# Chapter 4: Ethics


Introduction ........ 163
Oversight of the Tax Profession ........ 163
Qualified Individuals Eligible to Practice ........ 165
Circular 230 — In-Depth Analysis ........ 167
Other IRS Guidelines for Practice ........ 178
Powers of Attorney and the Centralized Authorization File ........ 180
Financial Privacy — Gramm-Leach-Bliley Act and Related Federal Trade Commission Rules ........ 183




Corrections were made to this workbook through January of 2004. No subsequent modifications were made.

## INTRODUCTION

Recently, business ethics have had a dramatic impact on the American public. In 2002 and 2003, large corporations faded into oblivion due to their lack of concern for doing the "right thing." The accounting profession has undergone a significant amount of scrutiny with the recent creation of new oversight. Society believes enhanced ethics need to be emphasized and ingrained into the fabric of business and financial reporting.

Ethics is described as a system of moral principles or the rules of conduct recognized in respect to a particular class of human actions or principles. In their paper titled "Moral Person and Moral Manager: Developing a Reputation for Ethical Leadership," Linda Trevino, Laura Hartman, and Michael Brown identify ethical leaders as "those who are personally ethical in word, thought, and deed and who conduct their decision making openly so that they're perceived as ethical even from a distance."

Interpreting a specific section of the Internal Revenue Code is often a quantifiable determination. The Code and other applicable authorities provide guidance in the form of tests that must be followed or criteria that must be utilized. Ethics in tax practice can be extremely challenging because practitioners must weigh the facts and the needs of their clients against a difficult determination of whether they are appropriately applying the law. Practitioners must weigh the consequences of their moral choices to determine whether their decisions are proper. There is always a risk that the client will not want to receive the interpretation or the advice the practitioner provides, but the tax professional must always do the "right thing."

Ethical dilemmas continually arise. Licensing authorities understand the need for continuing education in the area of ethics. While only attorneys are required to have periodic ethics instruction, other tax practitioners are also encouraged to seek ethics instruction.

## OVERSIGHT OF THE TAX PROFESSION

### OFFICE OF PROFESSIONAL RESPONSIBILITY

The Office of Professional Responsibility, formerly known as the Director of Practice, is responsible for administering and enforcing the regulations governing practice before the IRS. The Office's responsibilities include making determinations on applications for enrollment to practice before the IRS and conducting disciplinary proceedings relating to those individuals who are eligible to practice. The regulations governing tax practice are published in pamphlet form as *Treasury Department Circular 230*.

### Practice before the IRS

Practice before the IRS covers all matters relating to any of the following:

- Communicating with the IRS for a taxpayer regarding the taxpayer's rights, privileges, or liabilities under laws and regulations administered by the IRS,
- Representing a taxpayer at conferences, hearings, or meetings with the IRS, and
- Preparing and filing necessary documents with the IRS or taxpayer.

The greatest number of dealings with the IRS involves the preparation of various annual tax forms for submission to the IRS. The preparation of a tax return is not considered "practice." Likewise, appearing as a witness for a taxpayer to explain how a return was prepared does not constitute "representation." These acts and others can be performed by anyone to the extent provided by the regulations governing practice before the IRS.

> **Note.** Some states require licensing of tax preparers.

## PROFESSIONAL STANDARDS, GUIDELINES, AND SCRUTINY

Tax practitioners are subject to guidance from various professional organizations. Examples of professional oversight follow.

### American Institute of Certified Public Accountants (AICPA)

The American Institute of Certified Public Accountants has prepared two documents for CPAs to use in their tax practice. These documents are:

- Code of Professional Conduct and
- Statements on Standards for Tax Practice.

These two documents are issued to provide direction. The AICPA enforces them in order to maintain professionalism in the ranks of its members. The documents were prepared to answer questions and help with interpretation. In addition, the documents give the general public an assurance of the roles and responsibilities of the accounting profession in the area of tax practice. Noncompliance with the Code or Standards of Professional Conduct could result in the AICPA taking action toward the offending member.

### Bar Association

The Bar Association guidelines for practice are similar to those of the AICPA. They are referred to as the Model Rules for Professional Conduct.

### Other Groups

The trade associations mentioned previously provide tax practice guidelines for their members, which they require as a condition of membership in the organizations. As an example, the Standards of Professional Conduct of the National Association of Tax Professionals include items such as protecting taxpayer's interests, requirements to explain alternatives to taxpayer, reasonable basis for a position, adequate disclosures, lack of any appearance of an unduly close business relationship with the IRS, and disclosure of confidential information.

## PRACTICE BEFORE THE IRS — GENERAL

### *Circular 230*

*Circular 230* summarizes Treas. Reg. §31 CFR part 10. *Circular 230* was created by the Treasury Department as a restatement of the regulations governing the practice of attorneys, CPAs, enrolled agents, and enrolled actuaries before the IRS. In July 2002, the Treasury Department issued final regulations resulting in a need to amend a substantial part of *Circular 230*. Before the changes were finalized, they were made available for public comment. The Treasury Department considered the views of the professional community in its revision of the regulations and *Circular 230*.

Both the regulations and *Circular 230* have been periodically amended to address various issues in need of clarification.

- In 1985, the regulations were amended to provide standards for opinions in tax shelter offerings.
- In 1994, *Circular 230* was amended to included standards for tax return preparation, the limitation of the use of contingent fees in tax return or refund claim preparation, and expedited rules for suspension.
- The changes made to *Circular 230* in 2002 do not apply to tax shelter issues.



There will be future changes to *Circular 230* that govern standards for tax shelter opinions. This text will not cover any of the tax shelter provisions.

## QUALIFIED INDIVIDUALS ELIGIBLE TO PRACTICE

*Circular 230* provides guidance regarding who is eligible to practice before the IRS. The following professionals are entitled to full rights as specified in this document:

- Attorneys
- CPAs
- Enrolled agents
- Enrolled actuaries

It is important to emphasize that these individuals must currently be qualified to practice under both federal and state authority. For example, if a CPA does not renew a license requirement with the state licensing authority, he is not considered to be currently qualified and, therefore, is not entitled to represent clients before the IRS. The same rationale also be applies to an attorney, enrolled agent, or enrolled actuary.

