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Accountant's Advice in the Context of Midco Transactions: Do Larger Accounting Firms Give Better Tax Advice?

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Introduction

Whether it is a dream vacation, cheap concert tickets, or a lucrative tax shelter, if it sounds too good to be true, it probably is. Victims of fraudulent schemes are often unaware they are being offered a sham. Other times, people have initial doubts but later ignore risks that they may share in promised rewards. This problem has been the experience for many taxpayers involved with Midco Tax Shelters utilized primarily during the decade from the early 1990s to the early 2000s (Hill and Nessler, 2016; Persellin, Greenstein, and Royalty, 2016; Rizzi, 2009, 2012). Corporate shareholders, along with many accountants and financial advisors, ignored early warning signs associated with Midco Tax Shelters and encouraged their use. Many deals backfired and triggered massive tax liabilities for shareholders based on the theory of transferee liability. In addition, many accountants and advisors, knowing or unknowingly, supported what turned out to be criminal fraud.[1]

The primary focus of this article is the advice provided by accountants, attorneys, and other financial advisors with respect to Midco transactions. The primary goal is to determine if there is any qualitative difference in the advisors' advice based on firm size. Bobek et al. (2017) analyzed survey evidence to find a relatively stronger ethical climate at Big-4 accounting firms than in both industry and smaller accounting firms. This study finds evidence that is consistent with the proposition that larger Big-4 accounting firms provide advice that exhibits greater diligence and due care than their counterparts at small accounting firms. Also, regardless of firm size, attorney advisors have low scores on the due-diligence metric used in this study.

The remainder of the paper proceeds as follows. Section two describes what makes this study unique. Third, a review of the literature on the ethics and quality of taxpayer advice based on firm size is shown. Fourth, a brief description of a typical Midco Tax Shelter is presented. Fifth, a discussion of the legal and professional standards concerning Midco Tax Shelters is displayed. The sixth section contains a review of the court decisions covered in this study. The elements covered for each court decision include the date filed, the court, the disposition, the standard applied, CPA or Attorney advisor, firm size, and due diligence score. Each of these items are also presented in Table 1. The summary discusses these findings concerning the diligence and due care of tax advisors' advice.

What Makes this Study Unique?

This study is unique in that it does not rely on survey data to evaluate the ethical, professional, and legal compliance of tax advisors. Instead of asking respondents their views on ethics, this article evaluates the actual advice provided in the context of legal, ethical, and professional standards for Midco Tax Shelters. This approach avoids bias that respondents may exhibit when answering survey questionnaires (Choi and Pak, 2015). Secondly, this study is unique as it provides an evaluation of tax advice from attorneys and CPAs in the context of Midco decisions. Thirdly, this study provides not only a comparison between large and small accounting firms, but also between law firms and accounting firms. To accomplish these objectives, a due diligence score is constructed to more objectively compare firms' advice.

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[1] In 2013, the main owners of the most prolific Midco entity, Midcoast Financial, were indicted along with five co-conspirators. They were charged for allegedly causing more than $200 million losses to the U.S. government (Department of Justice 2013).

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Tax Advice (Ethics) and Firm Size

The ethics of accountants and tax advisors have been the subject of debate and research in the U.S. for many years (Dzienkowski and Peroni, 2016; Frecknall-Hughes, 2016; Maloney, 2016). Studies about practitioners' increasingly aggressive tax strategies that appear to cross the line from tax avoidance into tax evasion also have proliferated (Bandy et al., 1994; Cloyd, 1995; Cuccia, 1994; Duncan et al., 1989; Hanlon and Slemrod, 2009; Hansen, 2012; Jackson et al., 1988, 1989; LaRue and Reckers, 1989; Lennox et al., 2013; Murphy, 2004; Reckers et al., 1991; Roberts, 1998; Sanders and Wyndelts, 1989; Schisler, 1994). The results of studies that examine ethics and firm size is mixed, a majority of studies examined support the premise that larger Big-4 accounting firms demonstrate stronger ethics than either medium or smaller firms.

Previous Studies: Accountants' Ethics and Firm Size

Doyle et al. (2014) first incorporated firm size as a variable to measure and explain the ethical behavior of tax accountants. They found that the ethical issues faced by large international firms are different in nature and handled differently than those faced by smaller tax practices. However, they also concluded that this factor did not necessarily lead to different ethical outcomes. It is interesting to note, in gathering survey data for their study, that no practitioners ever admitted to being less than ethical themselves.

Loeb (1971) constructed 50 ethical situations and collected survey responses from CPAs at different firms. He concluded that accountants with large public accounting firms are more likely to behave ethically than accountants in smaller firms. Similarly, Eynon et al. (1997) analyzed survey data and determined that accountants from small firms have significantly lower levels of moral reasoning abilities (MRA) than accountants working in large firms. More recently, Pierce and Sweeney (2010, p. 80) distributed questionnaires to professional candidates for the Institute of Chartered Accountants in Ireland with four different scenarios. They found that firm size is significantly related to ethical judgement, ethical intention, perceived ethical intensity and perceived ethical culture. Overall, in comparison with smaller firms, trainee accountants from medium-sized firms have lower ethical views than respondents from large Big-4 firms. Sweeney and Roberts (1997) also analyzed survey data to investigate the impact of firm size on auditor independence judgements. They concluded that auditors from larger firms are no more likely to comply with independence standards than auditors from either mid-size or small firms. Finally, and most recently, Bobek et al. (2017) analyzed survey data and concluded that advisors from large Big-4 accounting firms have a stronger ethical environment than their counterparts at smaller public accounting firms.

What is a Midco Tax Shelter?

Midco Tax Shelters are a financial arrangement used when C corporations desire to sell their appreciated assets and distribute the proceeds to shareholders. Taxpayers often seek to avoid the double tax inherent in such corporate liquidations. Typically, the first step in this type of liquidation is the sale of the appreciated assets either to a Midco entity or to another unrelated corporation. Next, the corporate stock is sold to the Midco entity, which allegedly possesses favorable tax losses or tax credits. The favorable tax attributes ostensibly enable the Midco entity to avoid paying taxes on the capital gains from the corporate liquidation. The Midco's tax attributes usually prove illusory and/or nonexistent and the Midco ends up with the large tax liability (Skarlatos and Rule 2015a).[2]

The Midco entity typically proves to be nothing more than an empty shell corporation that distributes its assets and is then unable to pay the corporate tax liability. In the final analysis, the selling shareholders and the Midco entity typically agree to split the savings which accrue from not paying the corporate tax. In such disputes, the IRS frequently relies on Code Section 6901 and the theory of transferee liability in an attempt to recover the unpaid tax from the original shareholders.

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[2] For a discussion of the early Midco case history, see Rizzi, "Midco or Bust," 36 Corp. Tax'n 40 (Nov./Dec. 2009) and "Midco Transactions and Shareholder-Level Liability," 39 Corp. Tax'n 12 (Sept./Oct. 2012), as cited in

Standards for Tax Advisors and Midco Tax Shelters

Numerous articles have been written about the ethical, professional, and legal standards that apply to tax advisors (Blatch et al., 2014; Haimowitz, 2017; Horwitz, 2011). Gould (2002) wrote an excellent article on the ethical, professional and legal dimensions of giving tax advice. He posed, but did not answer the rhetorical question, is the growing nature of aggressive tax advice due to deteriorating ethical standards or inadequate professional standards. In the context of tax shelters, Gould properly indicated that ethical lapses do often play a role.

