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Giving Voice to Values
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Taxes and the Cannabis Business

Teaching Note

Case Overview

The case depicts a common occurrence in business when a person is being asked by a supervisor to compromise their values for the implied benefit or "best interest" of the company. Many students will face situations at work that bring their values into question—those times when what they believe is the right thing to do seems to be at odds with the demands of others, including supervisors and the organization. The Giving Voice to Values (GVV) methodology helps build "moral muscle" by helping people practice the skills needed to recognize, speak, and act on their values when these conflicts arise.

Hailey Delaney is a CPA and has responsibilities not only to herself and her firm, but to the accounting profession as a whole. The case provides students with the opportunity to explore and discuss the AICPA code and the importance of acting with integrity and not subordinating their judgment to their superiors. Delaney has an ethical obligation to protect the public's trust. The public expects CPAs to act with integrity regardless of the consequences for the professional, CPA firm, or client.

Delaney is under a significant amount of pressure as she prepares for the meeting with Harry Johnson, the tax manager at Central Coast Cannabis (CCC), and the partner in charge of the tax practice. She assumes the partner is on board with Johnson's position; otherwise, why would he include the partner in Monday's meeting?

Delaney knows she should not go along with the tax manager's request to ignore 25% of the cash revenue, which is a fraudulent action, but is worried that refusing to do so will negatively affect her future with the firm. As a result, she wonders what the consequences may be if she refuses to go along with the request. She also considers the consequences of violating the American Institute of Certified Public Accountants (AICPA) code of professional conduct, especially the acts discreditable rule.

The case also provides the opportunity to discuss inherent biases that people have and how they may impact decision-making. Delaney may feel intimidated in meeting with both the tax manager and tax partner; these two parties are not only her superiors at the firm, but are well respected by the profession. A common bias that people have is being overly obedient to authority and group pressures that can result in people accepting the "ethical" judgments of others. Delaney may feel obligated to do what is asked of her to be a loyal employee. However, she worries about subordinating her judgment, a violation of integrity under the AICPA code.

This teaching note was prepared by Steven Mintz, Professor Emeritus, California Polytechnic State University, San Luis Obispo; and William F. Miller, Associate Professor, University of Wisconsin–Eau Claire; under the supervision of Mary Gentile, Professor of Practice.

Cognitive dissonance suggests that we have an inner drive to hold all our attitudes and beliefs in harmony and avoid disharmony. When there is inconsistency between attitudes or behaviors (dissonance), something must change to eliminate the dissonance. Leon Festinger posits that dissonance can be reduced in one of three ways: (1) change one or more of the attitudes, behavior, or beliefs so as to make the relationship between the two elements a consonant one; (2) acquire new information that outweighs the dissonant beliefs; or (3) reduce the importance of the cognitions (i.e., beliefs or attitudes).[1]

The desire to please authority can bias Delaney's outlook on the tax issue, suspend her ethical judgment about right versus wrong, and cause her to bend to the wishes of her superiors. Cognitive dissonance suggests that she might be able to justify the difference between what she believes is the ethical thing to do and what the manager and partner want her to do, assuming she decides to change her beliefs to conform to what her superiors expect of her. Alternatively, she might rationalize going along with the superiors as being a team player. Perhaps this is an instance where she gives in but registers her concerns going forward. Or maybe she should draw a line in the sand on this issue.

Another bias at work in this case is that of underestimating the risk by Johnson and, we assume, the tax partner in charge. This bias can be viewed in two ways. First, the risk of their role in the tax fraud being made public and the risk of what happens to the firm if it does (underestimation of the consequences). Second, the risk in the message sent to other tax employees on what is and is not acceptable with respect to going along with the client's wishes. Could this open up a can of worms where others in the firm feel free to interpret tax law in ways that are improper? Organizational ethics should be considered as well since setting an ethical tone by following the rules rather than the client's wishes establishes an ethical culture that can positively impact other conflicts that may occur.

A discussion of the ethical rules in accounting and the biases in this situation can be used to facilitate the application of the GVV methodology as a proactive way for Delaney to get her point across about the improper request and for her to seek support from others in deliberating about what to do in Monday's meeting.

Instructors should monitor whether additional states legalize marijuana, any additional federal legislation or regulations, and whether ethics rules of the state board of accountancy change. These may be issues to discuss with students.