### UNENROLLED RETURN PREPARERS

The prior section refers to individuals who possess full practice authority under *Circular 230*. However, there are situations where specific individuals have limited practice authority as set forth in Rev. Proc. 81-38. IRS Pub. 470, *Limited Practice Without Enrollment*, discusses specifics related to this type of practice.

Unenrolled return preparers are eligible to represent taxpayers only in matters regarding tax liability or penalty situations arising from tax returns they originally prepared. They are eligible to receive questions and respond on behalf of the taxpayers. In order to assist in the resolution of a tax matter, unenrolled preparers are limited to discussion of only the questions, issues, and factual situations that relate to the tax return in question.

#### Limited Representation

Representation is defined as acting on behalf of a taxpayer by advocating, negotiating, and arguing facts or law before the IRS. Unenrolled preparers may only represent clients before revenue agents, tax auditors, and other compliance function examiners. They are not eligible to represent taxpayers before the appeals or collection offices. Other specific acts that are **beyond the scope** of unenrolled preparers are:

- Executing claims for refund,
- Receiving checks in payment for any refund of IRS taxes, penalties, or interest,
- Executing consents to extend the statute of limitations,
- Executing closing agreements with respect to a tax liability or specific matter, and
- Executing waivers of restriction on assessment or collection of a deficiency in tax.

A taxpayer has the right to designate any third party to receive tax information on a Form 8821, *Tax Information Authorization*. If an unenrolled return preparer is designated on a power of attorney form (Form 2848) but either did not prepare the tax return or is corresponding with IRS employees other than examining officers of the compliance function, the preparer is still entitled to receive information.

Unenrolled preparers are **not able** to:

- Negotiate payment agreements,
- Argue the validity of an assessment, or
- Request extensions on deadlines.

### Other Unenrolled Individuals — Qualified to Represent Under Rev. Proc. 81-32

According to Rev. Proc. 81-38, the following unenrolled individuals can represent specified taxpayers before the IRS provided they present satisfactory identification and, except in the case of an individual described in number one following, proof of authority to represent the taxpayer:

1. **An Individual.** An individual can represent himself before the IRS.
2. **A Family Member.** An individual can represent members of his immediate family. Immediate family refers to a spouse, child, parent, brother, or sister of the individual.
3. **An Officer.** A bonafide officer of a corporation (including a parent, subsidiary, or affiliated corporation), association, or organized group can represent the entity.
4. **A Partner.** A general partner, not a limited partner, can represent the partnership before the IRS.
5. **An Employee.** A regular full-time employee can represent his employer.
6. **A Fiduciary.** A fiduciary (trustee, executor, administrator, receiver, or guardian) may serve in the position of a taxpayer and act as the taxpayer, not as a representative.

### Unenrolled Preparer Ethics in Conduct

The IRS expects unenrolled preparers to behave in a manner so as they will not commit any acts of disreputable conduct. Disreputable conduct includes items listed in section 10.51 of *Circular 230*. These items will be discussed later. Unenrolled preparers are held to the same standards for solicitation and advertising.

### Persons Ineligible to Practice under Rev. Proc. 81-38

The following persons are **ineligible** to practice before the IRS.

Any individual:

- **Convicted of a criminal offense under the revenue laws** of the United States or any offense involving dishonesty or breach of trust within five years of attempt to exercise the privilege,
- **Under disbarment or suspension from practice** as an attorney or certified public accountant,
- **Disbarred or suspended from practice before the IRS,**
- Whose **application for enrollment to practice before the IRS has been denied,**
- Who is an **officer or employee of the United States or the District of Columbia,** or
- Additionally listed in Rev. Proc. 81-38.

### Prohibited from Practice before the IRS

Corporations, associations, partnerships, and other entities that are not individuals cannot practice. For example, an individual who wants his corporation to be on record as the representative of a client in order to protect himself from malpractice does not qualify.

### Loss of Eligibility

Generally, individuals lose their eligibility to practice before the IRS in the following ways:

- **Not meeting requirements** such as continuing professional education for renewal enrollment,
- Requesting to be placed in an **inactive retirement status,** or
- Being **suspended or disbarred** by state authority from practice as an attorney or CPA.



## *CIRCULAR 230* — IN-DEPTH ANALYSIS

### WHO MAY PRACTICE?

As previously stated, attorneys, CPAs, enrolled agents, and enrolled actuaries are authorized to practice before the IRS. The 2002 revision of *Circular 230* provides additional issues for which enrolled actuaries are authorized to represent taxpayers in limited practice. The list was expanded to include issues involving treatment of funded welfare benefits, qualified asset accounts, transfers of excess pension assets to retiree health accounts, tax on nondeductible contributions to qualified employer plans, taxes with respect to funded welfare benefit plans, and tax on reversion of qualified plan assets to employers.

**Example 1.** George passed his state's CPA exam five years ago, and has maintained the continuing education requirement. However, George failed to notify the state's licensing agency of his change of address. As a result of this oversight, George did not receive his payment notice for his CPA license renewal fee and his license lapsed.

**Question A.** The Smiths are involved in an Appeals hearing in Indiana. They want George to represent them as their CPA. Can George represent the Smiths on a power of attorney?

**Answer A.** George cannot represent the Smiths because his CPA license has lapsed. He would have to secure evidence from the State of Indiana professional licensing agency that shows he is currently licensed to practice as a CPA.

### ENROLLED AGENTS

### Enrollment

In addition to CPAs, attorneys, and actuaries, the Director of the Office of Professional Responsibility has the authority to grant enrollment to an applicant who demonstrates special competence in tax matters through a written examination administered by the IRS. Also, enrollment may be granted to former IRS employees. Former employees must apply and show evidence of their prior service. It is possible that a former IRS employee would be granted only limited enrollment authority based upon his prior experience.

### Continuing Professional Education

A change in section 10.6 of *Circular 230* that deals with mandatory continuing professional education impacts on course selection. Enrolled agents are now required to complete a minimum number of hours of continuing professional education in programs comprised of current subject matter in federal taxation or federal tax-related matters.

> **Note.** For enrolled agents who will be renewing enrollment effective after March 31, 2004, a minimum of 16 hours of continuing education credit must be completed during each calendar year of enrollment. Other professionals should review changes in their requirements.