Gould also noted, "It is clear that tax advice falls well below ethical, professional, and legal standards when it involves little more than recommending the use of accommodation parties, offsetting derivative instruments, or other subterfuges that reflect a tax-motivated transaction lacking any real economic consequences or changes in economic relationships." In a similar fashion, the Courts determined that the use of numerous Midco entities amount to nothing more than tax-motivated transactions lacking any real economic substance.

Code of Professional Ethics

The AICPA Code of Professional Conduct requires that members maintain objectivity, integrity, and be free of any conflicts of interest. A conflict of interest may occur, for example, when a member performs a professional service for one client and then performs another service for a second client who may have an adverse interest with the first. An example is where a tax advisor provides advice regarding a corporate liquidation and then accepts a fee for bringing a Midco entity to the table. Instead of bringing Midco entities into the transaction, tax advisors should warn selling shareholders of the risks that Midco entities pose. When stock sale transactions are not respected, transferee liability exposure can be enormous for selling shareholders. As discussed later, significant tax liabilities, including interest and penalties, are often imposed on liquidating shareholders.

Professional Standards

The AICPA also has a set of enforceable tax practice standards called the Statements on Standards for Tax Services (SSTSs). These standards are binding for members of the AICPA. Moreover, they inform the larger tax practice community on what is viewed as an acceptable standard of due care. In terms of specific requirements for tax advice, Rigos (2017) notes that CPAs are required under the standards, to have a good faith belief that all tax positions have a "realistic possibility" of prevailing if questioned under audit. CPAs may also recommend tax positions that have a "reasonable basis" of being sustained as long as there is adequate disclosure of such positions. While the standards do not specifically assign numerical probabilities for various levels of confidence in tax positions, the IRS has these probabilities posted on their website.[3]

Two SSTSs speak directly to the advice provided by tax advisors in the context of Midco transactions. SSTS 1 makes it clear that tax advisors have a duty to warn clients about the possibility and risk of penalties. Specifically, SSTS 1 requires that members advise taxpayers regarding the potential penalty consequences of any and all tax return positions. SSTS 7 also has relevance for advice provided by tax accountants in the context of MIDCO transactions. SSTS 7 requires that tax advisors use sufficient judgement to ensure that tax advice appropriately serves the taxpayers' needs. Taxpayers' needs are not well served when prospective transferee liability exposure is minimized or glossed over by tax advisors.

Legal Standards

Treasury Department Circular 230 contains the rules and regulations that apply to those who practice before the IRS. In addition, they also cover the relevant provisions for ethical conduct, as well as the disciplinary procedures that apply for members. Sauter (2016) notes that they provide crucial guidelines for tax professionals. For example, when providing advice or otherwise assisting taxpayers, tax advisors should provide clients with the highest quality representation concerning federal tax issues (Schreiber, 2010).

The first IRS Notice that put taxpayers and advisors on notice that "intermediary tax shelters" are prohibited was IRS Notice 2001-16.[4] With this Notice, the IRS labeled such transactions as "tax motivated" and therefore potentially subject to numerous penalties. While Notice 2001-16 had a chilling effect on taxpayers use of Midco transactions, it did not bring

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[3] See https://www.irs.gov/pub/irs-utl/statements_on_standards_for_tax_services.pdf
[4] Notice 2001-16, I.R.B. 2001-09, February 26, 2001.

them to a halt (Wood, 2008). The IRS issued Notice 2008-20 as the second notice regulating Midco tax shelters.[5] Notice 2008-20 was meant to clarify which transactions required disclosure. The problem with Notice 2008-20 was that it had the potential to treat certain transactions that were not tax motivated as tax shelters subject to various reporting rules and penalties. In response to an avalanche of criticism, the IRS retroactively superseded Notice 2008-20 with new Notice 2008-111.[6] As was the situation with Notice 2008-20, Notice 2008-111 clarified Notice 2001-16 and defined exactly which transactions would be considered as intermediary transactions.

Review of Midco Decisions and Advisors' Advice

Transferee liability has been part of the tax landscape at least since the 1950s. The duty to warn clients of the risk of transferee liability in the context of Midco transactions is a clear and basic responsibility for CPAs, attorneys, and other tax preparers. It also seems clear that tax advisors should warn clients of the risks and potential penalties under Notice 2001-16 and subsequent IRS Notices. Moreover, given the risk of conflict of interest, CPAs should avoid representing both selling shareholders and Midco entities in the same set of transactions. This conflict of interest is exacerbated when the CPA tax advisor or attorney also accepts financial compensation for bringing the Midco entity to the transaction.

Any consideration of taxpayer advice in Midco disputes must, by necessity, evaluate the actual advice provided as part of the case record. One may not definitively conclude that the omission of tax advice from the record proves its nonexistence. However, its omission from the record suggests that such advice may have been neglected or downplayed by the tax advisor. In any event, unwritten or casual advice from CPAs (attorneys) increases the possibility that malpractice allegations may be successful (Rood, 2012).[7]

Due Diligence Score

As a way to more objectively compare the advice provided in each dispute, a due diligence score is computed. Tax advisors score one point for each of the following pieces of advice: offering various tax strategies; warning about transferee liability exposure, and/or Notice 2001-16; and warning about the prospective failure of aggressive tax strategies. Advisors lose two points if they are involved in bringing the Midco entity to the transaction. Finally, advisors lose another point if they accept financial compensation for finding the Midco entity. The next section briefly summarizes each Midco case considered, along with the disposition, the standard applied, and whether it was a CPA or attorney providing tax advice. These items, along with the due diligence score are presented in Table 1.

Starnes v. Commissioner (The Initial Court Decision)

Numerous articles have been written about Midco tax shelters (Board, 2017; Chiem, 2015; Johnson, 2013; Marchbein, 2019; Meade, 2018; Reichert, 2016; Skarlotos and Rule, 2016; Townsend, 2015; Vlahos, 2015; Wood, 2016, 2015(a)(b), 2012, 2009(a)(b)). In the beginning, Courts decided in favor of taxpayers (shareholders) based on the determination that they lacked either "actual" or "constructive knowledge" that such transactions were fraudulent. Early cases also held that such knowledge was required under each state's version of the Uniform Fraudulent Transfer Act (UFTA). Over time, numerous appellate courts reversed course and ruled in favor of the IRS and against shareholders using Midco Tax Shelters. The appellate courts based their decisions on one of two theories. Certain appellate courts determined that, by definition, shareholders should or must have known that the transactions were fraudulent. Other appellate courts ruled in favor of the IRS and ignored taxpayers' intent and focused on the substance of the corporate liquidation. The decision that offered initial support for the use of Midco Tax Shelters was Starnes.