Answers

1. **What are the main arguments, reasons, and rationalizations that Delaney will need to address when she meets with Johnson and the tax partner?**

Locus of loyalty

The tax manager already raised the issue of loyalty to the firm and the client's position. Delaney should expect to be pressured into accepting that the tax return will omit 25% of cash sales. It's likely that the issue of expanding services to the tax client will come up. She also knows that retaining client business and bringing new clients to the firm is an important element of being promoted to partner, and she doesn't want to be responsible for losing a client's business. Delaney should anticipate being asked, "You want the firm to succeed, don't you?"

[1] Leon Festinger, *A Theory of Cognitive Dissonance* (Stanford, CA: Stanford University Press, 1957).

Expected or standard practice

The cannabis business is relatively new and CCC could be the first client in this industry for the firm. However, if other clients exist, then Johnson and the partner might argue that omitting some cash revenue is standard operating procedure. This may increase the intensity of ethical conflict for Delaney because it would seem that other tax employees have committed to go along with the fraudulent practice. She might even be pressured by her coworkers to do the same because any attempt to go public with her concerns could reflect negatively on those employees and jeopardize their position.

Materiality

To further solidify the expected or standard practice rationalization, Delaney should expect to hear a materiality argument as well. Johnson may claim that there is a small likelihood of being caught omitting revenue as the laws are just starting to catch up with the new cannabis business model. Moreover, the lack of a bank account makes it more difficult to discover the fraud.

Locus of responsibility

Delaney should anticipate that Johnson and the tax partner will emphasize that it is not her job to make the final determination on how to report tax revenue. She is expected to follow orders and carry out the wishes of her superiors. Johnson and the tax partner may try to deflect her concerns by assuming responsibility for the final decision. The goal may be to minimize the guilt Delaney feels and alleviate the biased feelings about the way tax revenues are reported. They may thank her for expressing her concerns and tell her they value her opinion, but at the end of the day it is the decision of the firm to omit 25% of the cash revenue from the tax return. If Delaney persists in voicing her point of view, they may suggest that she would be putting her career at risk with the firm if she does not get on board and support their position.

2. What is at stake for Delaney, Johnson, the tax partner, and the firm?

Delaney has a responsibility to be true to her beliefs and not change them to conform to the expectations of Johnson and the firm. She faces a potential bias by being intimidated by Johnson and the tax partner. Delaney should try to resolve the cognitive dissonance by making a strong case as to why the tax revenues should include 100% of the revenue from marijuana sales. She needs to maintain her integrity and not subordinate her judgment to that of Johnson and the tax partner. Her reputation as a CPA is at risk, and it is possible that a violation of the AICPA code might lead to disciplinary action. Delaney also needs to avoid the ethical slippery slope where she covers up her decision to go along with the improper tax position of her firm. Subordinating her judgment at this time, with this client, might make it more likely she will be asked to do it again in the future with other cannabis clients, which might make it harder to refuse.

The most effective way for Delaney to get her point across is by remaining emotionally detached and preparing herself to make reasonable and helpful responses to the position held by Johnson and the tax partner. She should not come off as insulting, blaming, or insubordinate. One way to do that is by saying something like, "As I understand it, the AICPA code has principles of professional conduct that require us, as CPAs, to act with integrity and not subordinate our judgment to that of the client. Perhaps we can discuss this a bit more." Having set the stage, Delaney can then point out the risks to their professional reputation and ethical concerns going forward. Given that the firm seeks to gain additional client services in the future, Delaney might emphasize that the firm needs to establish the boundaries between itself and the tax client from the beginning. Going along with the client may place the firm in a compromised position at a later time, assuming it is asked to audit the financial reports. The client might seek to interpret generally accepted accounting principles (GAAP) in a favorable way rather than strictly adhering to GAAP standards. Delaney should add that she knows the firm would not allow a client to pick and choose which accounting standards to apply. Still, the pressure from the client to do just that may be considerable and the conflict might be avoided by the firm standing its ground on the tax issue. Agreeing to go along with the improper tax reporting creates a slippery-slope dilemma that can lead to more serious ethical consequences and legal liability.

Intentionally underreporting the income on a tax return is a felony and subjects the client and culpable members of the CPA firm, and the firm itself, to both criminal and civil liability. This could jeopardize the future of the firm. Such actions might lead to disciplinary measures against all parties involved for violating the AICPA code including having committed an act discreditable to the profession. Delaney needs to get these points across, but not in a self-righteous or accusatory manner.

