ETHICS

I. INTRODUCTION

In addition to the laws and rules of conduct that govern their particular professions in their respective states and professional associations, tax practitioners are subject to Federal regulations (31 C.F.R., A, pt. 10) published in Treasury Department **Circular 230,** "Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service." Circular 230 was last revised in July 1994. On June 28, 2000, the IRS announced the selection of Michael E. Shaheen, Jr., to serve as Senior Counselor to the IRS Commissioner, focusing on revising Circular 230.

A. AUTHORITY TO PRACTICE

Subpart A of Circular 230, comprising §§10.1 through 10.19, contains the rules that govern authority to be a tax practitioner. The rules include definitions and lists of who may practice, eligibility for enrollment (either on examination or by virtue of former IRS employment), application procedures using Form 23, and requirements for renewal of enrollment, including requirements for Continuing Professional Education (CPE) and record keeping.

B. DUTIES AND RESTRICTIONS OF PRACTICE

Subpart B of Circular 230, comprising §§10.20 through 10.34, sets forth the duties and restrictions relating to practice before the IRS. The principal duties (against which most alleged violations are committed) are:

- To furnish promptly information lawfully and properly requested by the IRS and to the Director of Practice (§10.20)
- To advise the client of any known noncompliance, error, or omission (§10.21)
- To exercise due diligence as to the correctness of documents and representations (§10.22)
- Not to delay unreasonably the prompt disposition of matters before the IRS (§10.23)
- Not to represent conflicting interests except by express consent of all directly interested parties after full disclosure has been made (§10.29)

Other sections of Subpart B deal with solicitations of clients, advertising restrictions, negotiation of taxpayer refund checks, tax shelter opinions, and the "realistic possibility" standard for advising clients with respect to tax shelter provisions.

C. DISCIPLINARY PROCEEDINGS

Subpart C of Circular 230, comprising §§10.50 through 10.76, contains the rules applicable to disciplinary proceedings against tax practitioners.

The Secretary of the Treasury has the authority to **suspend or disbar** any practitioner from practice before the IRS. These disciplinary actions may be for a limited period of time or may be indefinite. To avoid the institution or conclusion of disbarment or suspension proceedings, a practitioner may consent to **suspension** from practice. A **letter of reprimand** may also be issued.

In the Cumulative Bulletin, the Director of Practice periodically issues summaries of various closed cases to inform practitioners of the types of activities that have led to disciplinary action. These summaries do not constitute a precedent for future cases.

D. DISREPUTABLE CONDUCT

Section 10.51 describes 10 different types of "disreputable conduct," for which a practitioner could be disbarred or suspended:

1. Conviction of any criminal offense under the revenue laws of the United States, or of any offense involving dishonesty or breach of trust [§10.51(a)]
2. Knowing participation in giving false or misleading information (including tax returns and financial statements) to the Department of the Treasury or any of its officers or employees "or to any tribunal authorized to pass upon Federal tax matters" [§10.51(b)]
3. Use of false or misleading representations to secure employment or intimating that the practitioner can improperly obtain special consideration from the IRS [§10.51(c)]
4. Participation in any illegal attempt to evade any federal tax or payment (due from the practitioner, the practitioner's employees, or a client); willful failure to make a federal tax return (the practitioner's own or a client's) [§10.51(d)]
5. Misappropriation of funds received from a client for the purpose of payment of taxes or other obligations due to the United States [§10.51(e)]
6. Direct or indirect attempt to influence the official action of any IRS officer or employee [§10.51(f)]
7. Disbarment or suspension from practice by a state or federal agency, body, or board [§10.51(g)]
8. Knowing aid or abetment of another person's attempt to practice when suspended, disbarred, or ineligible, including maintenance of a partnership with a person under disbarment [§10.51(h)]
9. Contemptuous conduct in connection with practice before the IRS, including abusive language and false accusations [§10.51(i)]
10. Giving of a false opinion, knowingly, recklessly, or through gross incompetence, on questions arising under federal tax laws [§10.51(j)]

E. EXAMPLES OF DISCIPLINARY PROCEEDINGS

The following examples of disciplinary proceedings for disreputable conduct and other violations were provided by the Director of Practice.