In 2003, Albert Starnes, along with other shareholders, decided to sell their interests and retire. After consulting with their advisors, the shareholders sold the company's only asset, a warehouse, to Prologis Inc. Next, a Midco entity named Midcoast Financial purchased the company's (Tarcon) stock and then sold it to another company. Midcoast then transferred all the remaining Tarcon cash to an offshore account. Meanwhile, Tarcon's 2003 tax returns were filed and capital losses were claimed that purported to offset the entire $3 million capital gain tax liability from the sale of the

[5] Notice 2008-20, I.R.B. 2008-6, January 17, 2008.
[6] Notice 2008-111, I.R.B. 2008-51, December 1, 2008.
[7] Claim experience of the AICPA Professional Liability Insurance Program shows that casual advice, especially when it is not documented in the tax preparer's file, increases the possibility that a malpractice allegation related to such advice will be successful.

warehouse. A two-million-dollar capital loss from high-basis low value foreign currency option was also claimed. The IRS audited the tax return and disallowed the losses and imposed the tax liability that Tarcon never paid. Accordingly, the IRS pursued former shareholders asserting that they were liable, as transferees, for the unpaid taxes.

The former shareholders contested the IRS Notice and filed petitions in the Tax Court. They testified that they did not understand what the purchasers meant by saying they had an asset recovery business or what Midcoast wanted to do with the stock, however, they made no inquiries. One shareholder said that it sounded strange but believed Midcoast purchased bad debts to use as write-offs against companies they purchased. Starnes also added, "It was not something I wanted to understand and that once they bought my stock, they could do whatever they wanted with it."

The Tax Court[8] initially exonerated Starnes stating that the taxpayer lacked actual or constructive knowledge of the fraudulent scheme. One year later, the Appeals Court for the Fourth Circuit[9] affirmed the decision of the Tax Court, which exonerated Starnes. The lack of business, tax, and finance education was also cited by the Court as further evidence that the shareholders did not have knowledge of the fraudulent intent of the Midco entity.

Advisors Due Diligence in Starnes

Brad Cherry, a commercial real estate broker, acted as the initial advisor for Starnes. Cherry encouraged Starnes to bring Midcoast Financial into the transaction in early 2003. Cherry also counseled Starnes to engage an accountant and an attorney as the details of this transaction were "out of his league." The accountant in this dispute was a sole practitioner and CPA by the name of Jerome Epping. The record contains only one reference to any due diligence performed by the accountant. A workpaper reference raised the question, but did not confirm, whether the transaction was 2001-16 reportable. In addition, the record did not include any other references to advice concerning potential exposure to transferee liability deficiencies from the involvement of the Midco entity. Therefore, as shown in Table 2, the net due diligence score for the accountant in Starnes is zero.

Starnes Paves the Way for Several Taxpayer Victories

After the Fourth Circuit affirmed the Starnes decision in May of 2012, the status of transferee liability cases was described by a tax blog[10] saying that the IRS had experienced little success in their efforts to collect corporate taxes through Section 6901. In fact, the Tax Court had ruled in favor of most all taxpayers in disputes involving transferee liability and Midco transactions. The cases cited were Starnes,[11] LR Development,[12] Griffin,[13] Frank Sawyer Trust,[14] Salus Mundi[15] and Slone.[16] Taxpayers also won a few other cases, such as Diebold[17] and Shockley,[18] on procedural grounds. For most of these decisions, the Tax Court concluded that the IRS had failed in its burden to show that the sellers of the stock knew or should have known that the purchasers of the stock had fraudulent intent.

LR Development v. Commissioner

In LR Development, the selling shareholders sold an entity named BCA. BCA engaged in the business of real estate development in Illinois and was owned by Bruce Abrams. On December 12, 1999 Mr. Abrams died and BCA passed into his estate. Initially, the estate planned to sell certain BCA assets. Eventually, a Midco entity named "Related" and owned by Fortrend, convinced representatives of the Abrams estate to sell their stock and thereby garner significant tax savings. After the purchase of BCA assets, Fortrend, the Midco entity, filed the 1120 corporate tax return for the year 2000. The tax

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[8] *Starnes v. Cir.*, T.C. Memo. 63 (2011).
[9] *Starnes v. Cir.*, 680 F.3d 417 (2012).
[10] Thompson and Knight, June 5, 2012, https://taxlawyer.typepad.com/blog/2012/06/transferee-liability-recent-developments.html
[11] *Starnes v. Cir.*, T.C. Memo 63 (2011), aff'd, 680 F.3d 417 (4th Cir. 2012).
[12] *LR Development v. Cir.*, T.C. Memo. 203 (2010).
[13] *Griffin v. Cir.*, T.C. Memo. 61 (2011).
[14] *Frank Sawyer Trust of May 1992 v. Cir.*, T.C. Memo. 298 (2011).
[15] *Salus Mundi Foundation v. Cir*., T.C. Memo. 61 (2012).
[16] *Slone v. Cir.*, T.C. Memo. 57 (2012).
[17] *Diebold v. Cir.,* T.C. Memo. 238 (2010).
[18] *Shockley v. Cir*, T.C. Memo. 8 (2016).

return included a capital gain of over $16 million from the sale of the appreciated assets along with a capital loss of $17 million from a Canadian foreign currency instrument contributed by Fortrend.

The IRS audited the return, disallowed the capital loss, and assessed a deficiency on the Abrams estate for the unpaid taxes. The Abrams estate then petitioned the Tax Court for relief.[19] In their deliberations, the Tax Court focused on the language of the agreement between BCA and (Related) Fortrend whereby the Midco entity assumed all tax liabilities stemming from the transaction. The IRS tried unsuccessfully to argue that this agreement was null and void.

Advisors Due Diligence in LR Development

In early April 2000, a CPA from the local accounting firm Rubin and Katz, introduced the Midco entity named "Related" and owned by Fortrend to BCA shareholders. Mr. Katz had worked with Fortrend in the past. The record indicates that there was zero due diligence performed with respect to Fortrend. The tax due diligence that was performed related solely to issues around the allocation of basis between tangible and intangible property and code section 1060. These three items culminate in the negative due diligence score of negative four for the accountant in LR Development as shown in Table 2.

Changing Tides of Transferee Liability for Taxpayers on Appeal

Apart from Starnes, LR Development, and Griffin, all of the aforementioned decisions were overturned on appeal. In Griffin, the Tax Court determined that the stock sale was not fraudulent. More specifically, the Court determined that the company had sufficient assets to liquidate all corporate debts, including the tax liability, after purchasing the stock.[20] However, all the other court decisions mentioned were eventually overturned and became significant losses and major tax liabilities for transferee shareholders.

IRS Achieves a String of Transferee Liability Wins on Appeal

Frank Sawyer Trust v. Commissioner

In Frank Sawyer Trust, the IRS determined that the transferees were liable for deficiencies, penalties, and interest. Initially, the Tax Court exonerated the Frank Sawyer Trust stating that the IRS failed to convince the court that they had either actual or constructive knowledge of the fraudulent intent of Fortrend, the Midco entity in this dispute.[21] While agreeing with the Tax Court on the issue of actual or constructive knowledge, the First Circuit Court[22] determined that they overlooked a novel type of exposure called "transferee of transferee" liability. In this regard, the Circuit Court concluded that the Trust could be held liable even if the Trust lacked the actual or constructive knowledge of the fraudulent scheme. They determined that a corporate transfer would be fraudulent if the corporation did not receive reasonably equivalent value in return for the transfer. The Court noted that the Trust had $39.6 million in cash and about $14.3 million in contingent tax liabilities for a net book value of $25.3 million. As part of the stock sale transaction, Fortrend paid the trust $32.4 million, which amounts to a premium of $7.1 million ($32.4 - $25.3 million). As was typical, the Midco company Fortrend split the unpaid tax liability of $14.3 million with the selling shareholders. After establishing this theory of liability, the Circuit Court remanded the trial court decision back to U.S. Tax Court for further consideration.

