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March 1, 2005

VIA EMAIL: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: *PCAOB Rulemaking Docket Matter No. 017*
Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees

Dear Chairman McDonough:

As President of Tax Executives Institute, I am pleased to submit the following comments relating to the Public Company Accounting Oversight Board's Rulemaking Docket Matter No. 017, on Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees (hereinafter "the proposed rules"). TEI shares the Board's interest in maintaining the integrity and vitality of America's self-assessment tax system and the financial reporting system of which the provision for taxes, at the federal, state, and local levels in the United States, and for foreign levies as well, is a material part.

The *Sarbanes-Oxley Act of 2002* ("the Act") was passed to address concerns that our members share with the investing public. Section 103(a) of the Act directs the Board to establish "ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports." The proposed rules issued by the Board on December 14, 2004, provide guidance in respect of whether certain tax services rendered by an SEC registrant's audit firm impair the audit firm's independence and thus should preclude the audit firm from rendering an opinion on the client's financial statements. TEI supports the goals of the Act as well as the efforts of the PCAOB to ensure the independence of registered public accounting firms.

BACKGROUND

Tax Executives Institute is the preeminent association of corporate tax executives in North America. Our more than 5,400 members are accountants,

attorneys, and other business professionals employed by approximately 2,800 of the leading companies in the United States, Canada, and Europe. TEI represents a cross-section of the business community, and is dedicated to the development and implementation of sound tax policy and to promoting the uniform and equitable enforcement of the tax laws. The Institute is proud of its record of working with congressional committees, government agencies, and other policy-making bodies (including the Financial Accounting Standards Board and the Securities and Exchange Commission) to minimize the cost and burden of tax administration and compliance to the mutual benefit of the government, business, and ultimately the public. We also support efforts to ensure that companies fairly present their financial position in financial statements and documents filed with the SEC.

TEI members are responsible for conducting the tax affairs of their companies and ensuring their compliance with the tax laws. Thus, members deal with the tax code in all its complexity, as well as with the Internal Revenue Service, on almost a daily basis. Most of the companies represented by our members are SEC registrants that issue financial statements. In addition, they are subject to scrutiny by the Internal Revenue Service and various other agencies in the United States and foreign jurisdictions on a continual basis.

As a professional association of in-house tax executives, TEI offers a different perspective on the issues from other organizations. The Institute does not represent the professional advisers who render the tax services that are the subject of the proposed rules. Rather, TEI's members work directly for the corporations that routinely enter into business transactions requiring an analysis of their benefits and burdens. These companies have professional staffs dedicated to ensuring compliance with the tax law while minimizing their tax liability. To accomplish this, TEI members regularly engage the services of professional tax advisers (whether attorneys or accountants), including those rendered by their companies' independent auditors. We, along with the government and the investing public, have the most at stake in trying to craft a financial reporting system that fairly presents the results of company operations, ensures the independence in fact and appearance of registered public accounting firms, and is as administrable and efficient as possible.

Hence, we believe that the diversity, background, and professional training of our members provide us with a uniquely qualified position from which to comment on the Board's proposed rules on the independence of registered public accounting firms and their provision of tax services. TEI provided comments to the Securities and Exchange Commission in respect of the auditor independence rules adopted on February 5, 2003. We are pleased that the SEC concluded that auditors should be permitted to render tax services to their clients on a pre-approval basis without impairing their independence. Moreover, TEI supports efforts to curb the marketing of inappropriate tax-advantaged transactions and to enhance the rules of professionalism for tax practitioners. Thus, we are pleased to provide the following comments on the Board's proposed rules on ethics and independence for tax services supplied by registered public accounting firms.

Overview

In general, the proposed rules are sound and represent a balanced and measured approach to the difficult line drawing that the Board must undertake. The rules must preserve the ability of registered public accounting firms to provide their clients with tax planning and compliance services — as both Congress and the SEC concluded would be beneficial — while proscribing classes of services that might impair the firms' independence in fact or appearance. Since we are concerned principally with ensuring that audit clients can obtain professional tax services from the advisers that the clients deem best suited to provide that advice, we offer specific comments on the three rules affecting tax services — Rules 3522, 3523, and 3524 — and offer additional comments for the Board's consideration.

Rule 3522 — Tax Transactions

Under Rule 3522, a registered public accounting firm is not independent of its audit client if the firm, or any affiliate of the firm, during the audit and professional engagement period provides any non-audit service to the audit client related to planning, or opining on the tax treatment of, a transaction —

(a) that is a listed transaction (within the meaning of Treas. Reg. § 1.6011-4(b)(2));

(b) that is a confidential transaction (within the meaning of Treas. Reg. § 1.6011-4(b)(3)); or

(c) that was initially recommended by the registered public accounting firm or another tax adviser and a significant purpose of which is tax avoidance, unless the proposed tax treatment is at least more likely than not to be allowable under applicable tax laws.

