

Tax Internship and Ethics: A Case

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## I. Background

John Doe is entering his final semester of undergraduate work as an accounting major in January of 2019. John attends Western Olympia University (WOU), a relatively small, but well-respected public university on the East Coast of the United States. The university is located in the small college town of Chucktown which primarily relies on the university for its local economy. With a business school enrollment of 1,600 students, the WOU accounting program has 350 undergraduate majors with 55 master's in accounting and another 25 master's in taxation students. John plans to attend the tax program after graduation in May. The program usually takes three semesters to complete: summer, fall, and spring. He should finish the master's program in May 2020 and begin working in August or September.

John is 21 years old and comes from a rural town about an hour south of the university. He is one of the top students in the program and he serves as president for the local chapter of the accounting honor society, Kappa Phi Alpha. In this role, he meets with many of the representatives and partners of the firms in the area who recruit at WOU. He is the first person in his family to attend college and the first to work in a professional field. His family members have historically been laborers or worked in retail positions. John has worked in restaurants since high school and is looking forward to leaving those jobs behind him. He has been able to afford college by securing numerous scholarships and thus he will graduate with only \$2,000 of student loan debt. The department has already approached him about a graduate assistantship during his graduate program, and it will fully cover his expenses. He does not anticipate the need to take on any more debt to finish his education.

John successfully completed an internship with a Fortune 50 company, The Pinnacle Manufacturing Co. (TPM), over the past summer in the tax accounting department. The company is headquartered two hours east of Chucktown in Mattsville and is a major employer of WOU graduates. Recruiters from TPM frequent campus through career fairs and presentations to the Student Accounting Association and Kappa Phi Alpha. TPM routinely funds scholarships for WOU students and supports the business school with regular donations. The Chief Audit Officer, Janie York, is a WOU alumna who serves on both the school's Accounting Advisory Board and the Board of Trustees for the university. There are currently about 40 WOU alumni working in accounting for TPM in headquarters in Mattsville with another dozen at regional offices throughout the world. TPM has over 1,000 accounting employees worldwide.

Over the course of his internship, John mostly worked on reconciliations between the financial accounting numbers and the tax numbers but got a little exposure in the international tax division and worked a transfer pricing project to wrap up his internship. He felt that his internship went very well and enjoyed the experience. He anticipates that he will receive an offer for employment, but the company has traditionally not issued offers to undergraduate students who will be attending master's programs until the October prior to the student's final graduation.

TPM is the highest paying employer in the area (starting salary for a master's graduate is about \$79,000 and has been steadily rising for the past five years, large public accounting firms start between \$58,000 and \$62,000), but John is still unsure if that is the path he wishes to take. He knows he wants to pursue a career in tax but does not have a strong feeling as to whether he wants to work in private or public accounting. He felt that the reconciliation tasks were rather methodical and not as exciting as the transfer pricing project on which he worked. He thought the global reach of transfer pricing was fascinating and believed this type of work would be a great start to his career. He wants to stay in the geographic area to be close to his family. His decision to go into public or private accounting will not affect his educational path; either way, he will complete the master's program and will pursue the CPA designation. In an effort to expose himself to the public

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accounting side of the profession, John will be starting a tax internship on January 15, 2019 with the public accounting firm Robb, LLP, located in the nearby city of Cava, commuting the 40 miles north to Cava from Chucktown four days a week.

Robb, LLP is a prominent firm with about 50 offices throughout the United States and about 20 international offices located mostly in Europe and Canada. Robb, LLP is generally regarded as the most prestigious job offer a WOU graduate could receive though some graduates go to larger firms in the major cities several hundred miles away. The managing partner of Robb's Cava location, Patricia Amey, is a WOU alumna and serves on the school's Accounting Advisory Board. She graduated a year behind Janie York and they know each other well. John has known Patricia through the advisory board since his sophomore year and has had several lunches with her in his capacity as president of the honor society. In many ways John sees Patricia as role model knowing that she too was a first-generation college student.

John is excited about the opportunities that Robb, LLP may present him if he chooses to start his career there after graduation. He has a chance to work with both wealthy individuals and international businesses. The advising aspect of public accounting has always been of interest to him as he enjoys personal fulfillment from helping people. The ability to help others is what originally attracted him to accounting, and he did not feel he was accomplishing that objective during his internship in private accounting.

#### II. Dilemma

After several weeks of training and tax return preparation at Robb, LLP, John felt he enjoyed the busy workload of tax season. It was not until he pulled a client's tax workpapers for completion that he felt some uncertainty in his tasks. John recognized the client he pulled, Will Minning, as the owner of Minning Rentals. The client owns a great deal of student rental properties in Chucktown. Minning Rentals operates about 300 rentable units across 22 properties. Minning Rentals is organized as an S-corporation with Will Minning as the sole shareholder. All Minning Rentals properties and all of Will Minning's business interests are in Chucktown. As John went through the workpapers, he noticed the client documented no income for four of the twelve apartments in Oak Hill Apartments. The papers claimed four units were vacant for the entire year of 2018.<sup>2</sup>

With friends who have lived in the complex for over a year, John knows for certain each apartment within the complex was occupied in 2018 and income should have been documented for all units. The property was wholly rented by his friends' fraternity. He would often be at the property for parties and knows all the members. He also knows that several of his friends pay their rent in cash each month as opposed to paying electronically through the Minning Rentals' website. John suspects the discrepancy between the workpapers and what he has witnessed is that the cash income from tenants is not being reported.

To further complicate John's dilemma, he knows that Will Minning has routinely been one of the most generous alumnus benefactors of WOU's business program. John was even a grateful recipient of one of the many scholarships that Minning funds during his sophomore year. John met Minning briefly during an awards lunch that year but never spoke to him in any depth. If Minning were willing to give so much money to the university, why would he bother to cheat on his taxes? Surely the university would be upset if one of their own were to expose a generous benefactor as a tax cheat.