**Example 2.** Roberta is an enrolled agent in a state that places limitations upon individuals practicing accounting. Under the laws of her state, only licensed CPAs and public accountants may do accounting beyond trial balances. Roberta does all of the accounting for a small corporation that is being audited by the IRS. It seems that Roberta is violating her state's law by performing accounting functions for the corporation.

**Question A.** Can Roberta, an enrolled agent, represent her client for the return under question?

**Answer A.** The client can authorize Roberta to serve as its representative, because she is qualified as an enrolled agent under *Circular 230*. The matter of accounting is a state issue.

## FURNISHING INFORMATION

The IRS has the right to request information relating to any matter before the IRS upon proper and lawful request of a duly authorized officer of the agency. No practitioner may interfere, or attempt to interfere, with the providing of such information. Paragraph (a) of section 10.20 requires a practitioner to respond promptly to these requests unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged. Under the old regulations, the phrase "exclusion of information of doubtful legality" was used. That language was changed to the following: "Where practitioners feel that the requests are not proper and lawful, they are allowed to resist efforts by the government to obtain documents or information that may be irrelevant to an inquiry, confidential privilege, or otherwise immune from request." Practitioners should discuss their positions on these matters with the IRS in a timely manner.

An additional change was made to *Circular 230,* requiring practitioners who do not have requested information, but know the identity of persons who have the requested information to disclose the identity of those persons. This requirement applies only when requested records or information are not in the possession or control of the practitioners or their clients. Practitioners have a responsibility to make reasonable inquiry of their clients to determine who has the information, but they are not required to make an independent verification of who possesses the information.

## KNOWLEDGE OF CLIENT'S OMISSION

Section 10.21 of *Circular 230* has historically required practitioners to advise their clients of any noncompliance, error, or omission. When practitioners recognize errors or omissions, they must bring the errors or omissions to their clients' attention in a timely manner.

**Examples of situations** where the preparers should notify their client and document the discussion would include:

- **Exemptions** — A child may not be eligible for exemption due to age or no longer being a full-time student.
- **Points on Refinancing** — Inspection of a closing statement of a mortgage refinancing may reveal that the points should be amortized over the life of the mortgage rather than taken as a current deduction.
- **Income Not Documented by a Form 1099** — The practitioner may encounter a situation where the client had income that was not covered by an information document. The client should be advised that the amount is includable in income.
- **Estimated Tax Penalty** — Tax preparers should advise clients to compute their estimated tax penalties when filing their returns.

The revision to *Circular 230* states that a representative must notify clients of the noncompliance, error, or omission as before. In addition, practitioners must advise their clients of the consequences under the code and regulation of the noncompliance, error, or omission. Practitioners should also advise their clients how to correct such errors or mistakes.

**Examples** of this type of situation would include:

- **Penalties** — Practitioners should inform their clients that understating income could possibly subject the client to a substantial tax penalty. Other penalties could be assessed for failure to file or failure to pay. Practitioners should analyze these situations to determine the impact on clients.
- **Interest** — Practitioners should advise their clients that while penalties may not be assessed, failure to pay tax could result in interest being charged.
- **Statutes of Limitation** — When the IRS makes requests for clients to extend the statute of limitation, practitioners should advise clients of the impact of signing. The statute could be held open indefinitely, and, therefore, it may not be in a client's best interest to execute the form to extend the statute.



**Example 3.** James and Mary Johnson submit information to their tax practitioner to be used for preparing their tax return. They ask the practitioner to prepare their return. The practitioner knows Mrs. Johnson provides childcare in their home. The Johnsons provided no information regarding the income and expenses from the childcare.

**Question A.** Should the practitioner complete the Johnson's return based on the information they submitted?

**Answer A.** The practitioner knows this client is not complying with the tax laws and knows the childcare activity impacts their tax return. The preparer has a responsibility to advise the clients of their noncompliance and, therefore, the possibility of an examination that could result in additional tax, penalties, and interest. If Mr. and Mrs. Johnson do not provide the information, the practitioner should not complete their return.

## DILIGENCE TO ACCURACY

Each attorney, CPA, enrolled agent, or enrolled actuary should exercise due diligence in their many responsibilities relating to federal tax practice. Due diligence is not defined in the text of *Circular 230*. However, due diligence may be defined as an action that was taken, which falls somewhere between a simple error in judgment and intentional, willful misconduct.

Many factors have an impact upon due diligence. Tax representatives should possess the knowledge that is necessary to perform the duties delegated to them. All representatives should have an understanding of *Circular 230* and the other guidelines that set ethical standards for their profession. Due diligence must be applied in the following situations:

- Preparing or assisting in the preparation, approving, and filing of returns, documents, and other papers relating to IRS matters:
  - ♦ Practitioners should make an effort to determine the correctness of information submitted with documents. Reliance on information from prior years' tax returns is not sufficient to justify the inclusion of amounts on current year's returns. If a client has been requested to prepare financial statements indicating personal living expenses for items such as installment agreements or offers in compromise, a practitioner should feel comfortable that the client's submitted data is accurate and realistic.
- In determining the correctness of oral or written representations made by the practitioner to the Department of Treasury:
  - ♦ During an examination, the practitioner may be asked under power of attorney to provide information regarding the filing of a tax return. If the practitioner feels that a client's information is not accurate or is questionable, the practitioner should make an inquiry to determine accuracy.
- In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the IRS.

- Practitioners have a responsibility to be honest and candid with their clients about the information they provide. The practitioner has a responsibility to inform the client if:
  - A client could be subjected to penalties, or
  - There is a possibility the examination will be expanded into subsequent years or expanded to related parties.
- Practitioners should not advise clients that examination of a tax return will be accepted as filed when nothing indicates the examining officer has already made that determination. Practitioners have a responsibility to provide their clients with accurate information regarding what is transpiring.

The revised *Circular 230* describes the new requirements that a practitioner is presumed to have exercised due diligence if he relies on the work product of another person and he uses reasonable care in engaging, supervising, training, and evaluating such person, taking proper account of the relationship between the practitioner and the person. It is expected that practitioners will use common sense and experience to guide their conduct.