In general, the proposed rule is sound and supportable. Moreover, the rule adequately describes the classes of transactions that might carry an unacceptable risk of impairing an auditor's independence. There are, however, several aspects of the rule's potential interpretation and application that could be clarified.

1. Neither the proposed rule nor the Board's explanatory Release[1] addresses what is meant by the phrase "planning, or opining on the tax treatment of a transaction." We believe the intent of the rule is to permit an audit firm to render an opinion on the fairness of the financial statement presentation of a transaction's tax effects so long as the audit firm has not rendered advice in respect of the merits of a transaction — *i.e.*, whether the client's treatment of a

[1] PCAOB Release No. 2004-015, December 14, 2004.

transaction or position will be sustained — or for protection of the audit client from the assertion of penalties by the tax authorities or the courts. We recommend that the rules be so clarified.

Moreover, TEI submits that an auditor should be permitted, *in response to a client's request*, to address whether the firm believes the transaction is a listed transaction (or substantially similar to a listed transaction), a confidential transaction, or an aggressive tax position. The goal of maintaining auditor independence should not be to inhibit the client from communicating with its registered public accounting firm about the treatment of the client's transaction by the tax authorities; rather, the goal should be to preclude the auditor from bringing or promoting a transaction to the client or assisting in the transaction's planning or implementation on a forward-looking basis. Thus, an audit firm should always be permitted to recommend against an audit client's participation in a transaction or aggressive tax position. If a client chooses to participate in the transaction or aggressive tax position, there should be no impairment of the independence of the auditor merely because the client asked for the audit firm's assessment of the transaction. The decision whether to engage in a transaction should rest with the client, but the client should not be precluded from seeking the candid and timely advice of its auditor in respect of the treatment of the transaction.[2] In TEI's view, an auditor's independence should not be considered impaired unless the auditor is a material adviser,[3] *i.e.*, has, in return for consideration, promoted the transaction to the client and assisted in planning or engaging in a listed, confidential, or aggressive transaction by providing a "covered," "limited scope," or "other" opinion within the meaning of the recently revised rules under Circular 230 prior to the transaction's execution.[4]

2. The Board's Release notes that the proposed rules do not address situations where a transaction is planned or opined on by the auditor and becomes listed after it is executed. TEI believes that a transaction that an audit firm plans or opines on that subsequently becomes listed after its execution should *not per se* impair the auditor's independence. As a practical matter, many registrants have adopted a blanket policy against using their audit firms for any tax services. Other registrants are refraining from using their auditors for tax planning services. For those registrants that continue to use their registered public accounting firms for tax planning and compliance services, a *per se* rule that causes the audit firm to lose its independence automatically as a result of a subsequent listing of a transaction by the IRS would be extremely

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[2] The proposed rule could be interpreted as prohibiting an auditor from providing an opinion at a level of less than more likely than not for client-initiated transactions or for transactions where a non-audit firm acted as the tax adviser. We do not believe this is the intent, nor should it be. The proposed rule could also be read as precluding an audit firm from assisting a client in its appeal of a client-initiated transaction with a less than "more likely than not" likelihood of prevailing. Such a result would be inconsistent with the goal of permitting audit firms to continue rendering traditional tax services, including advocacy of client tax positions where the auditor has not marketed a transaction to the client.

[3] *See,* I.R.C. § 6111 for a workable definition of a material adviser.

[4] *See* T.D. 9165, 69 Fed. Reg. 75839, December 20, 2004, amending 31 C.F.R. part 10, the so-called Circular 230 regulations, which govern practice before the Internal Revenue Service.

harsh and disruptive. This is especially the case since the mere listing of a transaction by the IRS is not determinative of its proper tax treatment; rather, when a transaction becomes listed, the client is subject to a special disclosure obligation to ensure that the IRS is aware of the transaction and can challenge it. Thus, we recommend against adopting a rule that would retroactively deem the auditor to lose its independence for transactions undertaken before a transaction is listed.

Presumably, a transaction that subsequently becomes a listed transaction would — prior to its listing — have been considered an "aggressive tax position" within the meaning of proposed Rule 3522(c). In other words, in such a situation the auditor would have "opined on" or "planned" the treatment of a transaction that had only substantial authority or a reasonable chance of success but did not have sufficient authority to warrant a conclusion that the tax treatment of a proposed transaction was "more likely than not" allowable. In the event the Board concludes — contrary to TEI's recommendation — that it should adopt a rule addressing the circumstances where an aggressive transaction subsequently becomes listed, then, at a minimum, a transaction that had a "more likely than not" chance of prevailing on the merits at the time the transaction was entered into should not cause an impairment of the auditor's independence.