Conflicted, John is unsure of what to do with this information. He is afraid if he comes forward with his beliefs that the client is intentionally underreporting income, he will cause problems at Robb, LLC. John, obviously, wants to make a good impression and do well in his internship. He is uncertain how accusing one of the office's largest clients of fraud in his first few weeks will be received. Yet he also feels the firm may be at risk by completing Minning's tax returns if what he suspects is true. He does not have any hard proof that the client is hiding income, but his experiences with the apartment complex make him doubt the claims in the workpapers. If this behavior is consistent across all his properties, the amount of income going unclaimed could be substantial. The possibility of the fraud also makes John feel conflicted because he knows Minning Rentals has been a fantastic landlord to his friends. He feels that hiding income like this is out of character with his friends' experiences with Minning. The company has been very accommodating for pets and has taken care of any problems quickly and efficiently, traits that have been hard to find in other Chucktown landlords.

<sup>&</sup>lt;sup>1</sup> Exhibit 1, Excel worksheet, can be obtained from Nicholas Robinson. nrobinson@eiu.edu

<sup>&</sup>lt;sup>2</sup> See Exhibit 1.

John decides that he needs to talk to someone outside the firm about his concerns. He stops by his tax professor's office hours to discuss the options. Their conversation was as follows:

"Hello Dr. Roberts."

"Hi John! You're in a tax internship this semester, right? How's that going?"

"Well... that's kind of the reason I stopped by professor. I have a situation that I'm just not sure what to do."

After John explained the situation to his professor, he asked what he should do.

"I feel that the rules of the profession say I have to tell my supervisor. But I just don't want to seem foolish for accusing him, and what if I'm wrong?"

"John, I understand your feelings in the situation, but it's not an easily answered problem you have. You must remember that the professional regulations proscribed by the AICPA that you've mentioned are just that-professional regulations. You're not a professional, not yet anyways. The AICPA's regulations don't apply to you. You need to ask yourself how you want to approach your career though. It's a small community of people with long memories. I can't tell you what to do, John. You're going to have to make that decision on your own."

"I understand, thank you for talking to me, Dr. Roberts."

## **III.** Discussion Questions:

- a. How should John proceed with the Minning case file? Should he ignore the possible discrepancies he believes exist, or should he tell his supervisor?
- b. John is concerned about his reputation and his future career in accounting. What concerns does this situation raise for John? How should his concerns affect his decision making?
- c. For only this question, assume Minning Rentals does not use Robb, LLP for its required bank audits. John suspects that Robb, LLP may be aware of the situation but is willfully turning a blind eye because Minning is such a large client. If this were true, what could John do to report this fraud to the proper authorities? What issues could this revelation raise for him personally and professionally? What legal issues could befall Robb?
- d. What responsibility does the firm have to assure that the income the client is reporting is accurate? Does or should this responsibility extend as far as investigating suspicions from an intern?
- e. Research What are the professional standards that John and Dr. Roberts were referring to in their conversation? How could they guide John in his decision? What are the possible consequences for Robb, LLP and for John if he fails to investigate the issue further and his suspicions were correct?
- f. Examine the conversation between John and Dr. Roberts. How would you evaluate the advice Dr. Roberts gave John? Was it good, bad, and why? Is there any information that Dr. Roberts left out of his analysis or any other questions he should have asked John? Explain.
- g. Tax Advisement and Research John has decided to bring the issue to his supervisor.
  - His supervisor is curious about the claims and asks John to explore the penalties that Minning could be facing for the Oak Hill property. He decided to extrapolate the behavior across the entire property portfolio as part of this project. Research the penalties that Minning would be facing if he was, in fact, failing to report rental income for the Oak Hill property. Use the Exhibits to estimate the range the penalty could be if Minning was not reporting cash payments across all the properties.
- h. Professional Writing/Presenting How would the IRS deem this behavior as "fraud;" how does that change the penalties? Explain your answers in a professional memo citing sources such as the IRC, IRS regulations, revenue procedures, revenue rulings, etc., and legal cases.

#### **Teaching Note**

This teaching note is developed to be used with "Tax Internship & Ethics: A Case." This case asks students to explore an ethical issue that they could likely come across in their own tax internship. There are two main learning objectives

for this case. The first is for students to understand how their professional decisions can have repercussion throughout their careers. The second learning goal is for students to understand how the professional world is interconnected, and how seemingly personal decisions can have far reaching consequences.

Answers to the discussion questions and the Excel spreadsheet, Exhibit 1, are available. Please contact the primary author for these resources. nrobinson@eiu.edu

### **Teaching Objectives**

Using this case study, students have the opportunity to:

- Explore a work-based ethical dilemma in an early career/student-oriented setting (Discussion questions a and b)
- Identify issues pertinent to ethical decision making (Discussion questions a and b)
- Weigh larger career consequences consistent with choosing a course of action when faced with an ethical dilemma (Discussion questions *a* and *b*)
- Reflect on their own work and internship experiences to evaluate a new dilemma posed in the case (Discussion questions *a* through *c*)
- Develop tax research experience in the context of professional responsibility and behavioral standards (Discussion questions *c* through *h*)
- Use tax research to develop a professional presentation to give to a supervisor, arguing a potentially controversial position (Discussion questions *g* and *h*)
- Gain experience with financial information from a rental business and subsequent tax consequences (Discussion questions g and h)

#### **Delivery Methods**

This case can be implemented in multiple ways. We have utilized the case in the following methods.

## I. Individual Assignment:

The first way that this case was used was as an individual assignment where the students were given the case and had about a week to answer the questions in a written paper. They were not given any other information to use other than the case but were allowed to review or research any outside sources they might find useful. In this method, the papers were well constructed, but certainly lacked in the analysis of the consequences when compared to the instructor-led delivery method. They admitted, after submitting their papers, that the case appeared easy on initial impression, but when they began writing it, they realized that it was more complex than it initially appeared.

## II. In-Class Assignment:

In the second delivery method, the case was presented to the class and the instructor led the class discussion. Ideas about how to handle the ethics issues in the case were discussed amongst the students and with the instructor. In this method, the class needed encouragement to look at the larger picture and analyze the effects of the decisions made. After the in-class discussion, the students were instructed to write about their personal positions on the ethical issues. This focus on the larger consequences in the class discussion beforehand resulted in their papers having far more depth and analysis of this element. Many students said, during the class discussion, that upon initial reading of the case, the "right" decision seemed obvious and the case appeared "simple." However, when the instructor led the discussion so that the students were forced to analyze the consequences, students admitted that the case was more substantial than it seemed, and the decision was more difficult than they initially believed.