Example 1. Conviction of Crime [§10.51(a)]. A tax preparer was convicted of aiding and assisting in the filing of a false tax return, based on allegations that he had knowingly participated in preparing a partnership return that understated by a material amount the proceeds received from a sale of property. He subsequently moved to dismiss the Director of Practice's action to disbar him since his plea bargain with the U.S. Attorney's office guaranteed that he would not be subjected to further prosecution for any tax-related offense for certain years. The administrative law judge denied the motion on the grounds that the plea bargain applied only to criminal prosecutions and not to a civil disbarment action.

Example 2. Misleading Information [§10.51(b)]; Due Diligence [§10.22]. At an IRS examination of a client's return, a preparer furnished documents purporting to support transactions reflected on the return. It was determined subsequently that the transactions had not taken place and that the documents were false. The practitioner explained that the documents had been prepared to show "proposed figures" on a contemplated transaction and that they had been prepared on another client's business stationery for "realism." The preparer did not remember that the transaction had not taken place and alleged that disgruntled colleagues may have placed the false documents in the taxpayer's files to make him look bad. The preparer offered his consent to **suspension** for 12 months.

Example 3. Failure to File Tax Return for Self [§10.51(d)]. For six consecutive years an attorney filed his own tax returns an average of 30 months after their extended due dates. He stated that a partner of his in a real estate venture had not maintained adequate records to provide him the information needed to complete his returns in a timely manner. The administrative law judge concluded that the attorney knew he was required to file his returns in a timely manner. His failure was "clearly a voluntary, intentional violation of a known legal duty" under §10.20(d), and he was **disbarred.**

Example 4. Willful Failure to File Tax Return for Client [§10.51(d)]. A taxpayer engaged a practitioner to prepare a federal income tax return before the required filing date. The return was not completed as agreed, and the practitioner informed the taxpayer that an application for an extension of time to file the return had been submitted. The extension date also passed without the completion of the return, despite the taxpayer's repeated attempts to secure a completed return. The taxpayer requested the return of all the records; the practitioner did not comply; and the taxpayer engaged an attorney to assist in getting the records returned. The practitioner was **suspended** for six months.

Example 5. Attempt to Influence IRS by Threats [§10.51(f) and (i)]. An accountant called the IRS office to protest that an auditor was unreasonable in seeking a penalty against the client. The auditor's supervisor assigned another employee to take the call, and the accountant stated that if the penalty was not abated, he "would hate to jeopardize" the auditor's job by raising the issue with the district director and with his congressperson. The accountant also said that if the penalty was not abated, he "might" assist his clients to "get IRS back" by filing false returns. When contacted about his use of threats and contemptuous conduct, the accountant responded that he thought that the auditor's conduct had reflected adversely on the professionalism, fairness, and competence of the IRS. Although behavior such as the accountant displayed is a serious matter, the particular circumstances of the case resulted in limiting official action to a **reprimand.**

Example 6. Threats and Contemptuous Conduct [§10.51(f) and (i)]. A CPA called an IRS revenue officer to discuss his client's case. After listening to the CPA's comments, the officer stated that the client could still expect enforcement action. The CPA answered, "How about my coming down there and jerking you around for a while?" adding that he "would not mind kicking down the door." The revenue officer terminated the call and called the IRS's Inspection Service. Later in the day, the CPA called back to apologize, stating that he had simply lost his temper. Because of the prompt apology and because this was the only instance of contemptuous conduct on the part of the CPA, he was issued a **reprimand.**

Example 7. Advertising Restrictions [§10.30(a)(1)]. A practitioner's advertisement in the telephone directory depicted the official IRS insignia. The Director of Practice notified the practitioner of a violation of §10.30(a)(1) because the ad suggested a special connection with the IRS. The practitioner immediately canceled the ad and stated that he did not intend to mislead his clients but only to indicate that his practice was limited to matters involving the Internal Revenue Code. In view of the practitioner's demonstrated good faith, a **reprimand** was issued rather than a more serious sanction.