3. Both listed and confidential transactions are defined by reference to regulations adopted by the Department of the Treasury and Internal Revenue Service. Although those definitions are workable in respect of a U.S. registrant and the U.S. federal tax treatment of a transaction, it is unclear how, if at all, either provision would be applied to transactions under foreign, state, or local laws. We recommend that Rules 3522(a) and (b) be clarified and limited to planning or opining on the U.S. federal tax benefits of a transaction.

The "more likely than not to be allowable" standard set forth in Rule 3522(c) relating to aggressive tax positions is also a U.S. federal tax law concept, but the rule is broad enough to serve as a general rule addressing foreign, state, or local transactions if it is understood to mean a more than 50-percent likelihood of success in the relevant tax jurisdiction. We recommend that Rule 3522(c) be so clarified.

4. Rule 3522(c) states that an auditor may not plan or opine on a transaction[5] "that was initially recommended by the registered public accounting firm *or another tax advisor* and a *significant purpose of which is tax avoidance,* unless the proposed tax treatment is at least more likely than not to be allowable under applicable tax laws." (Emphasis supplied.)

a. The operative phrase "a significant purpose of which is tax avoidance" is not defined in the rule or the Release. We recommend that the Board provide a definition for "a significant purpose." Now-superseded regulations under section 6111 of the Internal Revenue Code referred to items "structured to produce Federal income tax benefits that constitute an

[5] The heading of Rule 3522(c) refers to "aggressive tax positions," but the rule seemingly applies to "transactions." We recommend that the Board clarify the header by changing "Aggressive Tax Positions" to "Aggressive Tax Transactions."

important part of the intended results of the arrangement." The superseded regulations also provided exceptions for (1) transactions entered into in the ordinary course of business that were consistent with customary commercial practice and (2) transactions with well-accepted tax treatment. We recommend that the Board adopt a similar rule here.

b. Under the rule, any transaction recommended by "another tax advisor" (*i.e.*, any transaction entered into by the audit client that is not self initiated) that does not satisfy the "more likely than not to be allowable" standard would, if entered into by the client, seemingly impair the auditor's independence. TEI questions why the proposed rules for auditor independence should apply to transactions "initially recommended" by *another* tax adviser. Where another tax adviser brings the transaction to the attention of the client, there is no mutuality of interest between the auditor and its client in respect of the transaction's treatment. Thus, we believe the proposed rule is too broad and recommend that the phrase "or another tax advisor" be eliminated.

In addition, TEI recommends that the Board limit the rule's application to completed transactions involving a minimum fee, say, $250,000.[6] Without a minimum fee requirement, an informal exchange of ideas between tax professionals at an educational seminar, reception, or athletic event might be swept into the other tax adviser prong of the rule. As important, the terms "planning, or opining on the tax treatment of, a transaction" in the preamble of Rule 3522 are very broad and we believe it would be appropriate, especially in the context of 3522(c), to establish a minimum fee before an audit firm's or "another tax advisor's" activity is considered significant enough to cause a loss of the registered public accounting firm's independence. Finally, unless a transaction is completed, a registered accounting firm would not lack independence because there would be no transaction reflected in the client's financial statements that would be subject to audit.

5. The Release invites comment on whether other types of reportable transactions should be treated as *per se* impairments of an auditor's independence. TEI does not believe it is necessary to expand the rules to address the other categories of reportable transactions (*i.e.*, transactions with contractual protection, certain loss transactions exceeding a dollar threshold, transactions involving brief asset holding periods, or to certain book-tax differences exceeding a dollar threshold). Although these transactions trigger a disclosure requirement, they encompass many routine transactions where the tax treatment is not in question. Thus, expanding the rules to include these transactions would not further the goal of ensuring an auditor's independence.

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[6] I.R.C. § 6111(b) defines a "material advisor" as anyone who renders material assistance in carrying out a reportable transaction and who receives a fee in excess of a dollar threshold. For a corporation that engages in a reportable transaction, the threshold is $250,000.