The Tax Court then agreed that the Trust was responsible under the theory of "transferee of transferee" liability.[23] However, the Tax Court limited the damages to the difference between the amount paid and the FMV of the acquired company, along with interest and penalties. The final issue adjudicated in this dispute was a petition by the trust for a credit against the estate tax which they overpaid. The stock in the estate was initially valued at the overstated sales price. The Tax Court granted a credit against the estate tax for this excess valuation under the "equitable recoupment doctrine." These rulings dealt another serious blow to taxpayers and advisors who had been relying on the defense that sellers lacked actual or constructive knowledge of any fraudulent tax scheme.

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[19] *LR Development v. Cir.*, T.C. Memo. 203 (2010).
[20] *Griffin v. Cir.*, T.C. Memo. 61 (2011).
[21] *Frank Sawyer Trust of May 1992 v Cir.*, T.C. Memo. 298 (2011).
[22] *Frank Sawyer Trust of May 1992 v Cir.*, 712 F.3d 597 (1st Cir. 2013).
[23] *Frank Sawyer Trust of May 1992 v Cir.*, T.C. Memo. 59 (2014).

Advisors' Due Diligence in Frank Sawyer Trust

The attorney in Frank Sawyer Trust was the one that brought the Midco entity to the transaction. That is a two-point penalty in the due diligence score. Next, as trustee, Ms. Parks received a letter from Fortrend that they had the financial resources to consummate the stock purchase and were represented by a "Big-4" accounting firm. Unfortunately, the trustee did not follow up on this reference. The attorney advisor did perform due diligence to verify that Fortrend was not a sham. This performance is worth one due diligence point. The net diligence score for the attorney in Frank Sawyer Trust is a negative one.

Diebold v. Commissioner

In Diebold, Double D Ranch was the liquidating corporation. A substantial capital gain of approximately $81 million was incurred on the sale of Double D. Next, the Midco entity by the name of Sentinel Advisors purchased the stock of Double D. The corporate return reported the capital gain along with a capital loss sufficient to offset the gain. The IRS disallowed the capital loss and tried to collect the tax owed. When the IRS could not collect from the Midco entity, they sent a notice of deficiency to Diebold under the theory of transferee liability. Along with penalties and interest, the deficiency grew to over $100 million from the initial tax liability of $30 million.

On appeal of Diebold, the 2nd Circuit Court again overturned the Tax Court. The Tax Court ruled that under the NYUFCA,[24] the party seeking to recharacterize a transaction must show that the transferee had "actual or constructive knowledge" of the entire scheme that rendered its exchange with the debtor fraudulent. The Tax Court found that the shareholders did not have either actual or constructive knowledge of the entire series of transactions. The 2nd Circuit Court disagreed and held that it was unnecessary to prove that a party had "actual" knowledge of a scheme to show that they had constructive knowledge.[25] It was sufficient to show that, based upon the surrounding circumstances, they "should have known" about the entire scheme. The language of the Diebold opinion was more bad news for many transferees and advisers who relied on the lack of knowledge defense.

The 2nd Circuit Court also commented on the Tax Court's reference to IRS Notice 2001-16." While the Tax Court indicated that Notice 2001-16 had not yet been issued, this fact had no bearing on the question or issue of constructive knowledge."[26] The parties to this transaction were extremely sophisticated actors, deploying a stable of tax attorneys from two different firms in order to limit their tax liabilities. The Appeals court added, "While not every taxpayer in the country could have been presumed to have knowledge about the existence of such Midco transactions prior to the IRS issuance of Notice 2001-16, it is plain from the facts found by the Tax Court that these particular actors did." Having determined that the Tax Court erred in concluding that Diebold did not have substantive liability under state law, they remanded the dispute back to the Tax Court to determine whether Diebold and Diebold New York were transferees under Section 6901.

Advisors' Due Diligence in Diebold

An attorney from the large law firm of Chadbourne and Parke, was Diebold Trust's principal outside tax counsel. According to Leder, "it was generally known that there were some companies, for whatever reason, whatever their tax activities were, could make favorable offers to sellers with stock and appreciated assets. Accordingly, Mr. Leder invited the Midco entity Fortrend to the transaction. In terms of due diligence, this invitation is worth a negative two points. Moreover, the law firm failed to perform any due diligence with respect to potential transferee liability exposure. As shown in Table 2, the total due diligence score for the attorney is negative three.

Feldman v. Commissioner

The rulings in Feldman provided more good news for the IRS and bad news for taxpayers. Woodside Ranch was the liquidating corporation in this dispute. Shareholders were concerned about the tax liability from the sale of Woodside Ranch. The Tax Court applied Wisconsin law and determined that the petitioners (the Feldmans) should be held liable as

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[24] New York Uniform Fraudulent Conveyance Act.

[25] *Diebold Foundation Inc. v. Cir.*, 736 F.3d 172 (2nd Cir. 2013).

[26] In Notice 2001-16, the IRS put taxpayers on notice that they would challenge transactions where corporate assets are sold to one party and the stock is sold to another in some type of intermediary transfer.

transferees of Woodside Ranch.[27] The issue of whether the sellers had actual or constructive knowledge of the scheme was one of the petitioners' (Feldmans') main arguments. Petitioners argued that without either constructive or actual knowledge under Wisconsin law there could be no transferee liability. Unfortunately for the petitioners, the Commissioner successfully argued that the Feldmans should be treated as transferees and liable for the unpaid Federal income tax liability of Woodside Ranch under two closely related provisions of Wisconsin law. Neither of these provisions focused on taxpayer intent.

The Tax Court concluded that Woodside Ranch received nothing of reasonably equivalent value in exchange for approximately $1.3 million in cash distributed to petitioners. The transfer of Woodside Ranch's $1.3 million to petitioners left Woodside Ranch with remaining assets of approximately $453,000 in cash, insufficient to pay Woodside Ranch's Federal and State income tax liabilities exceeding $700,000. As a result of Woodside Ranch's cash distribution to petitioners, Woodside Ranch was rendered insolvent.

The Tax Court also determined that Woodside Ranch shareholders should have known that the Federal income tax liability arising from the asset sale would not be paid. In the eyes of the court, credible evidence was shown that the petitioners' primary interest in MidCoast Financial, the Midco entity, was the assumption that the corporate taxes would not be paid and that each party would pocket and retain a portion of the unpaid taxes. Despite representations to the contrary, the record was replete with notice to petitioners that MidCoast never intended to pay Woodside Ranch's Federal income tax liability. The 7th Circuit Court affirmed the Tax Court decision saying that the purported stock sale between petitioners and MidCoast lacked both business purpose and economic substance and should therefore be disregarded for Federal income tax purposes.[28]

Advisors' Due Diligence in Feldman

The primary advisor in Feldman was a CPA from a local accounting firm. There are three references to the advice provided by the accountant. First, he computed the federal and state tax liabilities from the sale of the appreciated assets as part of the liquidating of Woodside Ranch. Second, he brought the Midcoast Financial, the Midco entity to the transaction. Third, he accepted a fee of $25,000 for bringing the Midco entity to the transaction. With the eventual imposition of transferee liability, along with interest and penalties, the initial tax liability mushroomed to nearly $1.4 million from just under $600,000. As shown in Table 2, the net due diligence score for the CPA advisor in Feldman is negative three.

