

Tax services are unique among non-audit services for a variety of reasons. Detailed tax laws must be consistently applied, and the Internal Revenue Service has discretion to audit any tax return. Additionally, accounting firms have historically provided a broad range of tax services to their audit clients.¹⁰³

In the proposing release, we suggested that in determining whether a given tax service should be allowed, the audit committee should be mindful of the three basic principles. In response, some commenters¹⁰⁴ indicated that asking audit committees to evaluate the provision of tax services by the accountant in light of the three basic principles would significantly alter the Commission's historic position related to tax services. Other commenters raised significant clarity and certainty issues. Some commenters¹⁰⁵ that urged clarity would, for example, prohibit accountants from providing any tax services to audit clients. Other commenters¹⁰⁶ believed that accountants should be permitted to provide only certain types of tax services to their audit clients.¹⁰⁷ Some commenters¹⁰⁸ believed that allowing the accountant to perform tax services both enhances the quality of the audit and provides greater independent oversight over the provision of tax

services than would occur if a non-audit firm were engaged to provide these services. Additionally, one commenter's research suggests that higher levels of tax services fees are associated with substantially lower instances of financial restatements.¹⁰⁹

The Commission reiterates its long-standing position that an accounting firm can provide tax services to its audit clients without impairing the firm's independence. Accordingly, accountants may continue to provide tax services such as tax compliance, tax planning, and tax advice to audit clients, subject to the normal audit committee pre-approval requirements under 2-01(c)(7). Additionally, the rules we are adopting require registrants to disclose the amount of fees paid to the accounting firm for tax services. The rules are consistent with the Act which states that:

A registered public accounting firm may engage in any non-audit service, *including tax services*, that is not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer.¹¹⁰ (Emphasis added)

Nonetheless, merely labeling a service as a "tax service" will not necessarily eliminate its potential to impair independence under Rule 2-01(b).¹¹¹ Audit committees and accountants should understand that providing certain tax services to an audit client would, as described below, or could, in certain circumstances, impair the independence of the accountant. Specifically, accountants would impair their independence by representing an audit client before a tax court, district court, or federal court of claims. In addition, audit committees also should scrutinize carefully the retention of an accountant in a transaction initially recommended by the accountant, the sole business purpose of which may be tax avoidance and the tax treatment of which may be not supported in the Internal Revenue Code and related regulations.¹¹²

¹⁰⁹ See, comment letter of William Kinney, University of Texas, Zoe-Vonna Palmrose, University of Southern California, and Susan Scholz, University of Kansas.

¹¹⁰ Sarbanes-Oxley Act of 2002, Section 201.

¹¹¹ It would not be appropriate to provide a prohibited service, label it a "tax service," and argue that it is, therefore, permissible. For example, an accountant seeking to provide a broker-dealer service and arguing that, because there are tax implications of certain brokerage activities, the service is permissible would constitute an attempt to improperly circumvent the list of prohibited services. See, letter of Ernst & Young dated January 6, 2003 (p. 16).

¹¹² The Commission on Public Trust and Private Enterprise recently concluded as a "best practice" that an accounting firm should not be providing

C. Partner Rotation

For 25 years, partner rotation has been a component of quality control processes for a vast majority of the accounting firms that audit SEC registrants.¹¹³ The judgment about who should be subject to rotation and how long the partner(s) should remain on the engagement prior to rotating involves balancing the need to bring a "fresh look" to the audit engagement with the need to maintain continuity and audit quality.

The Sarbanes-Oxley Act requires rotation of certain audit partners on a five-year basis in order to continue to provide audit services for a registrant. Section 203 of the Sarbanes-Oxley Act of 2002 specifies that:

It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.

Section 301 of the Sarbanes-Oxley Act specifies that the Commission is to direct the national securities exchanges and associations to adopt company listing standards stating that the company's audit committee has the responsibility for appointment, compensation, and oversight of the work of the company's audit firm.¹¹⁴ In that capacity, the audit committee has the responsibility for evaluating and determining that the audit engagement team has the competence necessary to conduct the audit engagement in accordance with GAAS. Additionally, the accountant is required to conduct the audit in accordance with GAAS.¹¹⁵

"novel and debatable tax strategies and products that involve income tax shelters and extensive off-shore partnerships or affiliates" to audit clients. See The Conference Board Commission on Public Trust and Private Enterprise, *Findings and Recommendations*, January 9, 2003, p. 37.

¹¹³ American Institute of Certified Public Accountants (AICPA), *Division for CPA Firms SEC Practice Section Peer Review Manual*, 1978.

¹¹⁴ See, Release No. 33-8173 (Jan 8, 2003).

¹¹⁵ In addition to the audit, registrants are required to have their quarterly financial information subjected to a timely review by the accounting firm. Such review is typically conducted according to the provisions required by GAAS—see, AU § 722. Furthermore, Section 404 of the Sarbanes-Oxley Act, as well as the Commission's proposed rules—see, Release No. 33-8138, Oct. 22, 2002, (67 FR 66208)—would require the accounting firm to attest to management's report on the registrant's internal controls. Both a timely review engagement and an attestation engagement require the accounting firm to be independent with respect to the registrant. Accordingly, the Commission's rules for partner rotation extend to partners who serve on the engagement team that conducts the timely review of the registrant's

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¹⁰³ The provision of tax services by accountants to their audit clients existed and continued without change when Congress formulated the securities laws in the 1930s. The Sarbanes-Oxley Act also recognized that accountants may engage in certain non-audit services "including tax services * * * only if the activity is approved in advance by the audit committee."

¹⁰⁴ Some commenters (see, e.g., letter from Ernst & Young, dated January 6, 2003; letter from Deloitte & Touche, dated January 10, 2003; letter from KPMG, dated January 9, 2003; letter from the Chamber of Commerce of the United States of America, dated January 9, 2003; letter from SafeCo Corporation, dated January 7, 2003; letter from Pfizer, dated January 13, 2003; letter from The Business Roundtable, dated January 14, 2003) believe that asking audit committees to evaluate tax services in light of the three principles in its pre-approval process creates an unnecessary degree of uncertainty in the marketplace.

¹⁰⁵ See, e.g., letter from Norman Marks, dated December 9, 2002; letter from Harbor View Partners, dated December 4, 2002; letter from Douglas Estes, dated November 30, 2002; letter from William Fraser, dated November 26, 2002; letter from M.E. Saunders, dated November 26, 2002.

¹⁰⁶ See, e.g., letter from Robert T. Bossart, dated January 2, 2003; letter from FedEx Corporation, dated December 31, 2002; letter from the American Bar Association Section of Taxation, dated January 6, 2003; letter from California Public Employees' Retirement System, dated January 10, 2003.

¹⁰⁷ Commenters identified a variety of tax services they believe should be prohibited. However, there was no "consensus" view on what tax services should be prohibited.

¹⁰⁸ See, e.g., letter from Philip A. Laskawy, dated January 2, 2003; letter from FedEx Corporation, dated December 31, 2002; letter from The Business Roundtable, dated January 14, 2003.