3. What levers can Delaney use to influence Johnson and the tax partner to reverse their position?

Identification of what is at stake

Delaney should create a list of all the possible consequences should Johnson and the tax partner move forward (as outlined above) when she meets with them in order to make the strongest case possible to report the correct revenue on the client's tax return. Her strongest reasoning is to play up the possible violation of the profession's code of conduct if Johnson and the tax partner persist in their point of view. Their actions will not only jeopardize their position but that of the firm as well.

Delaney should rehearse what she will say based on the reaction of Johnson and the tax partner. Are there others in the firm to go to for support? Is there a managing partner of the firm who she could contact? Delaney can use this as leverage in the discussions.

Gather supporting material

Delaney needs to come off as an authority on tax matters with respect to marijuana sales to make her position more believable. She should research the relevant state and federal laws prior to the meeting. Further, she should apply relevant federal tax court cases from the cannabis industry to the client's situation.

Delaney should be prepared to discuss other tax issues such as the gross receipts tax on revenue collected. Gross receipts do not take into consideration the cost of goods sold, operating expenses, or invoices that haven't been paid. Some state jurisdictions charge businesses a tax on the total of gross receipts reported. Taxes can also be imposed per ounce on flowers and leaves. That's just state taxes. Cities might impose their own gross receipts taxes on dispensaries, manufacturing, testing, and other cannabis businesses. For example, a city might impose a tax on square footage of space for cannabis cultivation and nursery businesses.

With all this knowledge of tax laws, Delaney could strengthen her argument that omitting some of the cash revenues from taxable income has implications for the gross receipts tax and other possible taxes. She can use this knowledge to magnify the legal consequences if the firm does not change its position.

Gathering appropriate support allows Delaney to voice her concerns in an authoritative way and to counter the arguments, reasons, and rationalizations she may hear from Johnson and the tax partner. It also builds confidence in her position.

Build a coalition

Delaney needs to be careful not to violate her confidentiality obligation by discussing the taxability matter with others outside the firm. She needs to focus on how to use the firm's own policies and code of ethics to strengthen her position. She might also look at the firm's own quality controls on matters such as the taxability issue. What controls are built into the system? The firm might have an internal hotline for employees to express their concerns. Who is responsible at the firm level to review the final tax return? The final authority might be the partner in charge of the tax practice; however, there could be an additional level of review such as a compliance partner who ensures all relevant rules and regulations have been followed. Delaney could ask Johnson if they could approach the compliance officer together. That way, Johnson won't be as likely to feel she is going behind his back and reporting him.

Reframe the issue

Delaney can reframe the question from one of wanting to add the audit business and consulting services for the tax client to one of how best to attract new clients in this growing industry. By moving the conversation away from the demands of this particular client to how the firm has historically attracted and maintained its clients in other industries, she may be able to avoid having the meeting turn contentious. She can concentrate on discussing the firms' core strengths, industry knowledge, and reputation. The firm does not want to gain a reputation of bending to the will of a client. Delaney should emphasize the importance to the firm of building a reputation for trust in the cannabis industry to attract the right kind of client—one that is honest and takes personal responsibility for reporting revenue from marijuana sales properly. By taking a broader focus on professionalism, Delaney can focus on building a firm profile that it can use to attract more clients through responsible behavior. It also lessens the likelihood of negative government attention, and the firm will be able to compete with other marijuana businesses on the basis of its own reputation.

4. What is Delaney's most powerful and persuasive response to the reasons and rationalizations she needs to address? To whom should the argument be made? When and in what context?

Without seeming to lecture Johnson and the tax partner, Delaney needs to bring up points that build on the concept that ethics require consistency of behavior based on ethical values such as honesty and integrity, not a relativistic approach to right or wrong in any particular situation. It is the firm that should decide proper tax accounting, not the client.

Delaney's strongest arguing point is the accounting profession's own ethics rules. She should point out that it is sometimes difficult to navigate through the differences of opinion with a client when pressures exist to accept the client's position on a tax or accounting matter. She can then tie it to the requirements of the AICPA code and that the firm needs to cultivate a reputation for following the rules and not to jeopardize its professional standing and risk sanctions by the state board of accountancy or the federal government.

Delaney should also be prepared to discuss the separate tax ethics rules issued by the AICPA. These tax responsibilities, referred to as Statements on Standards for Tax Services (SSTS), pertain to a variety of issues including that a CPA should not recommend a tax return position or prepare or sign a tax return taking a position unless he or she has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits if challenged by the IRS. This is known as the *realistic possibility of success* standard, and requires that the tax return position should not be recommended unless the position satisfies applicable reporting and disclosure standards. It's possible that Johnson and the tax partner have not focused on these standards; at least, Delaney should approach the matter as if it could be an innocent oversight by her superiors. The way she approaches the matter might influence her superiors to reverse their position. Rather than being argumentative, Delaney should use the occasion to strengthen her position as an expert in tax standards. She might ask, "What would the firm do if the IRS investigates its position on taxability of revenue from the sale of marijuana?" The fact is the firm would not have a leg to stand on, but a more reasoned statement is in order, such as the need to avoid negative government attention.