#### III. Results:

In both delivery methods, students completed a pre- and post-assessment survey (see below). We have post-survey results for 19 students using delivery method 1 and 20 students using delivery method 2. Although the main purpose of this case is to present an ethical dilemma and not to evaluate delivery methods, this data is presented to allay concerns instructors may have in utilizing different delivery methods in their classes.

Based on the surveys conducted, the average time spent by the students on the ethics portion of this case was about 5 hours. While we find this time appropriate for the task, instructors can decrease this time by assigning fewer of the discussion questions.

## **Survey Questions**

Questions were asked on a Likert scale of 1 to 5. 1 is Strongly Agree, 5 is Strongly Disagree.

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Pre-Assignment Survey:	Mean	S.D.	n
1. I feel comfortable making a decision if faced with an ethical dilemma.	1.956	0.928	45
Delivery method 1	1.800	0.927	20
Delivery method 2	2.080	0.891	25
2. I understand how my decision may have larger consequences.	1.444	0.546	45
Delivery method 1	1.450	0.589	20
Delivery method 2	1.440	0.496	25
3. My personal interests are the most important thing when deliberating an ethical dilemma.	3.311	0.156	45
Delivery method 1	3.500	0.592	20
Delivery method 2	3.160	1.046	25
4. Staying quiet and keeping my head down is always a viable answer to a problem at work.	3.778	0.974	45
Delivery method 1	3.700	1.054	20
Delivery method 2	3.840	0.880	25
Post-Assignment Survey:			
1. After completing the case, I feel more comfortable making a decision if faced with an ethical dilemma.	2.128	0.767	39
Delivery method 1	2.158	0.744	19
Delivery method 2	2.100	0.768	20
2. After completing the case, I better understand how my decision may have larger consequences.	1.615	0.544	39
Delivery method 1	1.632	0.581	19
Delivery method 2	1.600	0.490	20
3. After completing the case, I believe my personal interests are the most important thing when deliberating an ethical dilemma.	3.256	1.019	39
Delivery method 1	3.421	0.990	19
Delivery method 2	3.100	0.995	20
4. After completing the case, I believe staying quiet and keeping my head down is always a viable answer to a problem at work.	4.077	1.070	39
Delivery method 1	4.000	1.214	19
Delivery method 2	4.150	0.726	20

5. The scenario in this case seems realistic.	1.769	0.627	39
Delivery method 1	1.737	0.636	19
Delivery method 2	1.800	0.600	20
6. This case is a useful learning exercise.	1.923	0.532	39
Delivery method 1	1.842	0.586	19
Delivery method 2	2.000	0.447	20
7. The case challenged me to think critically.	1.769	0.667	39
Delivery method 1	1.526	0.499	19
Delivery method 2	2.000	0.707	20
8. The case is relatable to me.	2.615	1.042	39
Delivery method 1	2.316	1.029	19
Delivery method 2	2.900	0.943	20

#### **Analysis of survey:**

The change in the students' assessment of their own ability to understand the larger consequences of their decisions between the pre- and post- assignment survey stands out. After completing the assignment, the students felt slightly less comfortable understanding the larger consequences. This difference was nearly identical in the two different formats of delivery so far used. We believe that this difference illustrates the anecdotal responses from the students that they felt the assignment was "easy" at first sight, but once they started working on it, they realized it was much more complex to analyze the consequences of their proposed actions.

Understanding the underlying complexity of a perceived "easy" decision made them realize that they were likely over-confident in their abilities going into the assignment.