Slone v. Commissioner

The liquidating corporation in dispute was Slone Broadcasting (SB). Citadel purchased the assets of SB, which triggered a $38 million capital gain. The Midco entity Berlinetta[29] purchased the stock of SB and filed the corporate tax return. The tax return reported the capital gain along with a capital loss from the sale of Treasury securities that offset the gain. After disallowing the capital loss as fictitious, the IRS was unable to collect from the Midco. The IRS then assessed a deficiency against Slone of $13.5 million, along with a penalty of $2.7 million and interest of $7.3 million, using the theory of transferee liability.

In the appeal of Slone,[30] the 9th Circuit also disagreed with the Tax Court[31] and held that the Slones had "at least" constructive notice that the series of transactions had no real purpose other than to avoid corporate tax liability (Adkisson, 2018). The Court determined that the sole purpose of the Slone's transaction with Berlinetta was tax avoidance and that reasonable actors in [the Slone's] position would have been on notice that Berlinetta never intended to pay Slone Broadcasting's tax obligation. The 9th Circuit concluded that this transaction was squarely within the constructive fraud provisions of Arizona's UFTA and that neither Slone Broadcasting nor Berlinetta were able to satisfy Slone Broadcasting's tax liabilities (Meade, 2018). This decision also dealt another setback to taxpayers who had been relying on the defense of lack of actual or constructive knowledge of the fraudulent scheme.

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[27] *Feldman v. Cir.*, T.C. Memo. 297 (2011).
[28] *Feldman v. Cir.*, 779 F.3d 448 (7th Cir. 2015).
[29] Berlinetta was a shell corporation owned by Fortrend and licensed in the state of New York.
[30] *Slone v. Cir.*, 788 F.3d 1099 (9th Cir. 2015).
[31] *Slone v. Cir.*, T.C. Memo. 57 (2012).

Advisors' Due Diligence in Slone

The CPA advisor in the Slone case was from a local small accounting firm. The record specifically indicates that the accountant did not offer any other tax strategies to offset the capital gain. Second, the due diligence that was performed made no reference to transferee liability. Third, the accountant brought Midcoast, the Midco entity, to the transaction. The net due diligence score for these activities is negative four for the accountant.

Shockley v. Commissioner

The Shockleys started their business with a radio station in Madison, Wisconsin in early 1985. They expanded the business to include over five radio stations. Contemplating retirement in early 2000, they met with a CPA, who then recommended a company by the name of ICA to facilitate the sale. The transaction ended up being a stock sale involving the Midco entity. When the IRS could not collect from Midco, they assessed a deficiency against Shockley of $41.5 million, along with a penalty of $8.3 million and interest of $27 million based on the theory of transferee liability.

The Tax Court initially ruled in favor of the IRS where they recast the stock sale as an asset sale followed by a liquidating distribution.[32] The Circuit Court ruling agreed with the Tax Court as follows, "Nowhere does the record reflect any legitimate business purpose or economic effects that satisfactorily explain why Petitioners undertook the Midco transaction that occurred in this situation, nor why the substance of this transaction should be disregarded in favor of its perplexing form.[33]

Advisors' Due Diligence in Shockley

The CPA advisor in Shockley was from the medium size tier two accounting firm of RSM McGladrey. As part of the negotiations for the sale of the company, the RSM McGladrey accountant introduced the Shockleys to ICA, who proposed the use of a Midco entity to mitigate the corporate tax on the appreciated assets. The record indicates that the partner/director from RSM McGladrey did engage in five different positive due diligence procedures. First, the CPA advisor presented a number of different tax strategies to potentially mitigate the capital gain. Next, the CPA presented an in-depth analysis of the stock versus an asset sale. The CPA advisor then warned the taxpayer that the IRS might recharacterize the transaction. He also emphasized the risks of transferee liability by sending copies of Notice 2001-16 to both the taxpayer and to the attorney advisor for Shockley. Finally, the RSM McGladrey director refused to let his firm be involved with the Midco transaction. Accordingly, the net due diligence score for the RSM McGladrey accountant in this conflict is positive five.

Trust UWO v. Commissioner

Petitioners in this conflict were the former shareholders of Arebec Corporation. Arebec was a C corporation whose assets consisted chiefly of appreciated marketable securities. Shareholders desired to liquidate Arebec's assets and receive the proceeds but did not want to pay the tax on the capital gain. Accordingly, a partner at Grant Thornton, another mid-sized accounting firm introduced shareholders to "Diversified," which was a leading promoter of Midco transactions. As part of the stock acquisition, Diversified paid Arebec a premium based on a percentage of the unpaid corporate tax.

The 2001 Arebec tax return reported a $20.1 million capital gain along with a $22 million capital loss based on high basis/low value securities, which the IRS later disallowed as fraudulent. When the corporate tax was not paid, the IRS assessed a deficiency against the shareholders of Arebec under the theory of transferee liability. The deficiency included the initial assessment of $7 million, along with a Section 6662 penalty of $2.7 million, and interest of $9.7 million. The only issue in this case was whether the IRS mailed the Notice of Deficiency to taxpayers in a timely fashion. The Court ruled these notices were mailed in a timely fashion.[34]

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[32] *Shockley v. Cir.,* T.C. Memo. 113 (2015).
[33] *Shockley v. Cir.,* 686 F.3d 1228 (11th Cir. 2012).
[34] *Trust UWO v. Cir.*, T.C. Memo. 182 (2018).

Advisors' Due Diligence in Trust UWO

In July 2000, the tax partner at Grant Thornton suggested the sale of Arebec and recommended the Midco company Diversified to accomplish the sale. The recommended price was fair market value of the stock less 7 percent of the capital gain. This amount constituted the Midco premium which would benefit Diversified. The record does not contain any reference to any due diligence performed by the tax advisor regarding transferee liability, Notice 2001-16, or the aggressive tax strategy to offset the capital gain. Therefore, the net due diligence score in this case for the Grant Thornton accountant is negative three.

Tricarichi v. Commissioner

West Side Cellular, the liquidating corporation in this dispute, had a net asset value of approximately $40 million at the time of the liquidation. The estimated aggregate tax liability after the 2003 liquidation was just less than $17 million, which left a net book value of $23 million. Nob Hill, the Fortrend shell company in Tricarichi, agreed to pay Westside approximately $34 million for the stock sale. This price included an $11 million premium over the net book value of the company. As was typical in the case in Midco Tax Shelters, this result left the remaining portion of the unpaid taxes ($6 million) for Fortrend. Next, the IRS disallowed the fictional losses claimed by Nob Hill and assessed the corporate-level tax against West Side.

