

## Irrevocable Election Teaching Notes

### *What Are the Relevant Facts?*

1. Steve made an error that the firm's review process did not catch.
2. Steve's error is not an error in the sense that the return is technically incorrect; it merely fails to take advantage of a strategy that would have benefited the client.
3. The tax law includes various elections a taxpayer can make that affect how and/or when certain income is taxed.
4. The election in this case is irrevocable and must be filed with the original return.
5. It would have been to the client's advantage to have filed the election; the exact nature of the election is not relevant to the case.
6. Had the partner been available to review the return, the election probably would have been attached.
7. While it is possible that legal problems could be encountered in attempting to deceive the tax authorities, the dilemma Steve faces does not rest on issues of legality.

### *What Are the Ethical Issues?*

1. Should the client, the firm, or Steve himself pay the additional tax resulting from the mistake? Should Steve comply with the partner's idea so that perhaps no one will have to pay the tax?
2. Is Steve at fault, or is the firm at fault for giving him an assignment he was too inexperienced to handle and for failing to review his work adequately? Are both at fault? Would it make a difference if Steve were a CPA?
3. Should Steve inform the client of the situation?
4. How should Steve balance his loyalty to his firm and to the client against his misgivings about compromising his integrity?

### *Who Are the Primary Stakeholders?*

- Steve
- The client
- The partner (and the firm)
- The tax authorities

### *What Are the Possible Alternatives?*

1. Attach the election to the firm's file copy, and "hope for the best."
2. Do not attach the election, but prepare future returns as if the election had been filed, and "hope for the best."
3. Do not attach the election, and let the client pay the extra tax.
4. Do not attach the election, but have the firm reimburse the client for the extra tax.
5. Resign, and let the firm handle the problem.

### *What Are the Ethics of the Alternatives?*

- Ask questions based on a "utilitarian" perspective (costs and benefits). For example:
  1. What are the probable consequences to each primary stakeholder of each possible course of action?
  2. Which action would provide the greatest benefit to the greatest number?
  3. The additional tax is a cost that is relatively easy to measure, but how much value should be placed on (a) maintaining the firm's reputation for quality work, (b) keeping the client satisfied, (c) Steve's loyalty to the firm, and (d) Steve's professional integrity?
- Ask questions based on a "rights" perspective. For example:
  1. Does Steve have a right to refuse the partner's suggestion?
  2. Does the partner have a right to order Steve to comply with the suggestion?
  3. Does the client have a right to be informed of the situation?
- Ask questions based on a "justice" perspective (benefits and burdens). For example:
  1. Which alternative distributes the benefits and burdens most fairly among the stakeholders?
  2. Is it fair for the client to pay for the firm's error?
  3. Is it fair for the tax law to be inflexible to the extent that the return cannot be amended to

include the election? (Keep in mind that the intent of the election deadline and of its irrevocability is to prevent taxpayers from changing their minds when they see new conditions emerging.)

*What Are the Practical Constraints?*

1. As noted above, it is too late to amend the return.
2. As an employee of the firm, Steve must consider his responsibility to his employer.
3. The firm must consider its reputation for integrity as well as for quality of work, including the responsibility it accepts when it chooses to practice before the IRS.
4. Since Steve performed the major work on the return, the partner will probably insist that it be Steve who prepares the untimely election. Should questions arise, it would be impractical for the

primary preparer to be unaware of the existence of the election in the firm's file copy.

5. Steve faces some risk to his career and livelihood regardless of the alternative he chooses.
6. Although not central to this case discussion, members of the AICPA must also consider provisions of the Code of Professional Conduct and the Statement on Responsibilities in Tax Practice.

*What Actions Should Be Taken?*

1. What actions should Steve take?
2. What would you do if you were in Steve's position? Why would you make that choice? Would it be an easy decision for you?
3. Which ethical theories (utilitarian, rights, justice) seem to you to be most helpful in this case?