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Accountant and the Lawyer in Tax Practice

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The Accountant and the Lawyer in Tax Practice*

By Charles R. Trobridge

There is probably no field of activity other than tax practice in which, generally speaking, both the lawyer and the accountant feel that they are fully competent to act for the best interests of their clients. The lawyer is doubtless of the opinion that he is better fitted than the accountant to handle tax matters, while the opinion of the accountant is that, in most cases, a lawyer should take a back seat, unless and until called upon for advice on questions of law.

The actual condition of affairs is that up to a certain point both are equally capable of handling tax matters, but beyond that point coöperation is not only advisable but necessary.

As I am addressing a body of representative accountants, I propose to devote this paper to the consideration of the conditions under which an accountant should call in a lawyer to coöperate with him in the handling of tax affairs of his clients.

The first question that presents itself is as to why an accountant should consult with a lawyer on any tax problem with which he may be confronted. The answer is that the fundamental training and resultant mental attitude of a lawyer and accountant towards questions of law are, generally speaking, widely different. Taken as a body, we accountants do not possess what might be termed "the legal mind." By training, we are inclined to lean to the equities of a situation. In considering questions of taxation, equity has no place, as tax statutes have to be interpreted according to the strict letter of the law. Most of us have doubtless learned from bitter experience that it is the method by which an end has been achieved which determines whether a taxable profit has been realized, rather than the end which has been achieved. To illustrate: A taxpayer corporation owns securities of which it desires to divest itself. Were it to distribute these securities by way of a dividend, the stockholders would be taxed on the basis of the value of the securities at the time of receipt by them. If, however, the taxpayer corporation sold these securities to a new corporation in exchange for the total capital stock of that corpora-

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tion and distributed among its own stockholders said capital stock, no taxable income would be realized by the stockholders of the taxpayer corporation by the receipt thereof.

Perhaps one of the best illustrations of the foregoing is the case of the General Electric Company, which owned securities of considerable value in numerous utilities of which it desired to divest itself. It proceeded to do so by forming a new company, the Electric Bond and Share Securities Corporation, to which it transferred all the securities which it owned in exchange for the capital stock of the new company. The capital stock of this new company was then distributed pro rata among the stockholders of the General Electric Company. The effect of this was to transfer the interest of the General Electric Company in these utility companies to its own stockholders in a manner which resulted in the realization of no taxable income by said stockholders. Had the securities in question been distributed by the General Electric Company direct to its stockholders, then said stockholders would have received income which would have been subject to tax. The attitude of the average man is that differentiations such as indicated above are refinements which should have no place in a scheme of taxation. He, however, overlooks the fact that, as stated above, tax law has to be interpreted according to its strict letter, and not according to equity or common sense. This principle was expressed by an eminent jurist in words somewhat as follows: "Where the law does not specify that the result of a particular transaction should be taxed, then it can not be taxed, however equitable it be that it should be taxed and conversely, where the law specifies that the result of a particular transaction shall be taxed, then it must be taxed, however inequitable it be."

In the course of his training a lawyer studies the interpretation of the law according to its strict letter and also learns in what class of statutes equity can be given consideration. As stated previously, the training of accountants leans rather to equity, but in saying this, I do not mean to infer that no accountants are capable of advising their clients on tax matters, or of suggesting methods whereby certain desired ends may be achieved with a minimum of taxation to those interested. However, I think it will generally be admitted that the greater number of us are so situated that our knowledge of what may be termed the finer problems concerning taxes must of necessity be somewhat meager and no accountant will lose the respect of his client by voluntarily suggesting that in

certain questions regarding taxes, the opinion of a lawyer should be sought.

In many instances federal tax problems have to be carried to the United States board of tax appeals, and while a duly enrolled accountant is permitted to practise before that body it is most unwise for him to attempt to appear for his client unless he is thoroughly acquainted not only with the theory but the actual practice of the law of evidence. It is true that in many instances the members of the board before whom the case is presented endeavor to assist the petitioner's counsel to overcome the objections of the representative of the solicitor of internal revenue, but to rely upon such assistance is not fair to the client.

An illustration of what I have previously termed the "legal mind" of a lawyer might be of interest. A lawyer propounded to me the theory that the portion of the depreciation reserve which represented accrued depreciation on assets which had been paid in for stock should be included in invested capital. The grounds on which he based his theory were that invested capital was a statutory concept and that inasmuch as the law stated that invested capital meant actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, the taxpayer was entitled to have such value included in computing his invested capital, and that to rule that in determining earned surplus provision must be made for depreciation on such tangible property was in effect to deny to the taxpayer his legal right to include in invested capital the full value of the property paid in for capital stock. Unfortunately, neither he nor any other lawyer, so far as I am aware, has carried the issue beyond the income-tax unit, but, it does not therefore follow that there is no merit in the theory.

I think it will be admitted by most accountants that they would never have propounded such a theory, because their training was such that under no stretch of imagination could they regard depreciation reserve as earned or any other class of surplus, nor could they consider that earned surplus could be determined without making due provision for depreciation.