II. EXTENSION OF THE ATTORNEY-CLIENT PRIVILEGE UNDER THE IRS RESTRUCTURING AND REFORM ACT OF 1998

Section 10.20 of Circular 230 obliges all practitioners to furnish promptly to the IRS and to the Director of Practice any records or other information these authorities request, unless the practitioner "believes in good faith and on reasonable grounds that such record or information is privileged or that the request for, or effort to obtain, such record or information is of doubtful legality." "Privileged" means covered by the common-law attorney-client privilege. Under the Internal Revenue Service Restructuring and Reform Act of 1998, **this privilege, insofar as it relates to professional advice in noncriminal federal tax matters, is extended to communications between the taxpayer and any individual authorized to practice before the IRS, not only an attorney.** Such a practitioner may (and, under the various state laws and regulations and codes of ethics governing the practitioner's profession, is obliged to) refuse to furnish the IRS information that is contained in such a privileged communication.

A. TO WHOM IS THE PRIVILEGE EXTENDED?

The 1998 Act extends the attorney-client privilege to "a communication between a taxpayer and any Federally authorized tax practitioner" [I.R.C. §7525(a)(1)]. A Federally authorized tax practitioner is "any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code" [I.R.C. §7525(a)(3)(A)].

These regulations are set forth in Circular 230 and cover the following categories of persons:

1. An attorney, in good standing before the IRS, who is **representing a particular client** and who has filed a written declaration with the IRS that he or she is currently qualified as an attorney and is authorized to represent that client [Circular 230, §10.3(a)]
2. A Certified Public Accountant, in good standing before the IRS, who is **representing a particular client** and who has filed a written declaration with the IRS that he or she is currently qualified as a CPA and is authorized to represent that client [Circular 230, §10.3(b)]
3. An agent who has been enrolled by the Director of Practice on the grounds of having passed an examination or of former employment in the IRS, and who is in good standing [Circular 230, §§10.3(c), 10.4, 10.5]
4. An actuary, in good standing before the IRS, who is **representing a particular client** in some matter relating to retirement plans and who has filed a written declaration with the IRS that he or she is currently qualified as a CPA and is authorized to represent that client [Circular 230, §10.3(d)]
5. A person who has been granted temporary recognition to practice pending a decision on enrollment [Circular 230, §10.5(c)]
6. The taxpayer: an individual representing himself or herself or a member of his or her immediate family; an employee representing his or her employer; an officer of a corporation; or a trustee or administrator representing a trust or estate [Circular 230, §§10.5(e), 10.7]

Observation. The persons mentioned in item 6 fall within the definition of "Federally authorized tax practitioner," but they are not distinct from the taxpayer. The privilege extension under the 1998 Act would not be an issue in these cases.

B. WHAT IS COVERED?

For a communication to be covered by the privilege, all of the following must be true:

1. The communication must be "between a taxpayer and any Federally authorized tax practitioner" [I.R.C §7525(a)(1)].
2. The communication must be "with respect to tax advice" [I.R.C. §7525(a)(1)]. "Tax advice" is defined as "advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice" [I.R.C §7525(a)(3)(B)]. In turn, "practice before the IRS" is defined as "all matters connected with a presentation" to the IRS "relating to a client's rights, privileges, or liabilities under laws or regulations administered by" the IRS. "Such presentations

include preparing and filing necessary documents, corresponding and communicating with the Internal Revenue Service, and representing a client at conferences, hearings, and meetings" [Circular 230, §10.2(e)].

3. The communication "would be considered a privileged communication if it were between a taxpayer and an attorney" [I.R.C. §7525(a)(1)]
4. The communication has been requested in a "noncriminal tax matter" before the IRS or a "noncriminal tax proceeding in Federal court brought by or against the United States" [I.R.C. §7525(a)(2)].
5. The communication is not "a written communication between" a practitioner and a "director, shareholder, officer, or employee, agent, or other representative of a corporation" concerning "the promotion of the direct and indirect participation of such corporation in any tax shelter [as defined in section 6662(d)(2)(C)(iii)]" [I.R.C. §7525(b)].

C. WHAT IS NOT COVERED?

There are two kinds of limitations on what communications are covered by the privilege. The 1998 Act imposes a set of limitations on the extension of the privilege. Another set of limitations is inherent in the common-law attorney-client privilege itself.