Rule 3523 — Tax Services for Senior Officers of Audit Clients

Under proposed Rule 3523, a registered public accounting firm is not independent of its audit client if the firm or any affiliate of the firm provides tax services to an officer in a "financial reporting oversight role" at an audit client. Again, TEI believes the proscription against auditors providing tax services to an officer of an audit client is generally sound. We recommend though that the Board consider clarifying which officers are subject to the rules, perhaps by cross reference to the SEC's definition of an officer for purposes of the insider trading rules under section 16 of the Securities Exchange Act.[7] If TEI's recommendation is not accepted, then, at a minimum, the rules should clarify specifically that employees who serve in an overseas assignment working for a *subsidiary* of the registrant-issuer are *not* covered unless they serve in a "financial reporting oversight role" for the *registrant-issuer*. Thus, nearly all expatriates working for a subsidiary of the registrant-issuer would be able to receive tax services from the auditor or the auditor's affiliates.

In addition, we recommend adoption of a transition rule exception for the tax year of the affected officers during which these rules become effective. In other words, if the proposed rule were adopted in 2005, we believe it would be appropriate to permit the client's auditor — subject to disclosure to, and approval by, the client's audit committee — to supply tax services to the affected individuals for the calendar year 2005 tax return.[8] Finally, if an auditor has supplied tax services to an officer in the past, there should be a transition rule that permits the accounting firm to respond to inquiries from, or audits by, tax authorities in respect of returns filed or transactions undertaken in connection with the officer's prior year returns. Because of the time lag between the filing of a return and its examination by the tax authorities, a transition rule for tax services rendered prior to the adoption of a final rule will be useful and necessary.

The Release invites comments on whether the prohibition on providing tax services to senior officers should be expanded to encompass other individuals at the audit client, including members of the client's board of directors. TEI believes the proposed rule provides a clear demarcation and should *not* be expanded. There are only four international accounting firms that most multinational companies are able to employ. Moreover, many individuals who serve as members of boards of directors serve on multiple companies' boards. Expanding Rule 3523 to

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[7] *See* 17 C.F.R. § 240.16a-1(f). The term "officer" shall mean an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Officers of the issuer's parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy-making functions for the issuer. In addition, when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer is a trust, officers or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust.

[8] In addition, a permanent transition rule would be beneficial in order to address situations where an individual becomes a covered officer.

include all members of clients' boards of directors may preclude such individuals from using any of the Big-4 firms for tax services and create a significant disincentive to serving as a member of a board. If, contrary to TEI's recommendation, the scope of the rules is expanded, we recommend that the rule be limited to *no more than* the audit committee of a client's board of directors.

Rule 3524 — Audit Committee Pre-Approval of Certain Tax Services

Under proposed Rule 3524, a registered public accounting firm is required in connection with seeking audit committee pre-approval to perform tax services for an audit client to provide the audit committee with a copy of the engagement letter, any amendment to the engagement letter, or any other agreement between the firm and the audit client disclosing the scope of the services and fee structure, including any fee-sharing arrangement.

Although TEI believes it is appropriate for the Board to consider providing guidance fleshing out the Act's and the SEC's pre-approval requirements, we regret that Rule 3524(a)(i) is far broader than necessary and imposes undue burdens on clients and audit committees as well as audit firms. More important, there is no evidence (and it is at least premature) to suggest that the SEC's pre-approval rules are not working. Even without Rule 3524(a)(i), prudent audit committees have adopted pre-approval policies pursuant to which they currently obtain significant amounts of information about the nature, scope, and cost of the tax services to be provided by a company's auditors. The proposed rule would effectively eliminate the flexibility that the SEC's rules afford to audit committees to decide which tax services engagements are material and warrant detailed review, which can be addressed summarily, and which can be given a blanket annual pre-approval subject to client personnel adhering to the policy guidelines adopted by the audit committee or the full board of directors in connection with the approval of the tax services.[9] Moreover, the proposed rule would create one standard for pre-approval of tax services while the SEC's rule would apply in respect of pre-approval for all other non-audit services. We believe the dual standard may confuse audit committees.

Engagement letters can run 30 to 40 pages or more, including a substantial amount of legal boilerplate that does not relate to the nature, scope, or cost of the tax services. For any one client, there may be numerous services provided during the course of a particular year, each pursuant to a separate engagement letter. Thus, under a literal application of Rule 3524(a)(i) audit committees may be inundated with hundreds of pages of documents that could be beneficially summarized by the auditor in several paragraphs (or a few pages) of a well-tailored

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[9] For example, in certain foreign jurisdictions, the tax return closely follows the statutory accounts attested to by the auditor. In the interest of efficiency, the local auditor (which may or may not be the same firm used in the United States) will often prepare the income tax return pursuant to a locally approved engagement. It is unclear how the purposes of the Act would be enhanced by requiring the audit committee to obtain each local engagement letter, translate them to English where necessary, and specifically approve each engagement in advance.