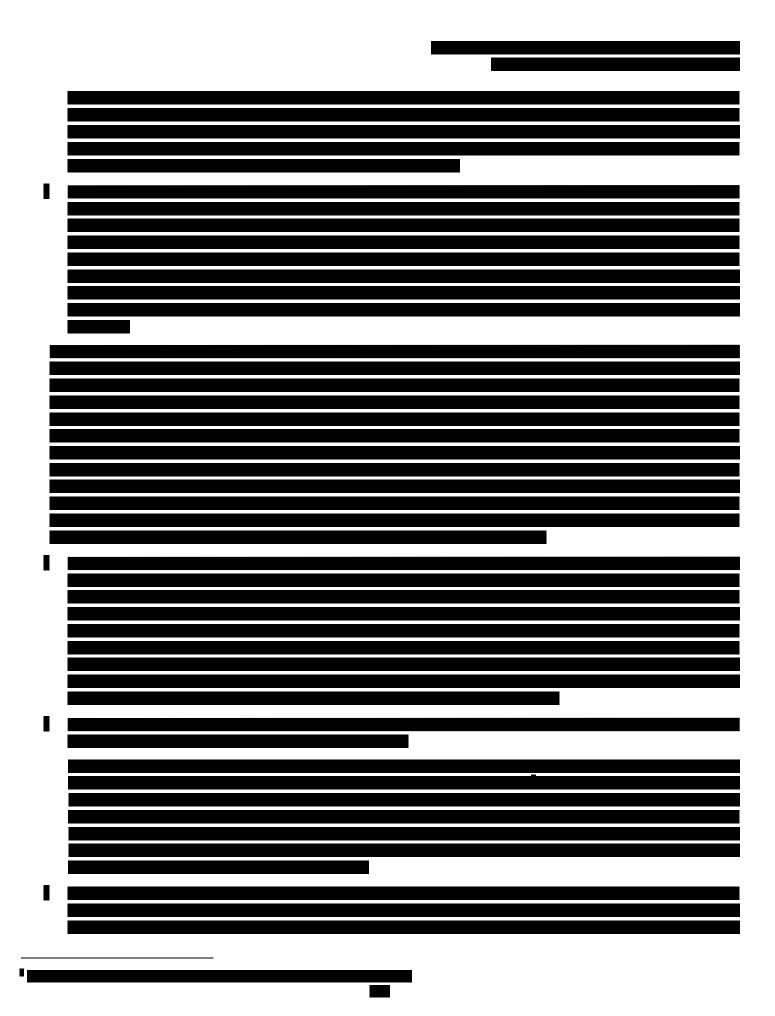
# **Ethics Grading Rubric**

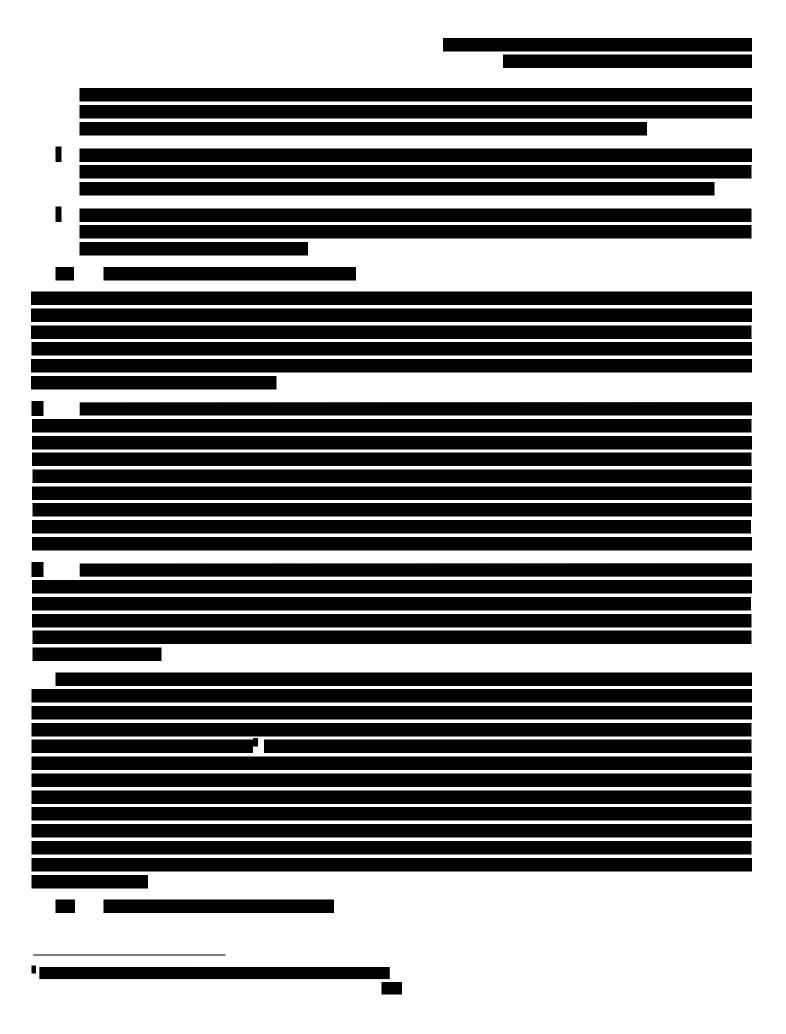
	Exemplary 109	Acceptable 86	Unacceptable 51
Identifies Dilemma Weight:	Describes, in detail, both the ethical dilemma and all relevant facts	Describes the ethical dilemma and/or the pertinent facts in an unclear or incomplete manner	Fails to describe the ethical dilemma and/or pertinent facts
Identifies Stakeholders Weight:	Determines all stakeholders that should be involved in the decision-making process, and thoroughly reflects on the impact to those stakeholders	Identifies most or all of the stakeholders who should be involved in the decision-making process but fails to fully reflect on the impact to them	Fails to identify multiple stakeholders who should be involved in the decision-making process
Analyzes Alternatives and Consequences Weight:	Analyzes and describes multiple alternatives and evaluates each on the basis of ethical principles in the context of stakeholder welfare	Insufficient identification of appropriate alternatives and unclear or incomplete evaluation of the alternatives presented	Fails to identify appropriate alternatives
Chooses a Proposed Action Weight:	Proposes an action justified by arguments and reason, taking reasonable counter- arguments into account	Proposes an action justified by arguments and reason but fails to account for counter- arguments	Proposes an action with no support or completely fails to identify or describe an appropriate action
Mechanics Weight:	Makes virtually no grammar, punctuation, or spelling errors	Makes occasional grammar, punctuation, or spelling errors; these are not distracting to the reader	Makes frequent or egregious grammar, punctuation, or spelling errors; these are distracting to the reader