If a practitioner does not have expertise in a specific area of tax law and hires a specialist to handle that situation, it is the responsibility of the practitioner to ensure the qualifications and the actions of the specialist. For example, if during an examination of a client's tax return where the agent is probing an issue related to tax-free exchanges under IRC §1031, the practitioner may want someone who is a specialist in this tax area to handle the analysis of the issue. The referring practitioner is ultimately responsible for the accuracy of the work and, therefore, must make a good faith effort to ensure that the specialist's work is accurate.

Representatives working under powers of attorney and working for firms are permitted to delegate some of their responsibilities for IRS actions to subordinates. Practitioners are required to exercise due diligence when relying on the work of subordinates. They cannot use as a defense the fact that they were not the ones who performed the work. Practitioners have a responsibility to ensure that **all** work is done properly. The distinction between specialists and subordinates is that practitioners are responsible for the supervision and training of subordinates, but they need only to monitor the completed work of specialists.

**Example 4.** Tina is busy preparing returns during the filing season when a new client asks her to handle a collection matter. Tina agrees to represent the client, but she has no background information regarding the client's standard of living or business dealings. She schedules an appointment with a revenue officer to request an installment agreement for her client. The client provides information, which Tina uses to prepare the document. As the practitioner, Tina looks at the amount that her client stated for food. Since Tina spends substantially less than that amount on herself and her family, she feels that the amount her client stated may be too high.

**Question A.** Should Tina accept the information that her client has offered?

**Answer A.** Unless there is specific information implying otherwise, Tina's reasonable inquiry to the client is sufficient. It is possible that the client in this example eats differently and therefore spends more for food than Tina spends for her family.

**Example 5.** Dick, a tax attorney, delegates the research for a contested tax issue to a paralegal who works for his office. The paralegal provides a listing of three court cases that ruled in the taxpayer's favor, but does not provide any dissenting opinions.

**Question A.** Is Dick responsible for ensuring that the research done by his paralegal is sufficient when there is an indication that there may be dissenting court opinions relating to the issue?

**Answer A.** Dick should make an inquiry to ascertain whether the paralegal's research was sufficient and if conflicting court decisions were considered. The reasonable possibility standard set forth in *Circular 230* as it relates to the taking of positions is discussed later in this text.

**Example 6.** James, an enrolled agent, is advised during an examination that the IRS agent has found an adjustment in favor of the taxpayer. The adjustment is based on an error that James made during his initial preparation of the return.

**Question A.** As an enrolled agent, does James have a responsibility to advise his client of the error that he made in his initial preparation of the return?

**Answer A.** James has a responsibility to advise his client of the error he made in the preparation of the initial return. Section 10.22 of *Circular 230* requires practitioners to make correct oral representations to both the IRS and their clients.



## PRACTICE BY FORMER GOVERNMENT EMPLOYEES AND THEIR PARTNERS AND ASSOCIATES

The final regulations reflect changes to the federal statutes governing the post-employee restrictions that are applicable to former federal government employees. There was a section 10.25 in the prior regulations that dealt with practice by partners of government employees. That section was removed because the statutory prohibition was repealed under other federal statutes. The current section of *Circular 230* defines the types of representation ex-government employees may provide to clients with whom they were previously involved.

It should be noted that for many years *Circular 230* placed restrictions on practitioners representing clients with whom they had previous involvement. *Circular 230* defines previous involvement as any transaction between the employee and the taxpayer. Such transactions may include:

- Examination of tax returns,
- Collection actions,
- Appeals actions,
- Exempt organization determinations,
- Letter rulings, and
- Technical advice requests.

> **Note.** The Sarbanes/Oxley Accounting Reform Act has promulgated many of the potential conflicts of interest that are included in *Circular 230*.

**Example 7.** Jack, a midlevel IRS manager who supervises the work of group managers and revenue agents, retires from the IRS. Immediately following retirement, Jack accepts employment with a CPA firm where he is assigned responsibility for a client's audit. This audit has been in process for two years. The IRS examiner assigned to the case was a revenue agent who worked for Jack.

**Question A.** Can Jack represent this client for the year in question?

**Answer A. No,** Jack had official responsibility for this employee and the employee's caseload. Therefore, the CPA firm's client had been technically under Jack's jurisdiction during the examination. Jack may have had confidential information about this client that was provided to him by either the revenue agent's group manager or even the agent himself.

## FEES

### Unconscionable Fees

The section of *Circular 230* relating to fees is very subjective. The language used in section 10.27 of *Circular 230* states that practitioners may not charge "unconscionable" fees for representing clients in matters before the IRS. The definition of unconscionable can be very argumentative. The fee provisions are meant to ensure that clients who are subjected to IRS examinations, collection actions, appeals, or other matters are not charged exorbitant fees.

While fees should be reasonable, there is some difficulty in determining what is considered appropriate fees for rendered services. Obviously, practitioners who have many years of experience can charge more than those who are less experienced. The IRS encourages practitioners to charge fees that are commensurate with fees charged for similar services in the immediate geographical area. The IRS will not question small variances in fees. However, if a client is charged a very high fee for services that do not require a significant expenditure of time, the practitioner's fee structure could be scrutinized and determined to be unreasonable or unconscionable. In this situation, the practitioner could be subject to investigation and possible disciplinary action.

> **Example 8.** A correspondence unit of the IRS contacts Mr. and Mrs. Dennis to verify a deduction claimed on their return. Mr. and Mrs. Dennis are high-income taxpayers who have the ability to pay a large fee. Their tax practitioner determines that it will take approximately two billable hours to resolve the situation. It is apparent to the practitioner that the taxpayers are entitled to the deduction and verification will require only the submission of documentation. There is little chance that the practitioner will have significant correspondence or expend a large amount of time to resolve the situation. If disallowed, the deduction would result in an additional tax liability of $5,000 for the couple. Since Mr. and Mrs. Dennis trust their practitioner, they pay him the $1,000 that he billed them for the work.

**Question A.** If the clients are willing to pay this $1,000 fee, is the amount unconscionable?

**Answer A.** The willingness of Mr. and Mrs. Dennis to pay this fee is not determinative. The $1,000 fee is unreasonable for the time expended. It exceeds reasonable rates when it is compared to the fees of other practitioners in the community. It could be viewed that this practitioner is charging unconscionable fees.

## Contingent Fees

*Circular 230* also addresses contingent fees for the preparation of returns. It is specifically prohibited to charge contingent fees for the preparation of an original return. Additionally, practitioners who represent clients in Appeals actions are prohibited from charging a percentage of their clients' tax savings resulting from a settlement in Appeals as their fee.