description. Requiring audit committees to read through each engagement letter and specifically approve each separate engagement in advance would substantially increase the workloads of audit committee members.[10] Indeed, the additional workload might distract audit committees from their oversight duties in other areas and thus be counterproductive to the goals of the Act. In addition, the added burden involved in approving tax services rendered by a company's auditors may lead many audit committees to adopt a blanket prohibition against using the company's auditor for routine tax compliance and planning services. Such a result would be clearly inconsistent with congressional intent, the SEC's rules, as well as the Board's expressed intention of permitting — even encouraging — auditors to supply routine tax planning and compliance services to their clients.[11]

In lieu of requiring the audit committee to obtain, read, and maintain all the legal boilerplate documentation for every engagement, we recommend that the Board consider permitting accounting firms to submit a description of the key terms of their agreements along with a detailed summary of the services to be provided in respect of each material engagement. In the event that the Board concludes that a stringent documentation requirement similar to Rule 3524(a)(i) is necessary under certain circumstances in order to buttress the SEC's pre-approval rules, we urge the Board to consider adopting a *de minimis* exception or supplying a definition of "material" tax services engagements subject to more stringent documentation, review, and approval requirements. For example, the Board might require the audit committee to review and specifically approve engagements for tax services where the fee for tax services would exceed the greater of five percent of the annual audit fee or $250,000.

Under Rules 3524(b) and (c), audit committees would be supplied with information to render a meaningful judgment about the independence of the auditor supplying the tax services. Thus, we believe that the burden of the documentation requirement can be reduced without undermining the audit committee's governance role and duties. We urge the Board to significantly narrow the scope and application of Rule 3524(a)(i).

Other Issues

Under sections 201 and 202 of the *Sarbanes-Oxley Act of 2002* and the Board's proposed rules, audit firms may supply tax return preparation and tax compliance services (subject to the client audit committee's pre-approval), but may not supply legal advocacy services such as

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[10] Most audit committees meet on a regular basis, but not necessarily every month. Requiring audit committees to obtain the required level of detailed documentation for every engagement no matter how minor the tax services will not only increase the committee's workload, but also potentially impair the timeliness of the tax services.

[11] There are only four audit firms that most multinationals can employ on a worldwide basis for both tax and audit services. Indeed, with conflicts of interests among clients and with disparities among the firms' expertise in various jurisdictions, there are fewer than four firms that multinational clients can employ in any particular country. If the proposed rule discourages audit committees from using the auditor for tax services, companies may have only one or no choice among the Big-4 firms in a particular country.

representing the audit client before a court or providing certain "expert services" for the purpose of advocating the client's position in a controversy. TEI recommends that the Board explicitly recognize that when an audit firm supplies tax return preparation or tax compliance services, the firm is obligated to the client and to the relevant taxing authority, such as the IRS, to explain and document its work upon request. Where a client's senior tax executive decides to outsource some of the company's tax return preparation or compliance work, the executive does so because the tax department lacks the internal resources or expertise to perform the work. The lack of resources or expertise extends to presenting, explaining, documenting, and defending the work before a revenue agent or an Appeals officer. A representation by the audit firm in these forums that it believes its work was correct should not be considered to rise to the level of advocacy. The Board should recognize that it is in the best interests of tax administration and the investing public for audit firms to be able to explain and document routine compliance and tax return preparation work without undue concerns about impairment of independence.[12] Audit firms should be permitted to perform a routine assistance role for the tax department without being viewed as impairing their independence.

Conclusion

TEI appreciates the opportunity to comment on the proposed rules and would be pleased to discuss the comments with the Board or its staff. These comments were prepared under the aegis of TEI's Federal Tax Committee, whose chair is Neil D. Traubenberg. If you should have any questions about the comments, please do not hesitate to contact Mr. Traubenberg at 303.673.3904 or neil_traubenberg@stortek.com or Jeffery P. Rasmussen of the Institute's legal staff at 202.638.5601 or jrasmussen@tei.org.

Respectfully submitted,

Judith P. Zelisko
TEI International President

[12] It would be consistent with both congressional intent and the SEC's rules permitting registered public accounting firms to provide tax services for the Board to explicitly recognize the auditor's obligation to provide the follow-up services described. If the Board's rules were otherwise, a transition rule would be necessary because of the normal lag in the completion of tax audits. Specifically, compliance and return preparation work performed prior to the passage of the *Sarbanes-Oxley Act of 2002* is currently being reviewed by tax authorities and it would be appropriate to permit the audit firms to complete those engagements.