power to effect change (e.g., public accounting firms and universities) (Sewell 1992).

The actors with the power to effect such change (here, the major public accounting firms) need to act expressly to facilitate such change. These actors must also be shown that it is ultimately in their own best long-run interests to act now to preserve the profession. Although there are short term economic benefits to ignoring the public interest, there is a high long-term cost in the loss of professional status. It is well established that professions are afforded many rights and freedoms[5] but the quid pro quo is that they act in a way that promotes the public interest. As Sellers et al. (2012)

[5]For example, professionals are afforded the right of self-regulation. Increased external regulation in response to scandals such as the abusive tax shelters marketed by KMPG highlights the potential risks from the loss of professional status.

note, the very survival of organizations depends on their ability to balance social fitness with the furtherance of their own advantage. The accounting profession's loss of professional status is not something that should be embraced lightly.

Ultimately, we argue that changing the thinking of tax accountants (such that they embrace the public interest notion) requires two things. First, there must be an acknowledgement by the firms that they have a public interest obligation and that they expect their employees to act accordingly. Second, there must be a change in professional education (Wilkerson 2010). Fogarty (2014) specifically identifies education as a source of potential substantive professional change. We agree with this assessment and propose a process by which this could be operationalized in the next section.

Further, we in the academy must shoulder some considerable responsibility because our research agenda has facilitated the demise of public interest thinking. There is an abundance of evidence that we have pursued an increasingly narrow research agenda dominated by neoclassical economics and limited statistical methodologies (see for example Williams et al. 2006; Reiter and Williams 2002; and Tuttle and Dillard 2007). We have lost sight of our own public interest role, and we have eliminated research into issues such as ethics from the mainstream on the basis that it is not scientific.

This limited research agenda has fed into our teaching. Goshal (2005) points out that business schools have routinely taught agency theory as an acceptable and legitimized fact in a way that has left students with the understanding that they have no moral responsibility beyond self-interest. Ironically, he notes that rather than the theory explaining behavior, the teaching of agency theory has in fact created reality; that is, it has influenced scripts and perpetuated behavior. That is, managers behave exactly as business schools taught them they should behave (by pursuing self-interest above all else, unless there is sufficient monitoring and bonding to curtail such behavior).

A critical response, then, must be script-modifying reform both to accounting research and education in order to re-establish the notion that professionals have a duty to the public that transcends private interest. In the next section, we outline an example of a practical educational model that can address this need. This example model trains students to explicitly consider professional public interest responsibilities when making decisions. By explicitly incorporating consideration of professional ideals and responsibilities, this example decision making model practically applies many of the professional education reforms in Wilkerson (2010). As we outline the model, we specifically use the tax shelter example to show how appropriate training may have equipped tax professionals to act in an alternate manner.

2.5.1 An Example of a Practical Educational Model

The example training and educational model described in this section applies a holistic decision process that facilitates and practices explicit consideration of public interest responsibilities. The model can facilitate and train consideration of public

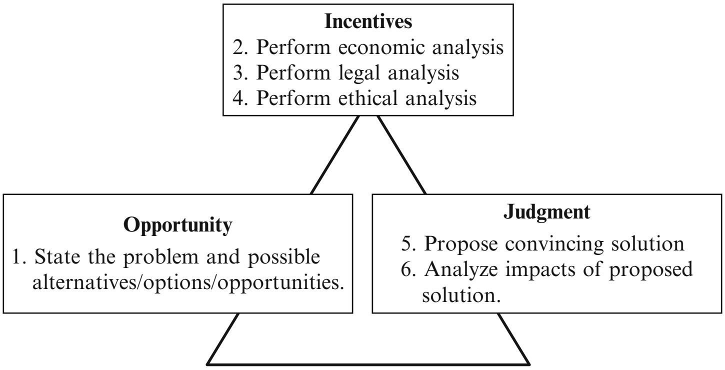

Fig. 2.4 Judgment decision model

interest responsibilities at both the pre-entry level (that is, at universities) and in professional training (once accountants have entered the profession). With regard to professional training, we advocate that this occur outside the confines of the individual firm; that is, the training be administered by a third party rather than the firm. This is because of Barley and Tolbert's (1997) observation that actors need to experience a change in context before they are able to see and embrace the flaws in the current scripts and initiate change. Thus cooperative efforts between accounting academia and the profession present collaborative opportunities for reversing the current demise in the public interest focus within the accounting profession. The model we propose is consistent with and practically implements many of the professional education suggestions of Wilkerson (2010).