There is a provision that practitioners may charge contingent fees for preparing amended returns or claims for refunds other than claims for refunds made on original returns prepared by the practitioners. However, a practitioner must believe that IRS will give the amended return or claim substantive review and possible inquiry. In its analysis of the comments on the proposed regulations, the IRS states that the Department of Treasury and the IRS remain concerned regarding the use of contingent fees and that they continue to probe for positions that are just and reasonable in these situations. Future revisions may be forthcoming.

> **Example 9.** A commercial tax preparation service advertises for taxpayers to provide their prior years' filed tax returns so the firm can check to see if the taxpayers have deductions, credits, or overstatements of income that could impact upon their tax liabilities for those prior years. If the firm identifies adjustments to those prior years' returns, the tax service charges the clients contingent fees to prepare their amended returns or claims.

**Question A.** Is advertising and charging contingent fees for the filing of amended returns a violation of *Circular 230*?

**Answer A.** The tax preparation service is allowed to charge contingent fees for the preparation of the amended returns and claims, because the fees are not related to any action that the IRS is taking against the taxpayers and because the firm did not prepare the original returns. The tax service would also be allowed to advertise based on these facts.

## Client Records

The final regulations include provisions that address the return of clients' records in fee disputes. If a client requests the return of his tax records, the practitioner cannot withhold the client's records, regardless of whether the client has paid the practitioner's bill for services. However, there is an exclusion for items like tax returns or other documents that were prepared by the practitioner. Practitioners may withhold any documents they prepared pending their client's payment for those particular documents. These provisions were incorporated to protect practitioners from being disadvantaged or compromised by clients seeking to obtain unfair advantage under this section.

There may be some state laws in favor of practitioners permitting liens on clients' records during the course of fee disputes. Even in these situations, practitioners still must provide their clients with access to review and copy any of their records.



> **Example 10.** Alex is a tax practitioner. For many years, he prepared his client Sandy's tax returns. As a tax preparer, Alex maintained schedules and continuously updated depreciation schedules he used to prepare Sandy's returns.

**Question A.** Sandy does not pay Alex for prior work and decides to prepare her own tax return. She cannot prepare the returns herself without the depreciation schedules. She asks Alex for copies of the schedules to prepare her own return, but he refuses to supply the information. Although Sandy is delinquent in paying her debt, does she have a right to the depreciation schedules?

**Answer A.** Sandy should be given the opportunity to have access to the records so that she can file her tax returns. She **does** have the right under section 10.28 of *Circular 230* to have access to the records so she can comply with federal tax law.

### Conflicting Interests

The prior language in section 10.29 stated that no practitioner could represent conflicting interests in his practice before the IRS except by express consent of all directly interested parties after full disclosure is made. Section l0.29 now also requires a client to provide informed written consent to representation by a practitioner when the representation of one client will be directly adverse to another client. The purpose of this rule, which conforms to a recent revision of the American Bar Association Rules of Professional Conduct, is to clarify that written information is required. This section also requires practitioners to retain the written consent for at least 36 months after the conclusion of the representation and to provide the written consent to the IRS if requested to do so.

> **Example 11.** Alan prepared joint tax returns for Stuart and Grace Reid. After 17 years of marriage, the Reids divorced. After the divorce, both Stuart and Grace claimed their only child as an exemption on their individual returns. Alan is asked to represent Stuart in an audit. He prepared Grace's return and claimed the exemption under her strict direction. Alan was unsure who was entitled to the exemption. He made a reasonable attempt to gather the information, and it appeared that either Stuart or Grace were eligible to claim the exemption.

**Question A.** Does Alan have a conflict of interest that should be disclosed under the requirements of section 10.29 of *Circular 230*?

**Answer A. Yes,** Alan should disclose there is a conflict of interest to both his clients and the IRS. He should state the conflict in writing and recuse himself from representing one of his clients. Although he was not sure who was eligible to claim the exemption, he was still actively involved on both sides of the issue.

## SOLICITATION

### Coordination with State Statutes

Section 10.30 of *Circular 230* provides guidelines for acquiring clients regarding matters before the IRS and states that no attorney, CPA, enrolled agent, or enrolled actuary shall use any form of public communication that contains a false, fraudulent, unduly influencing, misleading, coercive, or unfair statement or claim. The recent final regulations which were incorporated into *Circular 230* add the clarification that practitioners are prohibited from making written and oral solicitations of employment in matters related to the IRS if such solicitations would violate federal or state statutes or other rules applicable to practitioners regarding the uninvited solicitation of prospective clients. An example of this would be if an attorney is prohibited under his state's bar rules from making a certain type of uninvited solicitation, the attorney's uninvited solicitation with respect to a matter related to the IRS would constitute a violation of section 10.30. Conversely, if such a solicitation is permissible under the relevant state bar rule, the making of such solicitation with respect to a matter related to the IRS is permissible. Section 10.30 clarifies and coordinates the interpretation of the federal and state statutes.

This section also defines what is considered permissible solicitation. Over the years, the number of professionals who use advertising to acquire business has increased. If an individual is allowed to make certain types of promotion in a state, the individual may also be eligible to make the same type of promotion under *Circular 230* rules.

### Permissible Solicitation

No practitioner who is defined under *Circular 230* as being eligible to practice is permitted to make direct or indirect uninvited solicitations for employment in matters actively related to the IRS. *Circular 230* seems to direct this restriction to "in person" contacts and telephone communications. The restriction **does not** apply to:

- Seeking new business from either existing or former clients,
- Communicating with family members,
- Making the availability of professional services known to other practitioners,
- Solicitations by mail, or
- Noncoercive "in person" solicitation by those eligible to practice before the IRS while acting as an employee, member, or officer of an exempt organization listed in IRC §§501(c)(3) and (4).

In basic terms, a practitioner may solicit clients for tax practice when the solicitation is not specifically related to a matter that is currently being considered by the IRS. Solicitation can be made in the form of targeted direct mail. The solicitation must clearly identify the source of information that was used to choose the recipient.