While problems affecting invested capital are of little interest to present-day practitioners, there are still many problems in which a lawyer's viewpoint would be of great assistance to accountants, because in preparing or reviewing tax returns, or combating proposed additional assessments, all angles of the

case must be considered, in order that every possible claim may be made on behalf of the client.

It is axiomatic in tax practice that, generally speaking, one receives no more than one asks for, as, however good may be the intentions of the treasury department it has to be admitted that as a matter of practical politics that department has not the force nor the time to give to making extensive searches for possible grounds of refunds to taxpayers. On the contrary, its main efforts must of necessity be directed toward the collection of additional assessments. This being the case, a taxpayer in order to protect himself has only two alternatives, viz.:

(1) To prepare his return on the basis most favorable to himself, in which he takes advantage of every possible deduction to which he feels that he is legally entitled, whether in accordance with treasury-department rulings or not, and

(2) To prepare and file a return on the basis which is strictly in accordance with the department rulings and to file a claim for refund of overpaid taxes, based upon the additional deductions which are not admitted by treasury-department rulings, but to which he believes he is legally entitled.

Most taxpayers decide to file a return which indicates the lowest amount of taxes payable and to hope for the best. This being so, it is therefore beyond question that where an exceptional case arises, the accountant would be well advised to talk it over with an attorney. The question of whether the matter should be taken up with an attorney who is a specialist in tax matters or with one who is a general practitioner is open for discussion.

The tax specialist can, in most cases, best interpret the treasury department's probable attitude on the question at issue and because of his frequent contacts with that department can advise as to the best method of procedure. In most cases he will have an office, or at any rate a correspondent, in Washington, which is a distinct advantage, as it is beyond question that constant, personal contacts with the representatives of the department are of great help not only in presenting cases at conferences, but also in following them up.

On the other hand, while a general practitioner will not be so familiar with the treasury department's procedure and practice, he will come to the problem with an open mind, with the result that he may develop methods of approach to it which may not suggest themselves to a tax practitioner whose mind is steeped in

treasury-department rules and regulations and in decisions of the courts and United States board of tax appeals.

Tax problems which confront accountants arise in connection with both federal and state taxes, but principally the former. Some questions may arise in connection with local taxation, but they are relatively few and for that reason are not discussed herein.

Due to varying conditions existing in the forty-eight states of the union, I hesitate to express any general opinion as to whether an accountant or a lawyer is the better able to handle state tax problems. In some cases it is undoubtedly to the advantage of a client to have state tax matters handled by a lawyer familiar not only with the law but with peculiar local conditions. In others, and particularly where the basis of taxation is the income as reported for federal tax purposes, an accountant should be as fully capable of handling tax problems as a local lawyer. Even in such cases, however, there are times and occasions when a "well acquainted" lawyer would be a valuable adjunct to an accountant.

There are a few states, such as Massachusetts, which have evolved a form of return the preparation of which is reputed to have driven more accountants insane than any other cause. The return is something like a cross-word puzzle; if one is able to fill in an amount in each blank space, it is solved. If there are any blank spaces unfilled, then there is something wrong. I have heard it rumored that the basis of assessment in Massachusetts is so elastic that if one was advised by the tax commissioner of Massachusetts of the formulæ which he used in determining the tax for a particular year and the return for a succeeding year was filed on the same basis, the assessment that would be made by the tax commissioner could not be checked by the application of the formulæ used by the tax commissioner for the preceding year. This being the case, it is evident that the lawyers of the state of Massachusetts put one over on the accountants.

The majority of the problems of taxation with which accountants are confronted relate to federal taxes. It is therefore to these that I propose to devote my concluding remarks:

The federal tax practice of an accountant may be divided into three fields, viz.:

(1) The preparation of returns.

(2) The reviewing of returns and also of revenue agents' reports.

(3) The preparation of petitions and the handling of cases before the United States board of tax appeals.

The work of preparing returns is usually more or less routine and the assistance of a lawyer therein is not necessary. There are cases where exceptional conditions have arisen, or where an accountant is called in for the first time to prepare a return, where the advice of a lawyer on certain problems is desirable. In reviewing returns and revenue agents' reports, questions may also arise in which the coöperation of a lawyer would be advisable. In the majority of cases, however, an accountant familiar with the handling of tax matters should be able to carry the matter through the office of the local revenue agent in charge and through the income-tax unit in Washington.

If the amounts in dispute are large and a conflict develops between the accountant and the representatives of the commissioner of internal revenue on either facts or questions of law which appear incapable of a satisfactory settlement, it will then be advisable to arrange for an adjournment of the hearing with a view to presenting further evidence and submitting briefs in support of the taxpayer's case. In the majority of these cases, the assistance of a lawyer in the preparation of the evidence and briefs should be obtained, because the case is arriving at that stage where the next step will be the issuance of what is known as a "sixty-day letter," advising the taxpayer of the final conclusions of the commissioner and of his right to appeal to the United States board of tax appeals. When this stage has been reached, for reasons stated previously herein, the services of a lawyer are, in practically all cases, necessary, and it is therefore only fair, both to the lawyer and to the taxpayer, to associate the lawyer with the case in its last stages in the income-tax unit.