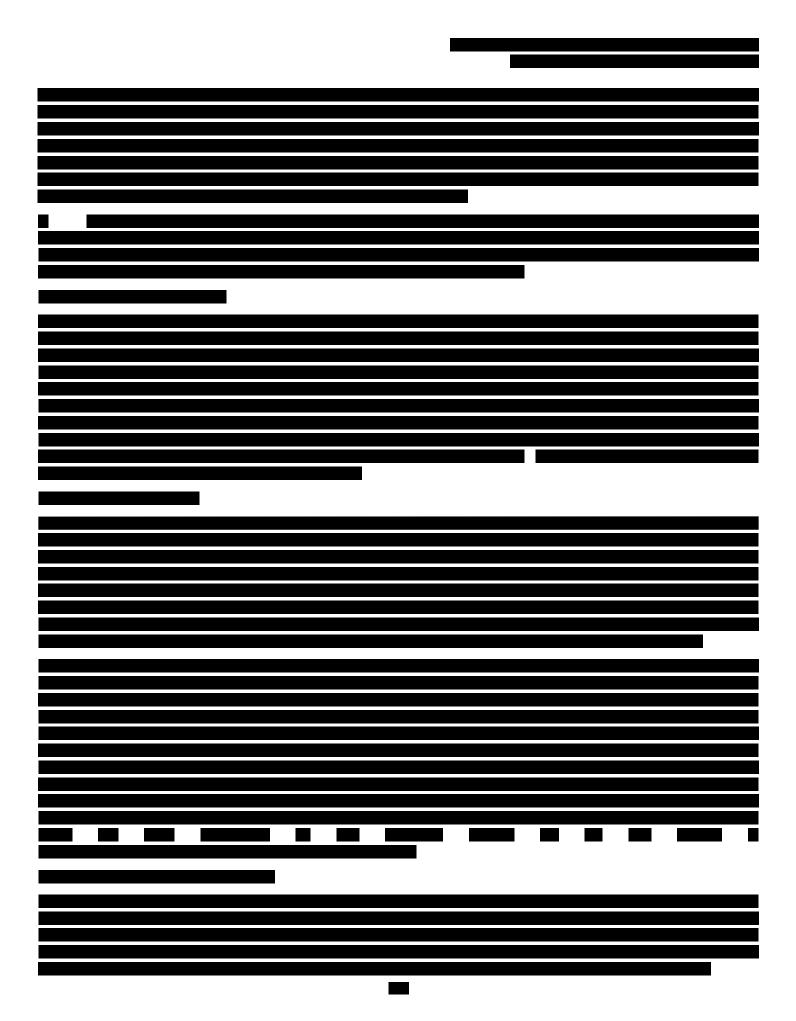
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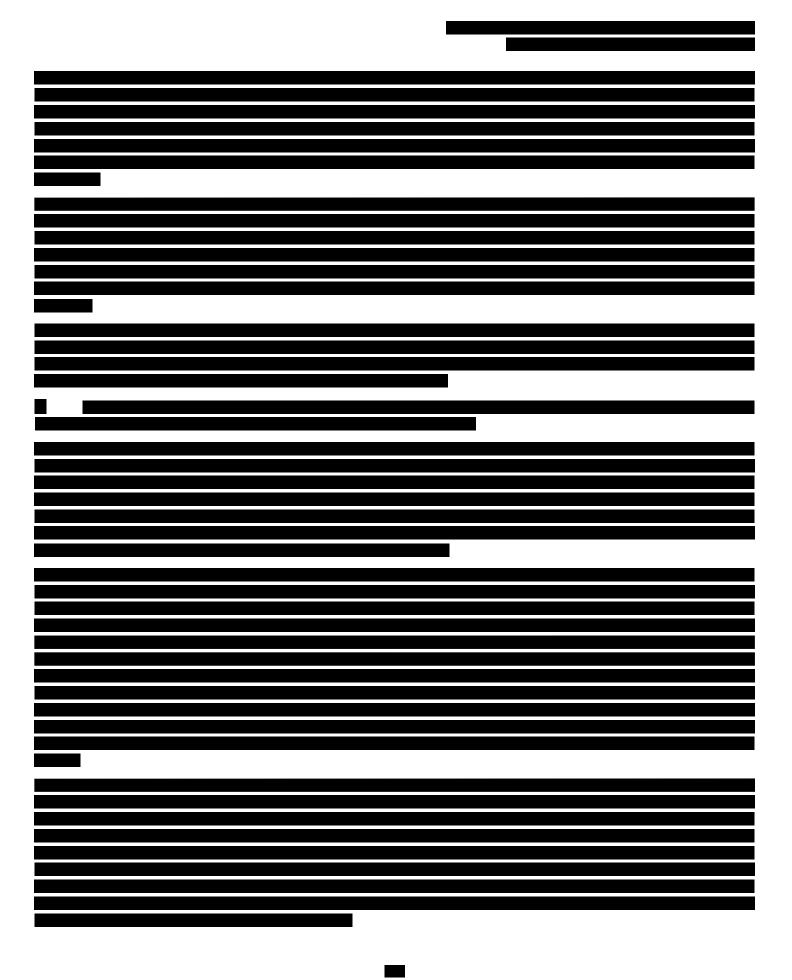
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