Section 10.30 also expands the prohibition of deceptive and other improper solicitation practices to cover private as well as public solicitations. The final regulations provide that practitioners may not (in matters relating to the IRS) assist or accept assistance from any person or entity that to the knowledge of the practitioner obtain clients or otherwise practices in a manner forbidden under this section.

> **Example 12.** Tom is a CPA. He wants to find new clients to avail themselves of his knowledge and talents in resolving collection problems with the IRS. Tom goes through property cards at his local county assessor's office to make a list of homeowners who recently had liens placed on their property by the IRS. He sends letters of solicitation to the homeowners describing himself as an expert at resolving collection tax matters. He advises these potential clients that the filing of a lien is a significant IRS action. He explains that he can work with homeowners to possibly create a situation where the IRS would accept an offer in compromise, resulting in a reduction of their tax liability and elimination of the lien.

**Question A.** Can Tom send letters to these individuals citing the lien filings as the purpose of his solicitation, or will he be in violation of *Circular 230*?

**Answer A.** Tom is allowed to make this solicitation, because the lien filings are public record. He should, however, cite the lien filings as his source of information. He is stating facts when he says that the homeowners have liens placed by the IRS and that he may or may not be able to reduce their tax liability.

There was a proposal made to include a provision in *Circular 230* that would permit enrolled agents to use the term "licensed" in describing their professional designation. However, it was decided not to include the language in the current revision. The Treasury Department and the IRS will solicit comments relating to addition of the designation for use by enrolled agents in the future.

### Disclosure of Fees

Practitioners are required to provide clients with specific information regarding their fees for service. They must inform their clients of the following charges:

- Fixed fees for specific routine services
- Hourly rates
- Range of fees for a particular service
- Fee charge for an initial consultation.



Practitioners are also required to inform their clients whether the clients would be responsible for any fees payable to the IRS. An example of such costs would be the filing fee required to secure a ruling from the IRS for IRC §501(c)(3) public charity applications.

### Solicitation — Additional Miscellaneous Provisions

Practitioners may advertise in various media. **The advertisement should be truthful.** It should not include any material that is deceptive or unduly influencing. Practitioners may not say that they have any type of relationship with the IRS or that all of their cases have been settled in appeals. Practitioners must keep and maintain copies of all advertisements and publications or solicitations that they send out to print media, directories, radio, television, or others for a period of 36 months from the date of the last transmission or use of the solicitations.

## STANDARDS FOR ADVISING

### Realistic Possibility Standard

Section 10.34 of *Circular 230* discusses the concept of a **realistic possibility standard**. Practitioners must not sign a return if they determine the return contains a position that does not have a realistic possibility of being sustained on its merits (the realistic possibility standard) unless the position is not frivolous and is adequately disclosed to the IRS. Practitioners should determine with a realistic basis of satisfaction that the positions taken on tax returns can be sustained. The CPA Society Standards also directs CPAs not to recommend positions unless they have a good faith belief that their positions will be administratively or judicially sustained. Treas. Reg. §1.6662-4(d)(3)(iii) provides additional guidance on this subject.

The IRS cannot examine every return that is filed. However, practitioners should not advise their clients to take positions that would exploit the audit selection process or for the sole purpose of obtaining leverage in bargaining with an Appeals Office. Practitioners should be advocates for their clients. Since the tax law is not “black and white” and can be “gray” for specific issues, practitioners should make reasonable efforts to ascertain whether there is realistic possibility that their positions or issues can be sustained.

Section 10.34 of *Circular 230* states that a position is considered to have a realistic possibility of being sustained on its merit if a well-informed analysis by a person knowledgeable in tax law would conclude that the position has an approximately one in three, or greater, likelihood of being sustained on its merits. If a practitioner finds no authority for a controversial position, the practitioner should not take the position on a client’s tax return.

> **Example 13.** A practitioner does research on a questionable issue and determines that the issue was litigated previously in several U.S. circuit courts. Out of all the litigated cases, only a single case was won by the taxpayer and that one case was in a circuit outside of the geographical jurisdiction of this practitioner and his client. The IRS did not acquiesce in that one case. All of the subsequent cases including those in the practitioner’s circuit were lost.

**Question A.** If the practitioner decides to take the position that is favorable to the client, has he satisfied the realistic possibility standard set forth in *Circular 230*?

**Answer A.** It would appear that the practitioner does not have a one in three, or greater, likelihood of having the position sustained on its merits.

## Potential Negative Consequences

Practitioners have a responsibility to advise clients of potential penalties that could be asserted if a questionable position is taken. The substantial penalty for understatement of tax is only one penalty that could be asserted. Practitioners have an additional responsibility to advise their clients to disclose the issue on their tax returns. The disclosure should be a clear indication that a questionable position is being taken and can be easily ascertained by a review of the tax return. Practitioners and clients cannot conceal a deduction or position on a return and declare that it was disclosed. Any disclosure must make it very clear that the position being taken has a realistic possibility of being sustained.

> **Example 14.** Susan advises her client that a certain position is questionable and does not meet the realistic possibility standard. She tells the client this position must be disclosed in order to eliminate the possibility of penalties being assessed in addition to the disallowance of the deduction. Susan's client still wants to take the questionable position. However, the client does not want to make the disclosure and instructs Susan to file the return without disclosure.

**Question A.** Should Susan follow the direction of her client and take the questionable position without disclosure?

**Answer A.** Susan has made a reasonable effort to advise her client under section 10.21, "knowledge of client's omission," and section 10.22, "diligence to accuracy," of *Circular 230*. She knows her client is not complying with the Internal Revenue Code and, in the opinion of the Code, does not have a realistic basis to be sustained. Susan should ask her client to comply. If her client refuses, Susan should not prepare the tax return and excuse herself from this engagement. She has a responsibility to diligence of accuracy.

## Authority to Disbar or Suspend

In 2003, the IRS created the Office of Professional Responsibility and appointed its Director to replace the Office of the Director of Practice. This office is responsible for monitoring and supervising tax professionals in practice and enforcing the guidelines set forth in *Circular 230*.

The Secretary of Treasury has the authority to suspend or disbar any practitioner from practice before the IRS. The wording of section 10.50 states that the Treasury may take action against any practitioner who:

- Is known to be incompetent or disreputable,
- Refuses to comply with any regulation in this part, or
- With intent to defraud willfully and knowingly, misleads or threatens a client or prospective client.