Limitations Based on the 1998 Act. Because of the language of the 1998 Act, the privilege does not cover any of the following:

1. Communication between a taxpayer and a person who is not a Federally authorized tax practitioner
2. Nonfederal tax advice
3. Any communications between a client and a practitioner with respect to a criminal case
4. Information requested by state or local governments or by federal agencies other than the IRS
5. Information requested in the course of a lawsuit or other transaction between the client and a third party
6. Communications between a practitioner and a person representing a corporation with respect to the corporation's participation in a tax shelter

Natural Limitations on the Attorney-Client Privilege. Because the privilege extended to tax practitioners by the 1998 Act is an extension of the common-law attorney-client privilege to a larger set of persons, it cannot apply to any kind of communication that would not be privileged if it were between the taxpayer and an attorney.

The communication must be made in the context of a professional relationship between the taxpayer and the practitioner. The practitioner must be acting as a professional in his or her field, not merely as an acquaintance or business advisor.

The taxpayer and the practitioner must behave as if they intend the communication to be in confidence. If the taxpayer divulges the information to a third party, the communication is not in confidence and is not covered by the privilege. As described in the following section, the practitioner must guard against breaching the confidentiality of any communication that may be privileged.

Several federal courts have held that information communicated to an attorney for use in **preparation** of a tax return is **not** covered by the attorney-client privilege. Different courts have given different reasons why the attorney-client privilege would not apply to tax return preparation:

1. Preparation of an income tax return is only an accounting service, not a matter of legal advice. *William Canaday v. U.S.* [66-1 USTC ¶9192], 354 F.2d 849 (8th Cir. 1966); *U.S. v. Craig Davis* [81-1 USTC ¶9193], 636 F.2d 1028 (5th Cir. 1981), *cert. denied,* 454 U.S. 862 (S. Ct. 1981).
2. When a client provides an attorney with information to be disclosed on the client's tax return, the client's intent to disclose means that the information is not confidential and therefore is not pro-

tected by the privilege. *Edward Colton v. U.S.* [62-2 USTC ¶9658], 306 F.2d 633 (2d Cir. 1962), *cert. denied,* 371 U.S. 951 (S. Ct. 1963); *U.S. v. Donald Cote* [72-1 USTC ¶9268], 456 F.2d 142 (8th Cir. 1972); *U.S. v. J. Martin Lawless* [83-1 USTC ¶9414, 13527], 709 F.2d 485 (7th Cir. 1983).

On the other hand, courts have also held that (1) when an attorney is not acting merely as an accountant but is informing the taxpayer about an issue such as the validity of a deduction or the likely outcome if the taxpayer goes to court, the attorney is indeed providing legal advice, and communications concerning that advice are privileged; and (2) communications with respect to information that is not disclosed on a tax return are confidential. *U.S. v. Schlegel,* 313 F.Supp. 177 (D. Neb. 1970); *U.S. v. El Paso Co*. [81-2 USTC ¶9819], 49 AFTR 2d 82-380 (D. Tex. 1981), *aff'd* [82-2 USTC ¶9534], 682 F.2d 530 (5th Cir. 1982).

D. POTENTIAL PROBLEMS

In a variety of situations the practitioner faces the risk that a communication that the client expects to be covered under the extended privilege will turn out not to be privileged. **A practitioner who is compelled to reveal information the client thought was privileged may be exposed to malpractice action from the client.**

Criminal Matters. Privileged communications are restricted to communications with respect to noncriminal tax matters before the IRS and noncriminal tax proceedings in federal court in a case brought by or against the United States. If the practitioner has received communications that so far have been covered by the privilege, but the case acquires a criminal aspect (for example, if the IRS assigns a special agent to the case or if the client tells the practitioner new information about unfiled returns or unreported income), there is nothing in the text of the statute or the regulations to prevent the previous communications in the matter from losing their privilege retroactively. Therefore, if the client is subject to a criminal tax proceeding, the practitioner should stop representing the client and shold refer the client to an attorney so that the attorney-client privilege will apply.