Delaney should also be prepared to respond to Johnson's position and that of the tax partner by noting that the firm is just starting to obtain clients in the cannabis industry and doesn't want to gain a reputation for being willing to do what the client wants rather than follow the prescribed standards. Future cannabis clients might expect the firm to do the same.

Delaney needs to be prepared to respond to the reasons and rationalizations identified above. She needs to do this in a noncombative manner by using phrases such as "I believe" and "I am uncomfortable." She should seek clarification of the firm's position and be prepared to argue her point from both an ethical and a professional perspective.

Some students might argue that it is the very reputation for letting businesses reduce their taxable income that will attract additional clients in the marijuana business (albeit perhaps the wrong type of clients). Instead, Delaney should focus on the fact that this is a new business under some scrutiny from the government and that her firm is gaining a reputation for work that is trusted by the authorities. Besides, using a low common denominator of ethical intent would not serve the firm well or protect the public interest.

Locus of loyalty

As to their argument that going along with this is a matter of loyalty and in the best interest of the firm, Delaney can share her belief that not going along with the plan is actually demonstrating her loyalty to the firm. She can refer to the consequences she identified above and demonstrate how going along puts the entire firm in jeopardy (e.g., firm reputation, attracting the wrong kind of clients, and unwanted attention by the government), and tell Johnson and the partner that she wants the firm to be successful for many years to come, so she cannot go along with their request.

Delaney should emphasize that her loyalty obligation is to the public and to protect the public interest. This is also beneficial to the firm because following prescribed ethical standards will protect the firm from violations of the law that might otherwise occur by giving in to the client's position.

Standard practice

As to their suggestion that this is standard practice and has minimal risk, Delaney can argue that there is nothing unique about a cash business. Whether they do or don't have a bank account is not relevant. It is simply a rationalization for an unethical action. The fact is that lots of business do a large amount of cash transactions (like retail stores). She can reference that she in not aware of any other firm clients with a cash-based business where the firm has agreed to underreport income.

Materiality

In regard to materiality, Delaney can explain that underreporting income on a tax return is a form of tax fraud. Fraud, by definition, is material because of the possible legal consequences. Materiality should be viewed from the perspective of the risk to firm reputation, loss of current and future clients, and potential legal ramifications for all parties. These considerations are quite significant when compared to any incremental revenue this one client might bring in through additional services.

Locus of responsibility

In regard to them stating it is not her job to make the final call and it is her responsibility to accept the firm's position, Delaney should emphasize it is her precise responsibility to ensure the firm does the right thing in all of its actions and decisions. In fact, the AICPA code requires CPAs to take differences of opinion with superiors up the chain of command to the highest level in order to avoid subordination of judgment. Delaney would not be living up to her ethical responsibilities if she went along with wrongdoing without taking whatever steps are necessary to change the firm's position on the taxability matter, including going to a tax compliance partner (if one exists).

Delaney should be prepared to react if she is unable to change the firm's position. If she cannot resolve the cognitive dissonance, then she should consider whether she wants to risk being fired for standing her ground. As a person of integrity, Delaney should be willing to pay the ultimate price for standing up for her beliefs and doing what is required under professional standards. She needs to take a long-term view and ask herself whether she wants to work for a firm that doesn't value her opinion and expertise.

Concluding Comments

In GVV, students are asked to adopt a position of the values-driven actor—Delaney in this case. In working through the case, students should craft responses in the give-and-take that consider the interests of the stakeholders and risks to all. Students should prepare scripted comments to counteract the reasons and rationalizations given by Johnson and the tax partner to underreport tax revenue by 25%. The goal is to make them understand why it is in the firm's best interest to include 100% of cash sales, with respect to both the ethical and legal responsibilities. The firm does not want to gain a reputation for being maneuvered into a position where the client calls the shots. Professionalism requires a commitment to ethical standards that honor the public trust. The way the firm handles this matter sets a tone for all future cannabis clients and other clients that may come to expect the firm to be flexible on accounting and tax-reporting issues rather than firmly adhering to the standards of ethical and professional practice expected by the AICPA and the public.