Concerning the issue of constructive or actual knowledge, the Tax Court made an unusual reference to buttress its point that the shareholders knew or should have known about the fraudulent nature of the transactions.[35] The Court cited the many pieces of advice provided by the Big-4 accounting firm PwC highlighting the risks associated with the Midco transaction. The Court wrote, "To conclude that the totality of these circumstances did not give rise to constructive knowledge on the petitioner's part would do away with the distinction between actual and constructive knowledge." Moreover, the Court wrote, "To relieve the petitioner and his advisers of the duty to inquire, when the surrounding circumstances cried out for such an inquiry, would be to bless the willful blindness the constructive knowledge test was designed to root out."[36] The 9th Circuit agreed with the Tax Court.[37]

Advisors' Due Diligence in Tricarichi

As noted above, the primary tax advisor in the Tricarichi case was the Big-4 accounting firm of PwC. Even in the face of significant push back from the client, PwC was resolute in articulating their concerns. The PwC tax advisors in Tricarichi scored one due diligence point for each of the following five acts. First, the Client Agreement included a provision whereby any reportable transactions would be specifically identified by PwC. Next, PwC raised the issue of whether the proposed tax strategy was "too aggressive." Third, PwC specifically warned the taxpayers that the IRS might challenge the excessive capital loss. Next, PwC explicitly warned Tricarichi that they might face "transferee liability issues." Finally, PwC advisors intentionally refused to participate in the negotiation of the "Midco premium."

Hawk v. Commissioner

The entity being sold in this dispute was a bowling alley by the name of Holiday Bowl. The sale of the bowling alley gave rise to a corporate tax liability of $800,000. After the sale in 2003, Midcoast Financial negotiated the purchase of the stock of Holiday Bowl. Midcoast agreed to a price of the cash of Holiday Bowl less 64.25 percent of the taxes due. This amount was the Midco premium which would accrue to Midcoast. Midcoast filed the tax returns and claimed a capital loss due to interest rate swaps that offset the capital gain. The IRS audited the return and disallowed the capital losses. When the IRS could not collect from the Midco entity, they proceeded against Hawk on the theory of transferee liability. The Tax Court ruled that Hawk knew from the outset that the underlying purpose of the Midcoast transaction was to obtain a financial benefit from the nonpayment of Holiday Bowl's 2003 income tax.[38]

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[35] *Tricarichi v. Cir.*, T.C. Memo. 201 (2015).
[36] Citing *Diebold Foundation Inc. v. Cir.*, 736 F.3d 172 (2nd Cir. 2013) at 189.
[37] *Tricarichi v. Cir.*, 16-74318 (9th Cir. 2018).
[38] *Hawk v. Cir.*, T.C. Memo. 154 (2012).

Advisors' Due Diligence in Hawk

The attorney advisor in Hawk was Wayne F. Thomas from Chambliss Bahner, one of the largest law firm in Chattanooga, Tennessee. Mr. Thomas submitted a research memo in this case which reviewed the potential transaction. The memo indicated that he had discussions with other attorneys who represented Midcoast in other transactions. He also vouched for Midcoast saying that they had not had any problems with the IRS. One glaring deficiency in this memo is the absence of any reference to transferee liability. This absence garners one negative due diligence point. The attorney also failed to consider the sustainability of the proposed aggressive tax strategy. Finally, he failed to perform any meaningful due diligence regarding Midcoast. The net due diligence score is negative three.

***Estate of Richard L. Marshall v. Commissioner*[39]**

Marshall Associated Contractors (MAC) was the liquidating corporation in this decision. MAC was the recipient of a $40 million litigation award. To avoid the corporate tax upon liquidation, the Midco entity Fortrend bought the stock of MAC and eliminated the corporate tax liability by claiming a $39.5 million loss from high basis/low value Treasury Bills. This transaction was somewhat unique as MAC did not generate a capital gain upon liquidation. Rather, the corporate tax stemmed from the $40 million litigation award.

The Tax Court determined that under the Oregon Uniform Fraudulent Transfer Act (OUFTA) the series of transactions between MAC and Fortrend should be collapsed and treated as if MAC had sold its assets and then made liquidating distributions to the shareholders. Since the transfers were collapsed, MAC was treated as having transferred substantially all of its assets to petitioners and receiving less than reasonably equivalent value. Their analysis focuses on what the parties knew. The IRS ruled, and the Tax Court agreed, that the selling shareholders had complete knowledge of the entire scheme.

Advisors' Due Diligence in Estate of Richard L. Marshall

The primary advisors in the Estate of Richard L. Marshall was also Big-4 accounting firm of PwC. As in Tricarichi, the PwC advisors in Marshall pressed their concerns and warnings to taxpayers in the face of significant pushback from the client. The PwC advisors' in Marshall have the highest due diligence score in this study. The fact that the advisors lost this client over their unwillingness to heed their advice also makes the case unique.

The advisors displayed due diligence from the beginning by offering numerous legitimate tax strategies to offset the capital gain. They also warned the client about potential exposure due to Notice 2001-16. Thirdly, they warned the client about the risk of bankruptcy if cash from the target was used to consummate the acquisition. Next, PwC warned the client that the transaction could be attacked as fraudulent. Fifth, PwC warned shareholders about the risk of transferee liability. The record also contained an explicit warning from PwC about combining the losses with the capital gain.

The next step in the progression of due diligence by the Big-4 accounting firm was to seek advice from the National tax office on the transaction. Upon further study by the National Office, PwC concluded, and communicated to the client, that the stock sale was similar to a listed transaction and then withdrew from the transaction and the business tax return. Even though they withdrew from the engagement, they still tried to discourage the client from entering into the transaction. PwC continued to prepare the client's personal tax returns. Accordingly, they insisted on the disclosure of the listed transaction on the client's personal returns. Lastly, at the insistence of PwC, the transaction was registered as a tax shelter with the IRS. The advisors net due diligence score in this situation is eight.

Review of Advisors' Due Diligence

Advisors' tax compliance with professional and legal standards, in the context of Midco standards, provides an opportunity to compare tax advisors' advice from different firms. This study examines advice from 16 tax advisors and 11 different Midco cases and assigns due diligence scores based on their compliance with established standards. The advisors in these cases are evenly split at eight each for CPAs and attorneys. Four of the CPA advisors are from small firms, two are

[39] *Estate of Marshall v. Cir.,* T.C. Memo. 119 (2016).

from medium or tier two accounting firms, and two are from a large international Big-4 accounting firm. Similarly, four of the attorneys are from large firms and four are from small law firms.

The due diligence scores are ranked by type of advisor (CPA vs. Atty.) and summarized in Table 3. A few conclusions emerge from a brief inspection of Table 3. First, the due diligence scores for advisors from the large Big-4 accounting firm are, by far, the highest. Second, the attorney-advisors' scores are almost all negative. Third, the due diligence scores for small accounting firms rank close to all law firms as they are either zero or negative. To measure the differences in due diligence scores means among groups, both the averages and the t-test for mean differences are discussed next.

The first comparison shows the average due diligence score for all CPAs is 0.5 while the similar average score for attorneys is -1.25. The t-test for difference of means reveals no statistical difference in these scores. Accordingly, the first conclusion is that accountants as a whole do not exhibit different due diligence scores than attorneys, Next, the average due diligence score for the large Big-4 accounting firm in this study is 6.5 compared to -1.25 for advisors from all law firms. The difference is statistically significant (p=.01). A similar result is achieved when comparing large and medium accounting firms to all law firms. The average due diligence score is 3.75 for accounting firms and -1.25 for attorneys. The difference is also significantly different (p=.01). Therefore, a clear finding here is that tax advisors from the large and medium accounting firms exhibit stronger due diligence practices than all attorney advisors in this study.