Observation. The attorney may enable the practitioner to continue being involved in the case by providing the practitioner with a new letter of engagement. The practitioner would then work under the direction and control of the attorney, and communications would be covered, not by the extended practitioner-client privilege granted by I.R.C. §7525, but by the common-law **attorney**-client privilege.

Tax Return Preparation. Certainly in situations in which the information communicated to the practitioner is eventually disclosed on the tax return, and where the practitioner is not providing expert advice but only the service of preparing documents, the communication is **not** covered by the privilege. If, during the course of one transaction with the client, a practitioner both prepares a tax document as an accountant and provides tax advice, the whole transaction may fail to be privileged.

Tax Accrual Work Papers. Tax accrual work papers are generally not protected by the attorney-client privilege, because an independent auditor may need access to them and therefore they are not confidential. *U.S. v. El Paso Co*.; *U.S. v. Arthur Young & Co*. [84-1 USTC ¶9305], 465 U.S. 805 (S. Ct. 1984).

Definitions of "Tax Advice" and "Practice before the IRS". As stated previously, according to the 1998 Act, "tax advice" must be "with respect to a matter which is within the scope of the individual's authority to practice." In turn, the regulations define "practice before the IRS" as "all matters connected with a presentation" to the IRS "relating to a client's rights, privileges, or liabilities under laws or regulations administered by" the IRS. "Such presentations include preparing and filing necessary documents, corresponding and communicating with the Internal Revenue Service, and representing a client at conferences, hearings, and meetings" [Circular 230, §10.2(e)].

This definition of "authority to practice" does not appear to include tax advice on planning transactions long before the transactions take place and are represented to the IRS. Consequently, communications in connection with transaction planning may well **not** be privileged.

Action Other Than Federal Tax Litigation. If the client is involved in litigation on matters other than **federal taxation,** such as a divorce, a tort, or a contract dispute, the practitioner may be compelled to disclose information provided by the client that would be privileged if the case were only a noncriminal tax case before the IRS or a noncriminal tax case in federal court in which the United States is the other party.

Similarly, federal or state agencies other than the IRS with authority to issue a summons may compel the practitioner to disclose confidential information.

State and local tax matters are not covered by the privilege. If a client becomes involved in a state tax case, the practitioner can be forced to divulge information that would be protected in a federal case.

Corporate Tax Shelters. Subsection (b) of I.R.C. §7525, removing the privilege from communications between a practitioner and a "director, shareholder, officer, or employee, agent, or representative of a corporation" with respect to "the promotion of" the corporation's participation in a tax shelter, was added to the bill at the last minute by the conference committee. A tax shelter as defined by I.R.C. §6662 is any plan or arrangement "a significant purpose" of which is the "avoidance or evasion" of federal income tax. This definition seems to include **any** kind of transaction planning in advance made with a view to the tax consequences. The conference committee report states that such tax shelters "include, but are not limited to" the arrangements that must be registered as tax shelters under I.R.C. §6111(d).

It does not appear that any tax planning communication between a practitioner and a corporate client can be counted on to be covered by the privilege.

E. PRECAUTIONS FOR THE PRACTITIONER

In view of the limitations and problems just discussed, a practitioner should take several precautions to ensure that he or she is not forced to disclose information that the client expects to be covered by the privilege extended under the 1998 Act.

Engagement Letter. At the outset of a professional relationship, the tax practitioner should explain to the client, preferably in writing, what the privilege is, what it covers, and, especially, what it does **not** cover, as described in the preceding subsections. This can be done in the tax engagement form letter. The letter should make clear that neither written nor oral communications can be **assumed** to be covered by the privilege and that the client must specifically indicate any communication to which it is intended to apply and take the greatest care to avoid divulging it in some other context.

The terms of engagement should also provide for payment for the practitioner's time and expense protecting the privilege.

Segregation of Communications. Communications that may be protected by the privilege–especially, conversations that the client intends to be protected–should be kept separate from communications that are not protected.

If the client wants to obtain tax advice, this should not be done at a conference at which the client presents the practitioner with routine documents whose contents are simply to be disclosed on the client's tax return. A separate meeting should be scheduled.