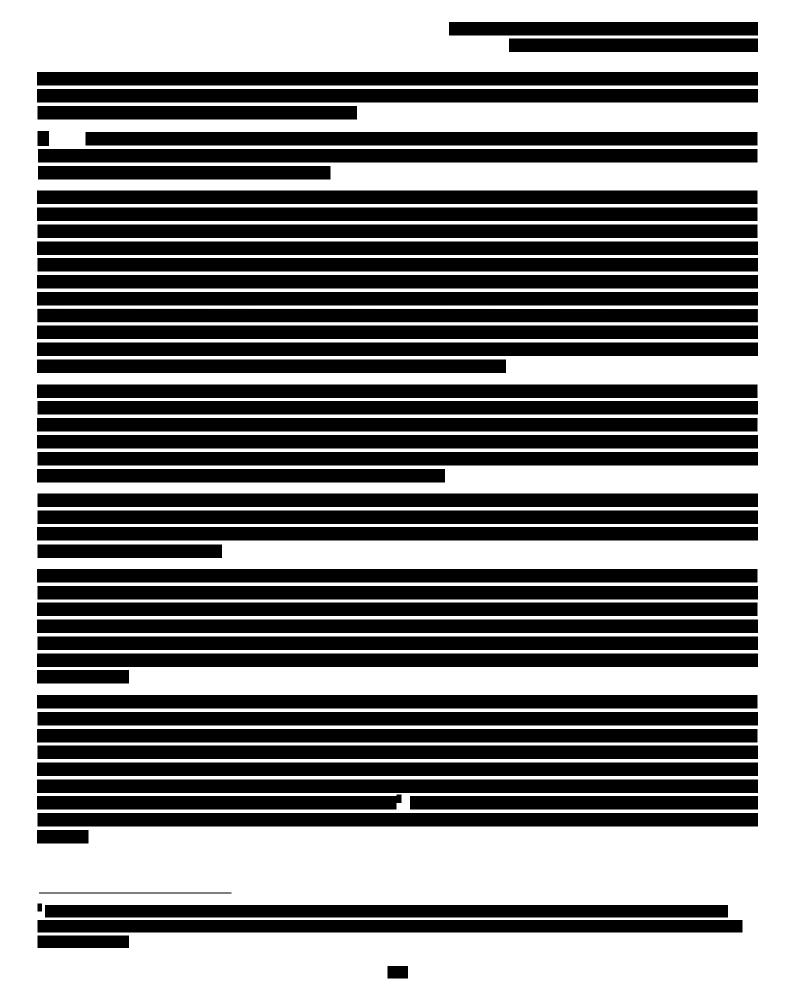
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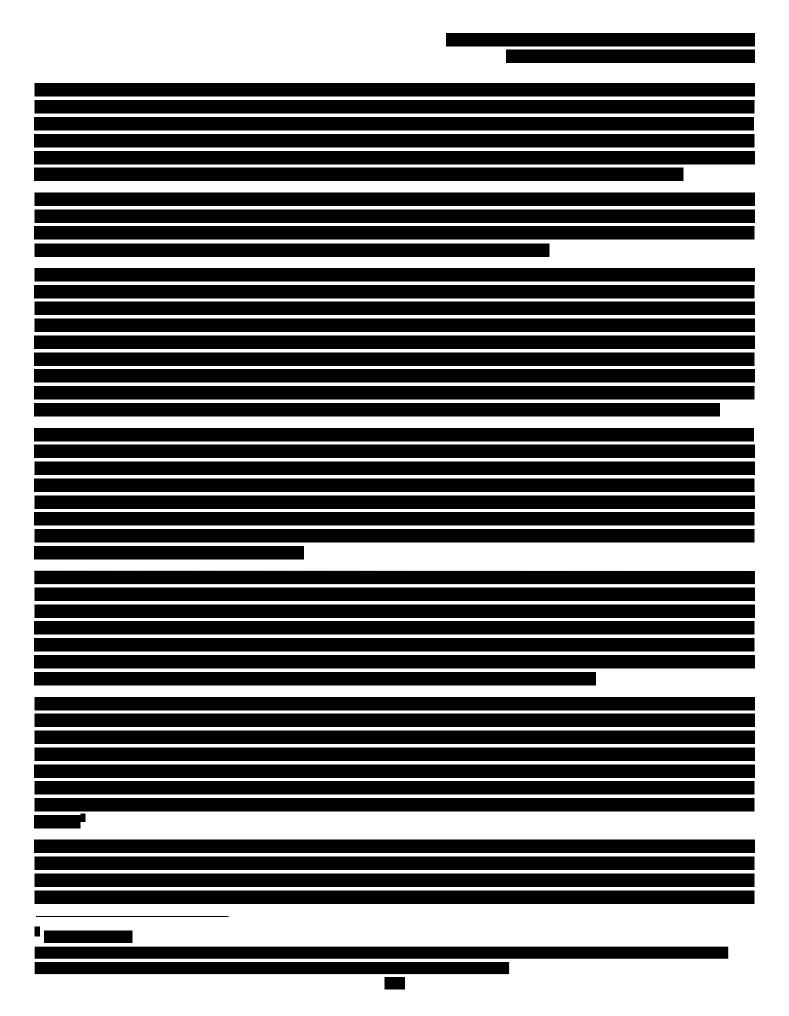


