

---

---

## STAFF QUESTIONS AND ANSWERS

### ETHICS AND INDEPENDENCE RULES CONCERNING INDEPENDENCE, TAX SERVICES, AND CONTINGENT FEES

April 3, 2007

---

---

**Summary:** Staff questions and answers set forth the staff's opinions on issues related to the implementation of the standards of the Public Company Accounting Oversight Board ("PCAOB" or "Board"). The staff publishes questions and answers to help auditors implement, and the Board's staff administer, the Board's standards. The statements contained in the staff questions and answers are not rules of the Board, nor have they been approved by the Board.

The following staff questions and answers related to ethics and independence rules concerning independence, tax services, and contingent fees were prepared by the Office of the Chief Auditor. Questions should be directed to Bella Rivshin, Associate Chief Auditor (202/207-9180; rivshinb@pcaobus.org) or Greg Scates, Associate Chief Auditor (202/207-9114; scatesg@pcaobus.org).

\* \* \*

#### **Rule 3522. Tax Transactions**

**Q1.** Does Rule 3522(a), Confidential Transactions, apply when conditions of confidentiality are imposed by tax advisors who are not employed by or affiliated with the registered public accounting firm?

**A1.** Yes. Under Rule 3522(a), 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 client related to marketing, planning, or opining in favor of the tax treatment of a confidential transaction. Under Rule 3501(c)(i)(1), a confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for

## STAFF QUESTIONS AND ANSWERS

which the taxpayer has paid an advisor a fee. As stated in the Board's adopting release, PCAOB Release 2004-015 (July 26, 2005), "Rule 3501(c) defines confidential transactions in terms of confidentiality restrictions imposed by tax advisors generally, not specifically auditors." Therefore, Rule 3522(a) applies not only when conditions of confidentiality have been imposed by a tax advisor that is employed by or affiliated with the registered public accounting firm, but also when conditions of confidentiality have been imposed by any tax advisor, including one that has no relationship with the registered public accounting firm.

**Q2.** For purposes of Rule 3522(a), Confidential Transactions, can a registered public accounting firm, when marketing, planning, or opining in favor of the tax treatment of a transaction, rely on representations from its audit client that another tax advisor did not impose conditions of confidentiality in connection with the specific tax transaction?

**A2.** Yes. In determining if any tax advisor imposed conditions of confidentiality in connection with a specific tax transaction, the registered public accounting firm may rely on representations from its audit client, provided that the firm does not know, or have reason to know, that those representations are incorrect or incomplete.

**Q3.** In planning a tax transaction, may a registered public accounting firm advise an audit client on the tax consequences of alternative ways of structuring the transaction?

**A3.** Yes, as long as the auditor does not recommend an alternative tax transaction structure: (1) that is not more likely than not to be allowable under applicable tax laws, and (2) a significant purpose of which is tax avoidance. Rule 3522(b) provides that a registered public accounting firm is not independent of the audit client if the firm, or any affiliate of the firm, provides an audit client any non-audit service related to marketing, planning, or opining in favor of the tax treatment of a transaction that was initially recommended by the firm 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 planning a tax transaction for an audit client that is permitted under Rule 3522(b), the firm may need or want to inform the client about the tax consequences of alternative tax transaction structures, some of which may not be more likely than not to be allowable and have a significant purpose of tax avoidance. As long as

## STAFF QUESTIONS AND ANSWERS

the firm does not recommend that the audit client engage in such a transaction, the firm will not violate Rule 3522(b).

**Q4.** How is a registered public accounting firm's independence affected by the Internal Revenue Service's ("IRS") subsequent listing of a transaction that the firm marketed, planned, or opined in favor of, as described in Rule 3522(b), Aggressive Tax Position Transactions?