Within the practitioner's office, conversations–whether business or friendly–about privileged matters should not be carried on in open areas where they may be overheard by third parties. Privileged documents should not be left on desks in open areas. Fax receivers should not be in open view. Computer security measures should be used to prevent unauthorized access to confidential material. Staff should be trained in the procedures for protecting privileged material.

III. DIFFICULT SITUATIONS TAX PROFESSIONALS FACE

A. CONFLICT OF INTEREST

In addition to state laws and professional rules of conduct, Circular 230 §10.29 forbids a practitioner to "represent conflicting interests" before the IRS, "except by express consent of all directly interested parties after full disclosure has been made."

Practitioner Malice. Sometimes a tax practitioner creates a conflict of interest maliciously.

Example 8. Conflict of Interest. An attorney failed to report all items of income for his clients and claimed deductions to which the clients were not entitled. In addition, he promoted a scheme in which sham sales were used to increase the basis of the value of the promotion's assets artificially. He was a partner in this promotion and represented some of his clients who were involved in this promotion. His interests were found to be in conflict with the interests of his clients. His preparation of his clients' returns was in willful disregard of the revenue laws. His conduct violated Circular 230 §§10.22 (due diligence as to accuracy), 10.29 (conflict of interest), and 10.51 (disreputable conduct), and he was **disbarred.**

Conflict of Interest Caused by Client or Circumstances. A tax practitioner can find himself or herself at risk for a conflict of interest as a result of client requests or changes in relationships among clients. The following examples illustrate situations when a conflict of interest can arise.

Example 9. Conflict of Interest. The former president, secretary, treasurer, and general manager of Defunct, Inc., have all received a Proposed Assessment of Trust Fund Recovery Penalty (Form 2751), a 100% penalty, in connection with unpaid trust fund taxes of Defunct. They schedule a meeting with practitioner C. P. Adams, intending to engage her in assisting them in avoiding liability under I.R.C. §6672 for the trust fund taxes. What should Adams do?

Answer. Adams must inform each of the individuals who sought her services that they have a conflict of interest among them because of their potential individual liability for the trust fund taxes. Adams should represent all of them in this matter only if they each sign a written consent to be represented by her despite the conflict of interest.

Example 10. Conflict of Interest. Practitioner N. Rolde has performed income tax services for Mr. and Mrs. Smith for many years. The Smiths divorce in 1999, and both of them approach Rolde to continue preparation of their individual income tax returns. Mr. Smith wants to deduct his payments to Mrs. Smith as alimony, which would make them income to Mrs. Smith, but Mrs. Smith wants to treat the payments as nontaxable property settlement, which would not be deductible to Mr. Smith. What should Rolde do?

Answer. Rolde must inform the Smiths of the conflict of interest. Rolde should not prepare both of their income tax returns unless they each sign a written consent to be represented by Rolde despite their conflict of interest. Given the direct conflict of interest, it is unlikely that Rolde can adequately represent each taxpayer even with consent. However, if the Smiths hire separate attorneys and resolve the issue of how the payments are to be treated, Rolde could prepare returns for both former spouses if he has their consent and if he consistently reports the payments on the two returns.

Example 11. Conflict of Interest. John and Jane Dough were separated from December 26, 1995, through September 25, 1996 (their anniversary). They file joint income tax returns for calendar years 1996 and 1997. In May 1999, the Doughs received a Statutory Notice of Deficiency asserting a deficiency in income tax for 1996 and 1997. On May 31, 1999, they engage practitioner A. Turney to handle the problem. Most of the 1996 deficiency relates to substantial unreported income received by John in 1996 without Jane's knowledge. On July 19, 1999, the Doughs are divorced. What should Turney do?

Answer. Turney Must inform John and Jane of the conflict of interest due to Jane's rights under the innocent spouse and separate liability rules. It is unlikely that Turney can adequately represent both John and Jane on this issue even if they each sign a written consent to be represented by Turney despite the conflict of interest.

B. RESPONSIBILITIES TO CLIENTS

Knowledge of Client's Omission. According to §10.21 of Circular 230, if a practitioner "knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper, which the client is required by the revenue laws of the United States to execute," the practitioner must "advise the client promptly of the fact of such noncompliance, error, or omission."