Next, the data is analyzed to compare the due diligence score between large, medium, and small CPA firms. The goal is to determine whether or not the results are associated with studies (Bobek, 2017; Eynon et al., 1997; Loeb, 1971; Pierce and Sweeney, 2010) which found stronger ethical judgements from large accounting firms *vis ά vis* smaller accounting firms. Accordingly, the first comparison is between the large Big-4 accounting firm and medium and small accounting firms. The average due diligence score for the Big-4 accounting firm is 6.5 compared to an average score of -1.5 for medium and small CPA firms. This difference is statistically significant (p=.05). A similar result appears when comparing due diligence scores from small accounting firms with those from medium and the large Big-4 accounting firm. The average due diligence score is 3.75 for the Big-4 and medium accounting firms compared to -2.75 for small CPA firms. The t-test reveals the difference as statistically significant (p=.05). Therefore, these results are consistent with the findings of Bobek et al. (2017) whereby the ethical climate and due diligence practices are stronger for accountants from large and medium accounting firms *vis a vis* their counterparts at small accounting firms.

Summary

Accountants and attorneys have a legal and professional duty to provide clients with the best available tax advice. In the context of Midco transactions, this advice includes warnings about possible exposure to transferee tax liability deficiencies, and penalties. A review of decisions involving Midco entities for this study revealed that such advice was generally lacking both from accountant advisors at small accounting firms and from all attorney advisors. Apparently, both accountants from small firms and attorneys are reluctant to upset the apple cart with respect to Midco transactions and subsequent stock sales. Also lacking from accountants' advice at smaller firms and from attorneys are any warnings concerning aggressive tax strategies or Notice 2001-16. On the other hand, CPA advisors and accountants at PwC, a Big-4 accounting firm, and RSM McGladrey, the medium size accounting firm, left a long trail of warnings and push back to clients using Midcos to liquidate their corporate entities.

Both Tricarichi and the Estate of Marshall, the court referenced the extensive warnings from PwC accountants as evidence that shareholders should have known about the "entire fraudulent scheme" involving Midco entities and stock sales. Moreover, PwC advisors also provided warnings about such aggressive tax strategies as using high basis/low value assets to create capital losses to offset capital gains. No such warnings were provided by accountants from smaller accounting firms or from attorneys. These results are consistent with the recent conclusions based on survey evidence of Bobek et al. (2017) that there is a higher ethical environment among accountants and advisors at Big-4 accounting firms than among their counterparts at smaller accounting firms.

What explains this observed weakness in advice and diligence from smaller accounting firms *vis a vis* larger Big-4 accounting firms? Three possible reasons for the stronger ethical environment among Big-4 firm are provided by Bobek et al. (2017). First, with more reputational capital to lose than other public accounting firms, the Big 4 have more incentive to promote strong ethical environments. Second, Big-4 firms spend more than smaller firms on ethical training. Finally, the

greater litigation risk and deep pockets for larger accounting firms provide extra motivation to maintain high ethical standards. Doyle et al. (2014) also included some characteristics of Big-4 firms that promote greater adherence to ethical, professional and legal standards. First, Big-4 firms have greater support structures than smaller accounting firms. This advantage leads to the availability of colleagues with greater knowledge resources available with Big-4 firms as was illustrated in the Estate of Marshall. Doyle also suggested that partners at smaller firms may become overly reliant on certain large accounts. Such overreliance may influence their decisions when it comes to tough calls. Bigger firms probably find it easier to call the shots with such clients (Doyle et al., 2014, p. 632).

In summary, this research provides evidence that is consistent with the proposition that accountants at larger Big-4 firms exhibit greater adherence to ethical and professional standards than their counterparts at both smaller accounting firms and at law firms. A limitation of the study is that it is based on a small sample of accounting firms providing advice in the context of Midco transactions. However, it does not suffer from the potential bias inherent in surveys where respondents may be reluctant to confess to poor ethics and substandard adherence to professional standards.

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Table 1: List of Cases, Disposition, Standard Applied, CPA/Law Firm, and Due Diligence (DD) Scores

Case	Tax Year(s)	Decided	Court	Disposition	MidCo	Standard Applied	CPA/Law Firm	Size*	DD Score
Starnes v. Cir.[40]	2003	03/15/11	Tax Court	Decision for taxpayer	Midcoast	Taxpayer lacked knowledge	Jerome Epping (CPA)	S	0
Starnes v. Cir.[41]	2003	05/31/12	4th Circuit	Decision for taxpayer	Midcoast	Taxpayer lacked knowledge	Jerome Epping (CPA)	S	0
LR Devel. v. Cir.[42]	2000	09/16/10	Tax Court	Decision for taxpayer	Midcoast	Taxpayer lacked knowledge	Rubin and Platt (CPA)	S	- 4
Sawyer Tr. v. Cir.[43]	2000, 2001	12/27/11	Tax Court	Decision for taxpayer	Midcoast	Taxpayer lacked knowledge	McLaughlin (Atty.)	S	- 1
Sawyer Tr. v. Cir.[44]	2000, 2001	03/29/13	1st Circuit	Decision for Govt.	Midcoast	Evidence fraudulent transfer	McLaughlin (Atty.)	S	- 1
Sawyer Tr. v. Cir.[45]	2000, 2001	03/03/14	Tax Court	Decision for Govt.	Midcoast	Transferee of transferee	McLaughlin (Atty.)	S	- 1
Dieboldt v Cir.[46]	1999, 2000	11/15/18	2nd Circuit	Decision for Govt.	Sentinal	Taxpayer had knowledge	Chadbourne & Park (Atty.)	L	- 2
Feldman v Cir.[47]	2002	12/27/11	Tax Court	Decision for Govt.	Midcoast	Taxpayer had knowledge	Fred Farris (CPA)	S	- 3
Feldman v Cir.[48]	2002	02/24/15	7th Circuit	Decision for Govt.	Midcoast	Taxpayer had knowledge	Fred Farris (CPA)	S	- 3
Slone v Cir.[49]	2001	03/01/12	Tax Court	Decision for taxpayer	Fortrend	Taxpayer had no knowledge	D. Jack Roberts (CPA)	S	- 4
Slone v. Cir.[50]	2001	06/08/15	9th Circuit	Remand to Tax Court	Fortrend	Carefully apply 2-Prong Test	Tom Chandler (Atty.)	S	- 1
Slone v. Cir.[51]	2001	06/13/16	Tax Court	Decision for taxpayer	Fortrend	No satisfaction of Stern test	Greg Gadarian (Atty.)	S	0
Shockley v. Cir.[52]	2001	06/22/15	Tax Court	Decision for Govt.	Fortrend	Taxpayer had knowledge	RSM McGladrey (CPA)	M	5
Shockley v. Cir.[53]	2001	10/03/17	11th Circuit	Decision for Govt.	Fortrend	Taxpayer had knowledge	Unnamed Law Firm (Atty.)	S	- 1
Tr. U/W/O v. Cir.[54]	2000, 2001	10/28/18	Tax Court	Decision for Govt.	Midcoast	Valid notice of deficiency	Grant Thornton (CPA)	M	- 3
Tricarichi v Cir.[55]	2003	10/14/15	Tax Court	Decision for Govt.	Fortrend	Taxpayer had knowledge	PWC (CPA)	L	5
Tricarichi v Cir.[56]	2003	02/07/18	Tax Court	Decision for Govt.	Fortrend	Taxpayer had knowledge	Hahn Loeser (Atty.)	L	- 1
Hawk v. Cir.[57]	2003	08/15/16	Tax Court	Decision for Govt.	Midcoast	Evidence of fraudulent transfer	Wayne F. Thomas (Atty.)	L	- 3
Marshall v Cir.[58]	2003	06/20/16	Tax Court	Decision for Govt.	Fortrend	Taxpayer had knowledge	Hornecker (Atty.)	L	0
Marshall v Cir.[59]	2003	06/20/16	Tax Court	Decision for Govt.	Fortrend	Taxpayer had knowledge	PWC (CPA)	L	8