The professional judgment[6] model presented here identifies and explicitly considers responsibilities in the presence of incentives. Such a model provides several educational advantages. It can *improve judgments* in a practical setting. Practicing habits of identifying and meeting professional responsibilities even in the presence of incentives when making decisions prepares the professional to make tough "in the moment" decisions. A decision model can also *communicate judgments* by providing assurance that the process exercised rigor and care in identifying and meeting public interest responsibilities. The decision model in Fig. 2.4 is the holistic incentives-based model in Stuebs and Thomas (2011) and Stuebs (2010) that evolved from the decision-making framework in Hosmer (2008).

This broader framework offers advantages over other less complete decision models because it *explicitly considers ethical professional responsibilities and incentives*: (1) economic incentives to pursue self-interest; (2) legal incentives to comply with regulations; and (3) moral incentives to meet responsibilities to others

[6]Professional judgment is judgment exercised with due care, objectivity, and integrity within a framework of professional standards by experienced and knowledgeable people (Gibbons and Mason 1988, 5; Mintz 2010, 115).

including public interest responsibilities. Notice also that the primary steps in this broader, incentives-based model are also advantageously compatible and consistent with the fraud triangle's elements: (1) State the problem and possible alternatives and *opportunities*; (2) Identify and consider various *incentives*; (3) Exercise *judgment*. Notice also that the incentives-based model can advantageously begin to foster moral development since it considers incentive categories that loosely follow Kohlberg's (1969) primary moral development stages: preconventional (motivated by self-interest), conventional (motivated by social and legal compliance incentives), and postconventional (motivated by identified responsibilities, duties and obligations).

Explicitly incorporating professional ethical public interest responsibilities into a general model that considers different incentives creates an integrative, inclusive, and versatile model with potential to facilitate integration of professional ethical public interest responsibilities into courses across academic curriculum and professional training (Wilkerson 2010). Repeatedly applied, such an approach aids students in habitually realizing professional public interest responsibilities as a primary part of a unified, integrated decision process.

This potential advantage is substantial. This model can aid faculty efforts to consistently and holistically address "ethics whenever possible because it is fundamental to an accounting education" (Mintz 2010, 131). This model can aid efforts to move toward a professional education curriculum founded in professional ideals and identity (Wilkerson 2010) by helping "provide the conceptual and judgment-based skills with an ethics underpinning needed by students" (Mintz 2010, 132).

While Stuebs and Thomas (2011) and Stuebs (2010) provide examples that apply each decision model component in detail, we use the KPMG tax shelter case to summarize how the decision model can be used to help identify incentives and meet responsibilities. A synopsis of the KPMG case is given in Stuebs (2010) and presented below.[7]

KPMG and the Sale of Tax Shelters: Synopsis

As one of the "Big 4" accounting firms, KPMG is one of the largest, oldest, most global, and most independent public accounting firms. The issue in this case is whether KPMG's marketing and use of a proprietary set of tax shelters was "right", "just" and "fair". Faced with the threat of criminal prosecution, the senior partners of KPMG negotiated a settlement including payment of $456 million in penalties. There were several notable aspects related to KPMG's tax shelters: (1) The extent of the tax savings created by these

(continued)

[7]The complete, expanded case with detail appears in Hosmer (2008, 83–96). A brief summary of the case is presented here.

(continued)

shelters was enormous—one estimate was $2.5 billion in avoided taxes; (2) Several senior level KPMG employees were involved in the tax shelters; (3) KPMG recorded extensive profits from the tax shelters; (4) KPMG intensely and aggressively marketed its tax shelters; (5) KPMG attempted to deliberately conceal the nature of the tax shelters.

But the most notable aspect of KPMG's tax shelters was that they had never been declared to be illegal in formal court proceedings. The line between improper tax shelters and more legitimate tax avoidance strategies is often blurry. Unlike legitimate tax shelters, abusive tax shelters have no real economic substance. The issue to determine the legal legitimacy of newly designed tax shelters, then, is the existence of a "real economic purpose"—an actual chance for growth and profit from an at risk investment. Senator Levin described four allegedly faulty tax shelters. Two of these four shelters, BLIPS and SC2, were described in detail.[8] Should KPMG sell its proprietary set of tax shelters?