Due Diligence. According to §10.22(a) and (c) of Circular 230, a tax practitioner must "exercise due diligence" in preparing all tax documents and in "determining the correctness of oral or written representations made by" him or her to clients.

C. RESPONSIBILITIES TO IRS

Information to Be Furnished to the IRS. According to §10.20(a) of Circular 230, no tax practitioner shall:

- Neglect or refuse to submit promptly "records or information" for which a "proper and lawful request" has been made by the IRS
- Interfere or attempt to interfere with a "proper and lawful effort" by the IRS to "obtain any such record or information"

An exception is allowed only if the practitioner "believes in good faith and on reasonable grounds that such record or information is privileged or that the request for, or effort to obtain, such record or information is of doubtful legality." The conditions under which information can be considered privileged are discussed in the first section of this chapter.

Information to Be Furnished to the Director of Practice. Under Circular 230, §10.20(b), a tax practitioner also has the duty, "when requested by the Director of Practice, to provide the Director with any information" he or she may have "concerning violations of the regulations in this part" (that is, Circular 230) "by any person, and to testify thereto in any proceeding instituted under this part for the disbarment or suspension of" a tax practitioner accused of a violation. Again, an exception is allowed only if the practitioner from whom the Director has requested the information "believes in good faith and on reasonable grounds that such information is privileged or that the request therefore is of doubtful legality."

Due Diligence. Under Circular 230, §10.22(a) and (b), a tax practitioner must "exercise due diligence" in preparing any documents relating to IRS matters and in "determining the correctness of oral or written representations made by" him or her to the Department of the Treasury.

Knowingly furnishing false or misleading information to the IRS constitutes disreputable conduct under Circular 230, §10.51(b).

Prompt Disposition of Pending Matters. Under Circular 230, §10.23, a tax practitioner must not "unreasonably delay the prompt disposition of any matter before the Internal Revenue Service."

Example 12. Due Diligence [§10.22]. A tax accountant signed his client's name on a power-of-attorney form rather than have the taxpayer sign it herself. The practitioner stated that he had had verbal authorization from the taxpayer to do so. After assuring the Director of Practice that he would be more diligent in abiding by correct procedures in the future, the accountant received a letter of **reprimand.**

Example 13. Due Diligence [§10.22]. An accountant prepared an individual income tax return on which the taxpayer's mother, two sisters, and brother were listed as dependents who lived with the taxpayer for the entire year. An IRS examination revealed that the dependents lived in Mexico, not with the taxpayer, and the taxpayer could not furnish evidence of support. The Director of Practice notified the accountant of possible violations of Circular 230, §10.22 (due diligence), §10.51(b) (disreputable conduct–false or misleading information), and §10.51(d) (disreputable conduct–attempt to evade federal taxes). The accountant replied that the taxpayer had shown him receipts for payments, sent to the dependents in Mexico, that had become lost by the time of the examination, and that the residency information had been entered by a part-time secretary. Although the accountant had not noticed the erroneous 12-month residency claim, new office procedures had since been instituted to avoid those errors. As a result, the accountant was given a **reprimand** for failure of due diligence, but it was determined that there was no willful disreputable conduct.

Example 14. Due Diligence [§10.22]. A practitioner provided tax services to a taxpayer who owned two S corporations. Corporation A transferred property to Corporation B, and Forms K-1 were issued showing the gain on the transfer. Several months later, the taxpayer determined that the transferred assets were worth less than their book value at the time of transfer. The practitioner prepared the taxpayer's Form 1040 reflecting the lower valuation, but on Corporation B's tax return the higher valuation was used for depreciation purposes. The practitioner stated that the errors were due to rapid turnover of employees working on the account. Because the element of willfulness was found to be absent, the practitioner received only a **reprimand.**

Example 15. Due Diligence [§10.22]. An enrolled agent prepared the corporate tax returns for nine corporations controlled by his client. An audit discovered that the agent had arbitrarily allocated income and expenses among the corporations and had improperly increased the cost of goods sold of two of the corporations; all of these arbitrary representations resulted in understatement of the overall tax liabilities. After being notified of possible violations of Circular 230, §10.22(a) (due diligence), §10.51(a) (disreputable conduct–false or misleading information to IRS), and §10.51(d) (disreputable conduct–attempt to evade tax), the agent answered that the taxpayer's records were so unorganized and confusing that the agent relied on the taxpayer's representations even though he realized that they were likely to be incorrect. While the Director of Practice was corresponding with the agent, the agent's enrollment lapsed, and he did not file for renewal. Therefore, official action was limited to a **reprimand.**