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[40] *Starnes v. Cir.*, T.C. Memo. 63 (2011).
[41] *Starnes v. Cir.*, 680 F.3d 417 (2012) at 4.
[42] *LR Devel. v. Cir.*, T.C. Memo. 203 (2010) at 5.
[43] *Frank Sawyer Trust of May 1992 v Cir.*, T.C. Memo. 298 (2011).
[44] *Frank Sawyer Trust of May 1992 v Cir.*, 712 F.3d 597 (1st Cir. 2013) at 2.
[45] *Frank Sawyer Trust of May 1992 v Cir.*, .C. Memo. 59 (2014).
[46] *Diebold Foundation Inc. v. Cir.*, 736 F.3d 172 (2nd Cir. 2013).
[47] *Feldman v. Cir.*, T.C. Memo. 297 (2011).
[48] *Feldman v. Cir.*, 779 F.3d 448 (7th Cir. 2015).
[49] *Slone v. Cir.*, T.C. Memo. 57 (2012).
[50] *Slone v. Cir.*, 788 F.3d 1099 (9th Cir. 2015).
[51] *Slone v. Cir.*, T.C. 115 (2016).
[52] *Shockley v. Cir.,* T.C. Memo. 113 (2015).
[53] *Shockley v. Cir.,* 686 F.3d 1228 (11th Cir. 2012).
[54] *Trust UWO v. Cir.*, T.C. Memo. 182 (2018).
[55] *Tricarichi v. Cir.*, T.C. Memo. 201 (2015) at 10, 12, 14, 16, 19, 48, 49, 50, 51.
[56] *Tricarichi v. Cir.*, 16-74318 (9th Cir. 2018).
[57] Hawk *v. Cir.*, T.C. Memo. 154 (2012) at 2, 3, 4.
[58] *Estate of Richard L. Marshall v. Cir.*, T.C. Memo. 119 (2016) at 6, 7, 9, 13, 14, 15, 34, 35, 36.
[59] *Estate of Richard L. Marshall v. Cir.*, T.C. Memo. 119 (2016).

Table 2: Itemized Due Diligence Scores

Case	Year	Disposition	Firm Size	CPA/ Atty.	Due Diligence	Points
Starnes v. Cir.	2003	Decision for taxpayer	Small	CPA	Accountant documented concern about Notice 2001-16 Failed to perform any due diligence regarding transferee liability	1 - 1
LR Development v. Cir.	2000	Decision for taxpayer	Small	CPA	Brought Midco entity to transaction No due diligence was performed for the Midco entity Fortrends Due diligence omitted any reference to transferee liability	- 2 - 1 - 1
Sawyer Trust v. Cir.	2000 2001	Decision for taxpayer Decision for Govt.	Small	Atty.	Brought Midco entity to transaction Performed due diligence to ensure Midco was not a sham	- 2 1
Diebold v Cir.	1999 2000	Decision for Govt.	Large	Atty.	Brought Midco entity to transaction Failed to perform any due diligence regarding transferee liability	- 2 - 1
Feldman v Cir.	2002	Decision for Govt.	Small	CPA	Brought Midco entity to transaction Received payment of $25,000 for introducing Midco	- 2 - 1
Slone v Cir.	2001	Decision for taxpayer	Small	CPA	Brought Midco entity to transaction Due diligence omitted any reference to transferee liability Did not offer any other tax strategies to offset capital gain	- 2 - 1 - 1
Slone v Cir.	2001	Decision for taxpayer	Small	Atty.	Researched the applicability of Notice 2001-16. Concluded that Notice 2001-16 did not apply Inquired about the details of the tax strategy for the Midco entity Midco stonewalled advisor, no pushback	1 -1 1 - 1
Slone v Cir.	2001	Decision for taxpayer	Small	Atty.	Considered risk of transferee liability and determined no risk	- 1
Shockley v. Cir.	2001	Decision for Govt.	Medium	CPA	Considered numerous tax strategies to offset capital gain Presented in-depth analysis of stock vs. asset sale Warned the client that IRS might recharacterize transaction Sent copies of Notice 2001-16 to client and counsel Refuse to be involved with Midco transaction	1 1 1 1 1
Shockley v. Cir.	2001	Decision for Govt.	Small	Atty.	Failed to explain any aspect of sales transaction to shareholders	- 1
Trust U/W/O v. Cir.	2000 2001	Decision for Govt.	Medium	CPA	Brought Midco entity to transaction Failed to perform any due diligence regarding transferee liability	- 2 - 1
Tricarichi v. Cir.	2003	Decision for Govt.	Large	CPA	Provision in agreement to identify reportable transaction Warned taxpayer of aggressive tax strategy producing capital loss Warned taxpayer that IRS might challenge excessive capital loss Warned taxpayer that he might face “transferee liability issue” Did not participate in the negotiation of “Midco premium”	1 1 1 1 1
Tricarichi v. Cir.	2003	Decision for Govt.	Large	Atty.	Conducted extensive research on reportable transactions Brought Midco entity to transaction	1 - 2
Hawk v. Cir.	2003	Decision for Govt.	Large	Atty.	Research memo omitted any reference to transferee liability Failed to perform any due diligence regarding Midcoast Financial Failed to comment on aggressive tax strategy	- 1 - 1 - 1
Marshall v Cir.	2003	Decision for Govt.	Large	Atty.	Brought Midco entity to transaction Warned about risk of bankruptcy if cash from target was used Warned shareholders that the transaction could be attacked as fraudulent Warned shareholders about the risk of transferee liability	- 2 1 1 1

					Did not follow up on any of the Midco references	- 1
Marshall v Cir.	2003	Decision for Govt.	Large	CPA	Considered numerous tax strategies to offset capital gain Warned client about exposure due to Notice 2001-16 Warned taxpayer about combining losses with capital gain Sought further advice from the National office Concluded stock sale was similar to a listed transaction and withdrew Tried to discourage client from entering into the Midco transaction As a listed transaction, insisted disclosure on client's personal tax returns Insisted that the transaction was registered as a tax shelter with IRS	1 1 1 1 1 1 1 1

Table 3: Due Diligence Scores for Firms Ranked by Type of Advisor

CPA firm	Size	Due Diligence Score	Law Firm	Size
Marshall	L	8		
		7		
		6		
Shockley	M			
Tricarichi	L	5		
		4		
		3		
		2		
		1		
Starnes	S	0	Marshall	L
			Slone	S
			Sawyer Trust	S
		-1	Shockley	S
			Slone	S
			Tricarichi	L
		-2		
Feldman	S		Diebold	L
U/W/O Trust	M	-3	Hawk	L
LR Development	S			
Slone	S	-4		