2.5.1.1 Incentives Analyses

After the problem is identified and stated, it can be analyzed on economic, legal and ethical bases, explicitly using respective theories to consider the primary incentives that exist in each category. Each of the economic, legal and ethical theories and analyses affect the identification and fulfillment of public interest responsibilities. Specifically, economic and legal analyses use respective theories to limit and simplify the identification and fulfillment of responsibilities. The ethical analysis uses ethical theory to identify, not limit, professional public interest responsibilities.

Perform an Economic Analysis

Based on economic theory, an **economic analysis** meets public interest responsibilities to maximize society's net benefit by using self-interested incentives to choose the action that maximizes self-interest and/or profit. The assumptions of economic theory limit an individual's public interest responsibilities to self-interest. According to economic theory (Friedman 1962, 133; McKie 1974, 19), open, free and competitive markets assure that individuals acting in their *individual* self-interests

[8] Details of Senator Levin's comments and the BLIPS and SC2 shelters can be found in Hosmer (2008, 89–95).

maximize *society's* net benefit (Hosmer 1984, 2008, 32–34). The individual's only moral responsibility is to act in his/her self-interest *if* the assumptions of economic theory hold. Market controls ensure society benefits from self-interested action and protect the public interest; individual self-controls are unnecessary. The assumptions of economic theory limit and simplify moral responsibility; however, using economic theory, assumptions and incentives to limit professional responsibilities (i.e., professionalism) to commercial self-interests (i.e., commercialism) can create social costs in practice.

In the KPMG case, KPMG should aggressively market and sell tax shelter products to increase profit and reported performance and fulfill self-interested responsibilities according to economic theory. However, market imperfections and legal ambiguities provide imperfect controls in this situation and cannot be relied on to ensure maximum net benefit for society.

The tax system is not open. Information asymmetries exist among tax system parties due to deliberately nontransparent tax shelter disclosures. Questionable tax shelter legality can result in external costs to society in the form of lost tax revenues passed onto U.S. citizens. An economic analysis uses economic theory and relies on market controls to simplify responsibilities. Costs result from these simplifying assumptions in practice.

Perform a Legal Analysis

Based on legal theory, a **legal analysis** fulfills public interest responsibilities to meet society's moral standards by using legal compliance incentives to choose the alternative that obeys the law. The underlying legal theory assumption is that the law contains and expresses society's collective moral standards (Hosmer 2008, 63–76). As a result, the individual's only moral responsibility is to obey the law. The legal theory assumption limits individual public interest responsibilities to legal compliance. Legal controls ensure society benefits from individual action and protect the public interest; additional individual self-controls beyond legal compliance are unnecessary. The assumptions of legal theory limit and simplify professional moral responsibility (i.e., professionalism) to legal compliance (i.e., legalism).

In the KPMG case, KPMG should obey relevant tax shelter laws and tax position recommendation laws to fulfill legal compliance responsibilities according to legal theory. However, the law is an imperfect control. Costs can result from using the law to simplify responsibility identification. First, political and special interests can influence the formation of the law and threaten whether resulting laws contain and express society's moral standards. The design of many legal loopholes is verifiably rigged in favor of influential taxpayers and creates problems for using the legal justification for certain tax-related practices. Second, applying laws relies on professional judgment that goes beyond compliance with technical form to compliance with underlying substance. While the assumptions of legal theory can simplify and limit the identification of responsibilities, the usefulness of legal compliance responsibilities is limited and incomplete.

Perform an Ethical Analysis

Based on ethical theory, an **ethical analysis** fulfills professional public interest responsibilities resulting from moral incentives by choosing the action that fulfills ethical duties, in this case professional public interest and client reporting responsibilities (i.e., professionalism). Unlike economic theory and legal theory, moral theory simply identifies responsibilities instead of using assumptions to limit and simplify responsibilities. Individual professional self-controls of competence to identify responsibilities and character to fulfill responsibilities ensure that society benefits from individual action.

The tax professional has a public interest responsibility to clients and the tax system to report truthful, accurate, useful tax advice and information to build trust in the tax system. The virtue ethics approach (Mintz 2010) uses these public interest responsibilities to guide the virtues needed by a tax accountant. Some needed virtues (though not a comprehensive list) can include integrity, objectivity, due diligence, competence and a desire to serve the public interest. Identifying these virtues and the public interest reporting responsibilities of a tax accountant guides the ethical decision. What would a diligent, competent tax accountant with integrity, objectivity, and a sense of public interest do to provide transparent tax information regarding tax shelters to clients and the tax authority? Virtue ethics provides a logical, practical method of identifying responsibilities to guide ethical decisions.