Example 16. Prompt Disposition [§10.23]. At a three-year examination of tax returns, a practitioner brought numerous supporting documents but, although three IRS employees were present to review the documents, the practitioner refused to allow them to see more than one document at a time, because, he claimed, the taxpayer had directed him to maintain control of each and every document, and he felt that he could maintain control over only one document at a time. This refusal was found to be unreasonable under the circumstances and a violation of §10.23 of Circular 230. The practitioner was issued a letter of **reprimand** and was warned that future occurrences would result in suspension or disbarment.

Example 17. Prompt Disposition [§10.23]. After scheduling appointments with IRS employees in connection with ongoing examinations, a practitioner routinely canceled them, claiming that the examinations were "repetitive." The practitioner also made frivolous requests to the IRS and postponed scheduled appointments until the requests were acted on. It was found that the practitioner violated §10.23, and the practitioner received a **reprimand** and a warning that any repetition of this conduct could result in suspension or disbarment.

Example 18. Prompt Disposition [§10.23]. An accountant canceled five conferences with an appeals officer in six months, and each time he did so by leaving a message on the officer's answering machine before normal business hours on the day of the conference, claiming that he had to cancel because of "scheduling problems" or "prior commitments." Three out of every four telephone calls from the appeals officer to reschedule were not returned. The accountant felt that by giving notice of his intention to cancel, he had met his responsibilities. The Director of Practice issued a **reprimand** because the accountant consistently showed no respect for the officer's time, had no objective reason for the delays, and took no interest in rescheduling the appointments.

D. RESPONSIBILITIES TO EMPLOYEES

Practitioners must ensure that employees are properly trained and supervised to prevent errors in reporting (see Examples 13 and 14) and inadvertent breaches of confidentiality of privileged information (see Section II of this chapter).

E. RESPONSIBILITIES TO SELF AND PROFESSION

Personal Tax Matters. A practitioner's own income tax situations must be handled as professionally as his or her clients'.

Example 19. Failure to File Tax Return for Self [§10.51(d)]. For several years a practitioner failed to file Form 1040 for himself but made estimated tax payments that exceeded his personal income tax liability. He claimed that because he always gave his clients first priority he had no time to file his own returns, and that his estimated tax payments not only showed his good faith but also satisfied his income tax obligations. The practitioner was **suspended.** Willful failure to file is not a mere formality even when the taxpayer is due a refund.

The practitioner must make sure that the firm's employment taxes are handled in a prompt and professional manner. Failure to file or failure to pay employment taxes for the practitioner's firm constitutes conduct as disreputable as failure to file or failure to pay a client's taxes.

Example 20. Willful Failure to File Withholding Taxes for Employees [§10.51(d)]. An accountant owned and operated an accounting firm with employees. Although the proper amounts were withheld from the employees' paychecks, the owner failed to deposit the taxes or file Form 941. The owner said that he had insufficient funds with which to pay the taxes on behalf of his employees. The failure to file 941 forms and deposit the withheld taxes were a violation of §10.51(d), and the owner was **suspended** for a period of not less than five years.

Client Selection. There are various reasons why a particular client will not be profitable to a practitioner. The client may fail to pay fees or pay consistently late; the client may treat the practitioner and employees abusively; the client may present the practitioner with a jumble of disorganized papers and demand that the practitioner prepare legally binding documents based on those records on short notice; the client may insist on the practitioner's cooperation with ethically dubious activities or refuse to provide access to important information; or the client may simply require services beyond the practitioner's competence. A practitioner is advised to instruct such clients, courteously but firmly, to seek services elsewhere. Practitioners are also advised to screen potential clients for signs of these various sources of unprofitability. See E. Danziger, "Just Say No to Costly Clients," *Journal of Accountancy,* June 1999.


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DEATH OF A TAXPAYER