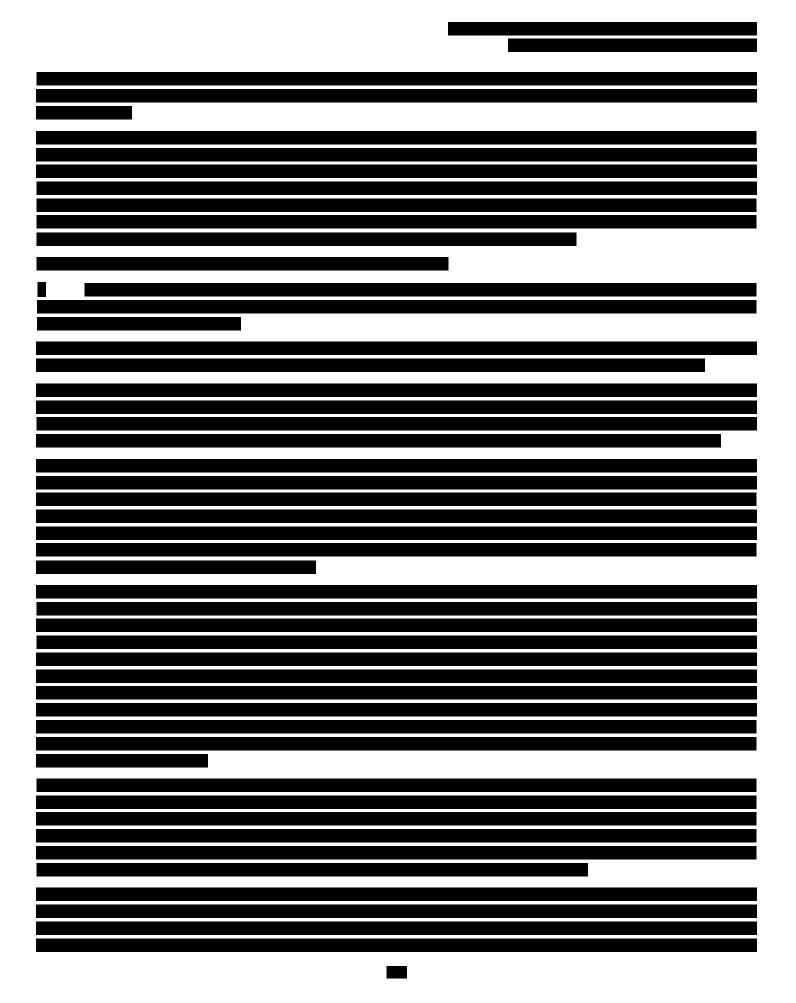


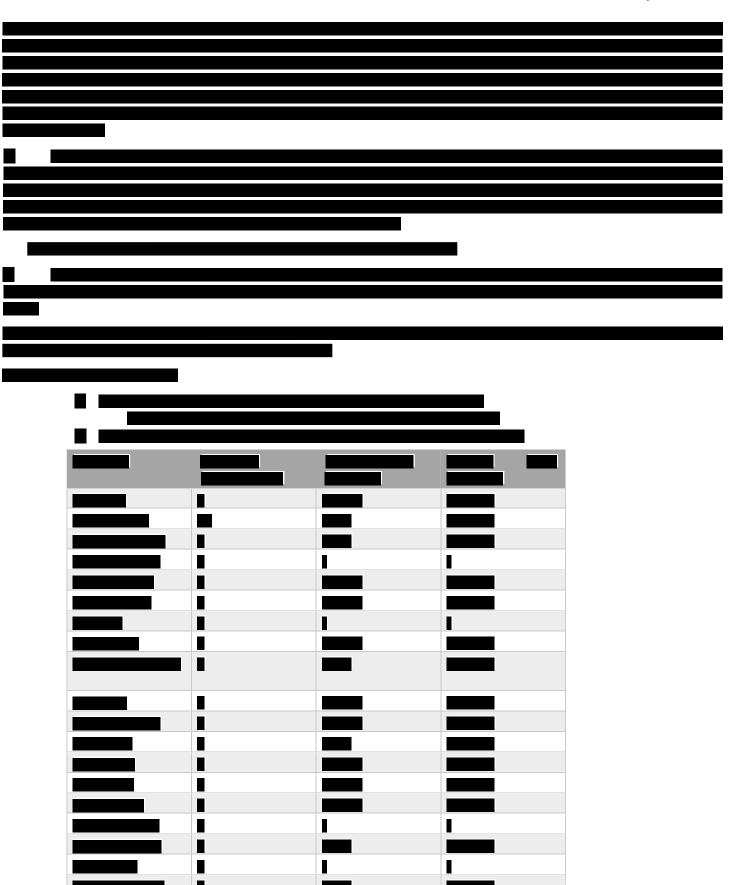


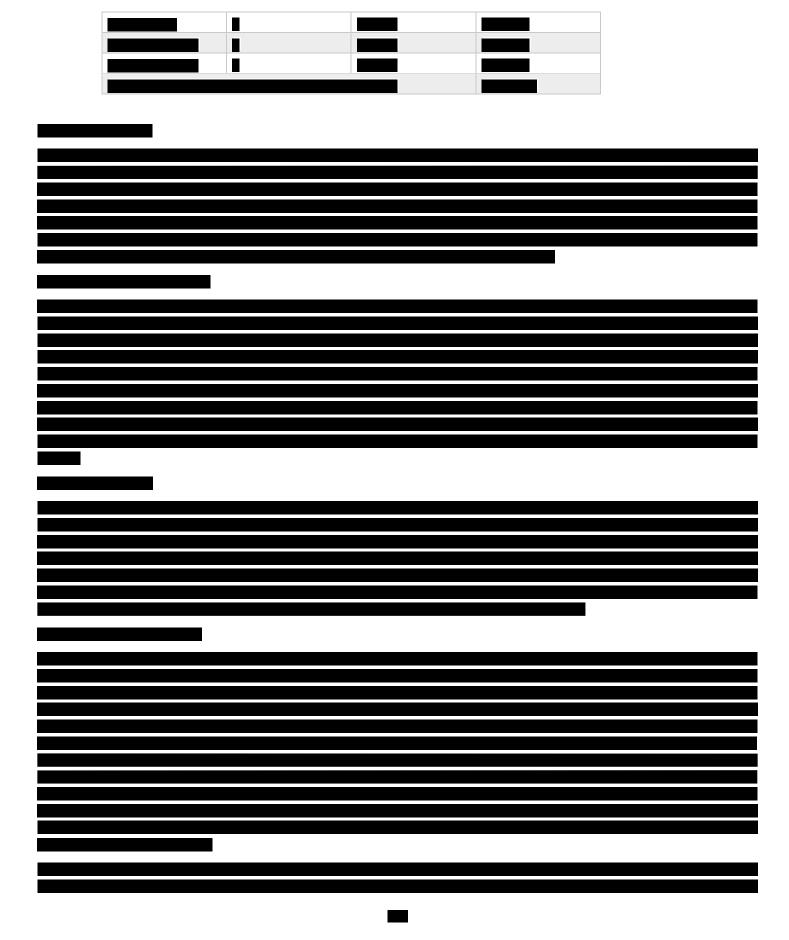


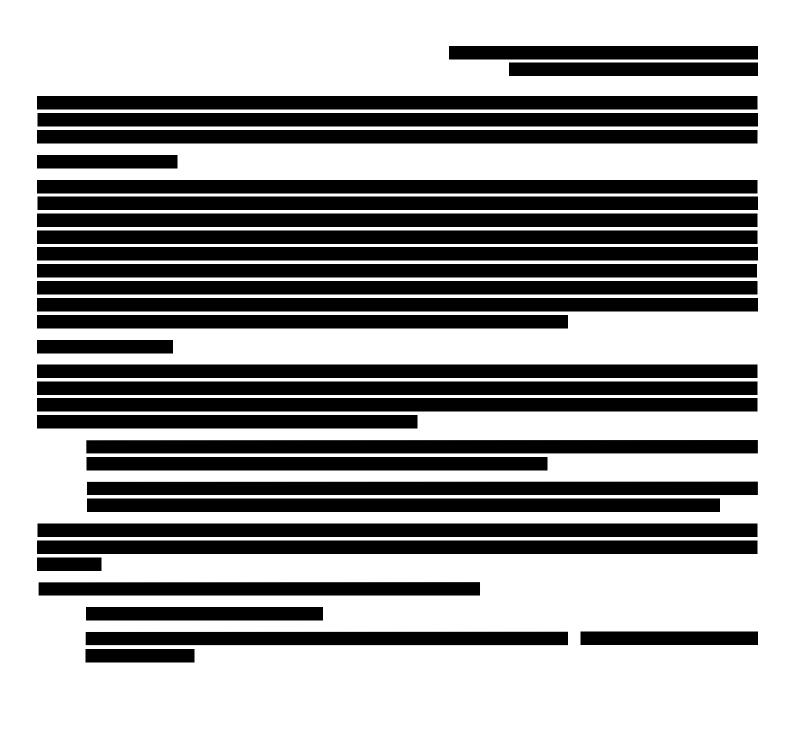












#### I.R.C. Sections and Other References

#### **I.R.C Sections:**

- $\S 61(a)(5)$  States rents received included in gross income
- § 856(d)(1) Defines the types of income classified as rent income
- § 6662 Establishes the imposition of accuracy-related penalty (20%) on underpayments
- § 6662(b)(1) Applies to negligence or disregard of rules and regulations
- § 6662(b)(8) Applies to any inconsistent estate basis
- § 6662(c) Applies to negligence
- § 6663 Discusses the imposition of fraud penalty (75%)
- § 6694 Discusses penalties of understatement of taxpayer's liability by tax return preparer
- § 6694(a) Understatement due to unreasonable positions
- § 6694(b) Understatement due to willful or reckless conduct
- § 7201 States that any person who attempts to evade or defeat tax will be guilty of a felony if convicted along with other imposed fines and penalties
- § 7203 States that any person who willfully fails to file a return, supply information, or pay tax at the time or times required by law will be guilty of a misdemeanor if convicted along with other imposed fines and penalties
- § 7206(1) States that any person who commits fraud and false statements will be guilty of a felony if convicted along with other imposed fines and penalties
- § 7206(2) Criminalizes aiding or assisting with the preparation of a false return
- § 7212(a) Makes any act that either corruptly obstructs or impedes, or endeavors to obstruct or impede, the due administration of the Code, a crime
- § 7623(a) Amount of award the IRS may pay out if reported fraud results in '>= \$2 million' in unreported taxes. The IRS will pay 15% to 30% of the amount collected. The fraudster's annual gross income must also be more than \$2 million.
- § 7623(b) Amount of award the IRS may pay out if reported fraud results in '< \$2 million' in unreported taxes. The IRS may pay out an award no more than 15% up to \$10 million.
- § 1.61-1 States cash received from whatever source counts as income
- § 1.6694-2 Establishes the more-likely-than-not standard for an unreasonable tax position

#### Cases:

- <u>Cheek v. United States, 498 U.S. 192 (1991)</u>: Cheek, a tax protester, was convicted of willful failure to file tax returns and tax evasion. The Supreme Court reversed the conviction because Cheek believed in good faith that he was not violating the law.
- Mathews v. Commissioner of Internal Revenue, T.C. Memo. 2018-212: Mathews, a taxpayer, was found not guilty of committing fraud because he was confused regarding the taxability of his income. The judge deemed Mathews as an unsophisticated taxpayer. The judge found that the IRS failed to show fraud by clear and convincing evidence.
- <u>Plummer v. American Institute of Certified Public Accountants, 97 F.3d 220 (1996)</u>: Plummer, a CPA, violated the AICPA's ethical standards concerning conflicts of interest by performing an audit on a trust in which he was a cotrustee. Plummer was found guilty of violating the AICPA's bylaws.

#### **Other Material:**

18 U.S.C. 371 – Criminal fraud law

- <u>AICPA Bylaws</u> Rules created to regulate the actions of its members
- § 7.4 Discusses the AICPA's ability to expel or suspend a member from practice
- § 7.6 A suspension or revocation of AICPA membership will be made public