The next section clarifies what types of conduct would justify harsh actions of this type.

## Disreputable Conduct

Section 10.51 defines disreputable conduct for which a practitioner may be censured, suspended, or disbarred. Examples of disreputable conduct include the following:

- Filing frivolous complaints against IRS personnel
- Advancing frivolous arguments in collection cases
- Conviction of a felony
- Providing false or misleading information to a representative of the IRS

- Attempting to influence the action of an officer or employee of the IRS
- Unprofessional behavior

### Frivolous Complaints

The filing of frivolous complaints against IRS personnel becomes disreputable conduct under section 1203 of the IRS Restructuring and Reform Act of 1998, if the practitioner knows the complaint is false. This 1998 act created what the tax profession has referred to as the "10 deadly sins." An allegation that an IRS employee committed any of these actions could subject the employee to an extended investigation and the possibility of eventual firing. These provisions have had a dramatic impact on the morale of IRS employees and, to some extent, on their productivity.



### Frivolous Arguments in Collection Cases

Under the current revisions, advancing frivolous arguments in collection due process hearings or in connection with offers in compromise, installment agreements, or the appeals process could constitute disreputable conduct. The IRS is making efforts to avoid protraction of the collection process through the misuse of the collection administrative and appeals processes.

### Conviction of a Felony

The definition of disreputable conduct was amended to include conviction of any felony involving conduct that renders a practitioner unfit to practice before the IRS. Obviously, such a determination can to be made only after a thorough investigation to ascertain whether the practitioner is unfit to practice due to his conviction of a felony in a non-tax-related situation. An example would be that of a practitioner convicted of embezzlement at a company where he was performing accounting services. Such a practitioner may be considered unfit to practice tax representation because he was proven to be disreputable in the area of accounting.

### Providing False or Misleading Information

The providing of false or misleading information to the IRS in connection to a pending matter would be another form of disreputable conduct. Misleading information includes providing inflated personal living information to justify an installment agreement, willfully failing to file a tax return or intentionally evading any federal income tax or tax payment, or advising a client to set up a fictitious trust to avoid taxable income.

> **Example 16.** Lenny has not filed tax returns for a number of years. He asks his tax preparer, Ellen, what he can do to prevent his delinquency from becoming visible to the IRS. Ellen advises Lenny to show more exemptions on his W-4 than he is entitled to, resulting in no withholding on his tax return. Although Ellen is giving Lenny this information, she is not actually preparing his Form W-4.

**Question A.** Since Ellen did not prepare the form and no tax returns were filed, is she in violation of the disreputable conduct provision of *Circular 230*?

**Answer A.** As the practitioner, Ellen is unquestionably attempting to assist her client in evading federal income taxes. The action of filing the W-4 is an illegal plan to evade taxes, making Ellen liable to scrutiny for disreputable conduct.

### Attempting to Influence Actions

Attempting to influence the action of an officer or employee of the IRS by the use of threats, false accusations, duress, by the offer of any special inducement or promise of advantage, or by the bestowing of any gift, favor, or thing of value could be construed as disreputable conduct.

> **Example 17.** During an extended IRS examination, Brian, a CPA, and Mark, a revenue agent, become friends. Mark mentions to Brian that after many years of hard work, he was finally obtaining his MBA degree. The next time the men go to lunch, Brian gives Mark a $50 clock. Brian says the clock is a gift recognizing Mark's educational achievement.

**Question A.** Does giving this gift to Mark constitute disreputable conduct?

**Answer A.** It appears that Brian took this action in friendship and not with the intent to influence Mark's actions as an IRS employee. However, under the IRS rules of conduct, Mark must return the gift because of his relationship with Brian on an active investigation. In addition, Mark should pay for his own meals when the two men go to lunch.

### Unprofessional Behavior

Practitioners are expected to maintain decorum when they deal with the IRS. They should not use abusive language, make false accusations or statements, or circulate or publish malicious or libelous matter. IRS employees have a right to professional treatment.

The IRS defines improper conduct as a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary error that a practitioner should have observed under the circumstances. Providing a false opinion in an isolated situation may not warrant disciplinary action. However, such behavior may result in future scrutiny by the IRS. A distinction is made when practitioners show a pattern of providing incompetent opinions, false information, or other misleading material to the IRS. Practitioners will be warned of improper behavior when it occurs. If such behaviors reach a point where a trend can be identified, an IRS employee will make a referral to the Office of Professional Responsibility for its appropriate action.

> **Example 18.** Bill is an attorney who represents clients before the IRS and presents workshops across the United States on ways of creating offshore bank accounts, businesses, and trusts to avoid taxation. Bill receives substantial fees for these presentations. He knows that neither the IRS nor the courts concur with the information that he is providing.

**Question A.** Since Bill does not prepare tax returns and is merely providing opinions, could the IRS subject him to sanctions or disbarment for providing erroneous information?

**Answer A.** The IRS could take action against Bill up to and including disbarment or suspension from practice before the IRS for providing this erroneous information. *Circular 230* stipulates that a pattern of providing incompetent or false opinions or misstating facts or laws may warrant disciplinary action.

### Institution of Proceedings, Filing of Complaints, Hearings, and Other Related Matters

The remainder of *Circular 230* covers the investigation process that is taken by the Office of Professional Responsibility. Disciplinary action definitely has devastating impact on a practitioner. Actions like disbarment and suspensions that the IRS and the Department of Treasury take against practitioners are published in the IRS *Weekly Bulletin*, which is disseminated both electronically and in hard copy form. In this way, the public receives written notice of disreputable conduct. The publishing of this information is allowed under the privacy statutes of federal law.

## OTHER IRS GUIDELINES FOR PRACTICE

### POLICY STATEMENTS

Policy statements are written to provide guidance to IRS employees. They provide IRS employees with the discretion and guidance they need to administer the tax law. These statements are found in paragraph 1.2.1 in the chapter entitled "General Management" of the *Internal Revenue Manual*. This section of the Manual is public information.

### P-4-6

An examiner may not examine a return if a relationship impairs impartiality. IRS examiners are not permitted to examine or make determinations regarding taxpayers with whom they conduct business or interact socially since it might impair their impartiality and independence. Revenue agents cannot examine the tax returns of relatives, close friends, or others with whom a conflict of interest could arise. However, merely knowing the identity of an individual does not exclude an examiner from doing an examination, because impartiality would not be impacted.