Professional standards can also provide guidance for identifying public interest reporting responsibilities. The AICPA's Statements on Standards for Tax Service (AICPA 2009) impose a requirement on practitioners that they comply with any standards imposed by a tax authority. Regardless of the level of such standards, the Statements require that practitioners at minimum ensure that any recommended tax positions have a "realistic possibility" of being sustained[9]. The danger of such standards, however, is that they can serve as a means of justifying inappropriate behaviors. Even if a transaction can be structured to artificially meet a minimum threshold, the essence of our proposal is that professionals should be able to look deeper than the technical-compliance surface. Serving the public interest extends beyond meeting the letter of a standard and goes rather to meeting the spirit embodied in the standard. It is for this reason that professionals are afforded the

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[9] Interpretation No. 1–1, "Reporting and Disclosure Standards" and Interpretation No. 1–2, "Tax Planning" of Statement on Standards for Tax Services No. 1, *Tax Return Positions* (2011) provide further clarification on the meaning of this standard.

benefit of *self-regulation*; that is, they are trusted to go beyond a legalistic approach and adopt a holistic, professional approach that identifies and fulfills public interest reporting responsibilities.

2.5.1.2 Judgment: Propose a Convincing Solution and Analyze Impacts

The economic, legal and ethical incentives, analyses, and resulting decisions should guide and support the eventual solution. Professional responsibilities should not be compromised in reconciling these analyses and arriving at a final decision. In addition, the benefits, costs and other impacts of the final decision can be assessed.

Analyzing impacts can lead to valuable modifications through an iterative process that improves the eventual solution. The final solution is based on reconciliation of economic incentives, legal incentives, moral incentives and analysis of resulting impacts while not compromising professional or public interest responsibilities.

In the KPMG case, one possible solution is to not market or sell abusive tax shelters since this decision is consistent with public interest ideals and ethical professional responsibilities to serve the public and protect the client by providing accurate and reliable information. In this example, the ethical analysis extends professional reporting responsibilities beyond the legal and economic analyses. Primary benefits are that the public and clients can trust KPMG and tax professionals and the tax profession benefits from public trust created by dutiful fulfillment of professional ideals and responsibilities in the tax system.

Applying tax law and meeting professional public interest responsibilities relies on professional judgment. This decision model gives students an opportunity to practice considering and analyzing different economic, legal and ethical incentives and responsibilities when making professional decisions. A key lesson is that substantively fulfilling professional responsibilities is a confining prerequisite to selecting an action. It is not a burden, but a professional privilege and should become a habitual, natural choice.

2.6 Conclusion

There can be little doubt that the accounting profession is facing a fundamental problem. The root of the problem can be found in the loss of the public interest focus of the profession. There is ample evidence that this public interest focus has been replaced by an entirely private interest (economically motivated) focus. In our capitalist system, we need to ask ourselves the question: why does this matter? Quite simply, it matters because we are a profession. It is well established in the literature that professions are given very significant privileges (for example, barriers to entry, creating a higher price for the services provided by the profession) but the *quid pro quo* is that the profession will look not only to its own interests but also the interests of the public more generally. If as a profession we fail to deliver on the latter, we might lose the privileges that go along with being characterized as a profession.

In previous chapters the problems of deprofessionalization were identified. In this chapter, we have drawn on the sociology literature to examine a possible way out of the stasis in which we find ourselves as a profession. The sociology literature is quite clear that change from within a structure is unlikely; rather, the likely outcome is continued replication of the existing structure. What is needed is some external influence that results in a disruption of the normal process of reproducing the current structure. Such a disruption offers an opportunity for individuals to reflect on the current "taken for granted" scripts and allows for a re-awakening of personal ethics and virtues that have become suppressed by the current structure. We suggest that education is an external force with the potential to disrupt the current pattern and set change in motion. Although pre-entry education is essential, we concur with Fogarty (2014) that firm training is an integral part of system change. To achieve this, we argue that there is a vitally important role for independent cross firm education. There is little doubt that this may have adverse implications for firm autonomy and power. Nonetheless the sociology literature on structural change suggests that the extent to which the profession can be revitalized is almost certainly linked to the willingness of the major professional accounting firms to willingly and actively embrace change. What we do next will demonstrate to our society whether we really have a legitimate claim to being a "profession."

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