- <u>AICPA Code of Professional Conduct</u> guidelines created by the American Institute of Certified Public Accountants outlining the ethical and professional responsibilities of a CPA
- § 0.300.020 CPAs should exercise professional and moral judgement
- § 0.300.030 CPAs should act in a way that will serve the public interest, show public trust, and demonstrate commitment to professionalism
- § 0.300.040 CPAs should perform duties to the highest level of integrity to maintain and expand public confidence
- § 0.300.050 CPAs should remain independence in fact and appearance free of conflicts of interest
- § 0.300.060 CPAs should be aware of technical and ethical standards while striving to improve competence and quality of services provided
- § 0.400.31 Defines the AICPA's use of 'member' in its Professional Code of Conduct as a CPA
- § 1.000.020 Establishes ethical conflicts and how to address such conflicts
- § 1.00.020.04 When an ethical conflict arises, a CPA should consider discussing the matter with proper persons within his/her firm or organization of employment
- § 1.700.001.02 (3) Forbids members from using client information to personally benefit themselves
- Fassin, Y. (2012). Stakeholder Management, Reciprocity and Stakeholder Responsibility. Journal of Business Ethics, 109(1), 83–96.
- Freeman, R. Edward. 1984. Strategic Management: A Stakeholder Approach (Pitman, Boston).
- Hooker, John. 2011. Business Ethics as Rational Choice (Pearson).
- IRS Circular 230 Establishes rules governing those who practice before the IRS, some rules prohibit specific content
- § 10.22 Establishes the "due diligence" level of care in the practice as a tax professional
- § 10.34(d) Practitioners cannot ignore outside information in the completion of a return
- § 10.50 Outlines the sanctions available for violations
- <u>IRS Informant Awards</u> Awards provided to people who provide specific and credible information to the IRS and information results in collection of taxes, penalties, interest, or other amounts from the fraudster
- <u>IRS Whistleblower Office</u> Pays money to people who 'blow the whistle' on others who are failing to pay appropriate federal taxes owed. https://www.irs.gov/about-irs/whistleblower-office-at-a-glance
- Joint Committee on Taxation, Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Including Provisions Relating to Corporate Tax Shelters) Establishes a numerical value based on the
- <u>Joint Ethic Enforcement Program</u> A program that attempts to bridge the gap between differing bylaws of state societies and the AICPA Code of Professional Conduct
- JEEP §4.14 Discusses actions a panel may take if the respondent is found guilty of one or more charges
- Lorcher, P. S. (2003). Worry and irrational beliefs: A preliminary investigation. Individual Differences Research, 1(1), 73-76.
- Rev. Rul. 2018-32 Discusses amount of interest imposed on underpayments
- State CPA Licensing Rules State Ethics or Morality Requirements

Arizona - Laws 2011, Ch. 240 (SB 1458)

New York – EL A. 149 § 7404(1)(7)

North Carolina - 21 NCAC 08F .0103 (f)

Pennsylvania - 49 Pa. Code § 11.18

Texas - TPAA, § 901.253(a) of the Occupation Code

<u>Statements on Standards for Tax Services</u> – Offers specific guidance on professional behavior relating to tax services, from the AICPA. Important to note it does not offer sanctions for failure to follow guidelines, sanctions bounce back to The Code of Professional Conduct.

<u>U.S. Attorney's Criminal Resource Manual, Section 923</u> – Establishes the elements necessary for a conspiracy