**A4.** The listing by the IRS of a transaction after the firm marketed, planned, or opined in favor of the tax treatment of the transaction would not retroactively affect the firm's independence. Whether the firm was independent when it planned, marketed, or opined in favor of the transaction would instead depend on the facts available at that time. An analysis under Rule 3522 would consider, among other things, whether the tax treatment of the transaction was, at the relevant time, at least more likely than not to be allowable under applicable tax laws, including whether the transaction was itself listed or substantially similar to a listed transaction.

After a transaction marketed, planned or opined on by the firm becomes listed, however, the firm's independence may, depending on the circumstances, become impaired. For example, even if a firm was independent at the time the tax transaction was executed, because it reasonably and correctly concluded the transaction was not the same as, or substantially similar to, a listed transaction, once a transaction is actually listed (or a substantially similar transaction becomes listed), the firm that participated in the transaction may find its independence impaired. In this situation, a mutuality of interest could be created by the fact that once a transaction is listed, the firm or client, or both, may be required to defend the tax treatment of the transaction and, in some cases, pay penalties. When a tax transaction in which the firm participated is subsequently listed (or is substantially similar to a transaction that is subsequently listed) by the IRS, the firm should evaluate the potential effect on its independence and discuss it, as appropriate, with the audit client's audit committee.

## STAFF QUESTIONS AND ANSWERS

### **Rule 3523. Tax Services for Persons in Financial Reporting Oversight Roles**

**Q5.** Rule 3523 restricts the provision of tax services to a person in a Financial Reporting Oversight Role ("FROR") at an audit client or an immediate family member of such person. FROR is defined under both SEC and PCAOB rules as a role in which a person is in a position to or does exercise influence over the contents of the financial statements or anyone who prepares them. For purposes of Rule 3523, must the auditor evaluate whether persons are in a FROR at any entities other than the one being audited?

**A5.** Yes. Auditors must evaluate whether a person is in a FROR at an "audit client." Because Rule 3501(a)(iv) defines "audit client" to include "any affiliates of the audit client," a person in a financial reporting oversight role at an affiliate of the audit client (and that person's immediate family members) are covered by Rule 3523, subject to two important exceptions. First, a firm's independence is not impaired under Rule 3523 if it provides tax services to a person who is in a financial reporting oversight role at the audit client (or an immediate family member of such a person) only because of the person's relationship to an affiliate whose financial statements are not material to the consolidated financial statements of the entity being audited. See Rule 3523(b)(1). Second, a firm's independence is not impaired under the rule if it provides tax services to a person who is in a financial reporting oversight role at the audit client (or an immediate family member of such a person) only because of the person's relationship to an affiliate whose financial statements are audited by an auditor other than the firm. See Rule 3523(b)(2).

**Q6.** What types of situations does the term "other change in employment event" in Rule 3523(c) encompass?

**A6.** Rule 3523(c) provides a time-limited exception to Rule 3523's restrictions on the provision of tax services to persons in financial reporting oversight roles at an audit client and certain of its affiliates. The exception applies when, among other things, a person becomes subject to the rule through a hiring, promotion, or "other change in employment event." Whether there has been an "other change in employment event" depends on the changed status of a person at an audit client. A change experienced by a company, such as a change in auditor or a

## **STAFF QUESTIONS AND ANSWERS**

change from a private company to a public one, is not, by itself, an "other change in employment event."

Some changes experienced by a company could, however, result in an "other change of employment event" for a particular person. For example, a person who is not in a financial reporting oversight role might, as a result of a business combination, be assigned additional duties and responsibilities that put him or her into a financial reporting oversight role. A business combination could also result in a change in a person's employer – for example, from an acquired company to a surviving company. A change in employer is also an "other change in employment event" under Rule 3523(c). For example, if Company A acquires Company B, a person who was in a financial reporting oversight role at Company B would experience an "other change in employment event" if he or she became an employee of Company A in a financial reporting oversight role as a result of the acquisition. If such a person had been receiving tax services from Company A's registered public accounting firm pursuant to an engagement in process before the acquisition, the time-limited exception in Rule 3523(c) would apply.