Questions arise regarding whether practitioners should deal with IRS employees when there is the possibility of a conflict of interest. Ethics would dictate that in any situation where there may be the possibility of a conflict of interest, it would be advisable to discuss the situation with the examiner or a manager to determine whether someone else should be assigned to the case.

**Example 19.** Daniel Hall is a revenue agent. He notifies Paula, an enrolled agent, that he is auditing the tax return of one of her clients. Paula tells her husband that she will be handling her client's audit with Daniel Hall. Her husband tells her that Daniel's wife has recently applied for a job at the company where he is a manager.



**Question A.** Does this situation represent a conflict of interest for Paula? Should Paula as an enrolled agent bring this information to the attention of the IRS?

**Answer A.** While *Circular 230* is not totally clear in this regard, it appears that this scenario presents a situation where a conflict of interest could arise during the normal course of the examination. It would be wise for Paula to discuss the situation with Mr. Hall and, if possible, eliminate the conflict.

### P-4-65 Voluntary Payment of Bar Deficiency or Account Shall Not Be Solicited

P-4-65 states the IRS will not make any effort, real or implied, to solicit voluntary payments of a deficiency or of a taxpayer delinquent account barred by statute. It further states that payments freely made by the taxpayer will be accepted. Therefore, it is possible that a tax liability could fall through the "cracks" and not be subject to collection action by the IRS, because the statute of limitations had expired.

**Example 20.** A revenue agent prepares a Form 872, *Consent to Extend the Time to Assess Tax* for a taxpayer he is auditing. Ted, a practitioner, has the taxpayer's power of attorney. Ted takes the Form 872 and sends it to his client instructing him to sign it. Later the IRS sends an executed copy of the Form 872 to Ted under his power of attorney. Ted sees that his client has converted the general consent to a restricted consent by adding only the names of specific partnerships under investigation. His client has not included the name of one specific partnership that could potentially have a substantial adjustment. The IRS executes the consent without reviewing the edit made by Ted's client.

**Question A.** Should Ted inform the IRS about the alterations made to the consent form and the fact that the form no longer protects the government's interests?

**Answer A.** Ted has a responsibility to advise his client that the client did not act in good faith and that the action could have an impact on the examination. Ted's client could then authorize him to inform the IRS of the mistake. However, since IRS employees erred in executing the agreement without reviewing it, Ted does not have a responsibility to disclose the information to the IRS. The Waiver of Statute of Limitation was a contract. Nothing in the law precludes a contract from being revised to accommodate the needs of either party. However, Ted may want to abstain from representing this client, since he does not agree with the manner in which the client is operating. His client's behavior might have an impact on Ted's future credibility with the IRS. The IRS could perceive this incident as the start of a pattern of potential disreputable conduct, justifying an investigation of Ted's practices in the future.

### P-5-133 Delinquent Returns Enforcement of Filing Requirements

When an individual has not filed returns for an extended period of time, the IRS will not enforce the delinquency procedures for more than six years unless there was prior managerial approval of the enforcement. Therefore, an individual who has not filed returns for 20 years may not be asked to file returns for 14 of those 20 years.

**Example 21.** Mary goes to Jane, a tax attorney. She tells Jane she cannot sleep because she has not filed tax returns for 17 years. Jane is aware of the policy statements and knows as a general rule the IRS will only pick up six of the 17 years. Mary tells Jane that she wants to file all of the returns in question.

**Question A.** Should Jane advise Mary to file returns for only six of the years or for all 17 years?

**Answer A.** Jane should work with the IRS and offer six years of tax returns. She should cite P-5-133 as her basis for filing only six years. She should also communicate the facts and circumstances relating to Mary. It will be the decision of the IRS whether its enforcement will go beyond a 6-year period.

## POWERS OF ATTORNEY AND THE CENTRALIZED AUTHORIZATION FILE

### POWERS OF ATTORNEY

A power of attorney is a taxpayer's authorization permitting another individual to represent him before the IRS. Powers of attorney authorize the representatives to perform any and all acts that the taxpayers can perform such as signing consents, extending the time to assess tax, recording an interview, or executing waivers agreeing to tax adjustments. Taxpayers may allow their power of attorney to substitute another representative or delegate authority to another person. All individuals who represent taxpayers on powers of attorney must be eligible to practice before the IRS.

When a *Power of Attorney* Form 2848 is prepared, it must specifically state the types of taxes, tax form numbers, and the years or periods for which the power of attorney is being granted. The IRS will not accept a general reference to "all" years. Each form must specifically cite the years that it covers.

Form **2848** (Rev. January 2002)
Department of the Treasury
Internal Revenue Service

# Power of Attorney and Declaration of Representative

► **See the separate instructions.**

OMB No. 1545-0150

**For IRS Use Only**
Received by:
Name ____
Telephone ____
Function ____
Date / /



## Part I Power of Attorney (Type or print.)

**1 Taxpayer information.** Taxpayer(s) must sign and date this form on page 2, line 9.

| Taxpayer name(s) and address | Social security number(s) | Employer identification number |
|---|---|---|
| **John & Jane Taxpayer**<br>**11 Happy Way**<br>**Anywhere, Anywhere 11111** | **999 ⋮ 88 ⋮ 7777**<br>**777 ⋮ 88 ⋮ 9999** | ⋮ |
| | Daytime telephone number ( **000** ) **111-2222** | Plan number (if applicable) |

hereby appoint(s) the following representative(s) as attorney(s)-in-fact:

**2 Representative(s)** must sign and date this form on page 2, Part II.

| Name and address | |
|---|---|
| **Sam Sharp**<br>**2 First Street**<br>**Anywhere, Anywhere 11111** | CAF No. **CP-xxx**<br>Telephone No. **000-222-1111**<br>Fax No. **000-222-3333**<br>Check if new: Address ☐ Telephone No. ☐ |
| Name and address | CAF No. ____<br>Telephone No. ____<br>Fax No. ____<br>Check if new: Address ☐ Telephone No. ☐ |
| Name and address | CAF No. ____<br>Telephone No. ____<br>Fax No. ____<br>Check if new: Address ☐ Telephone No. ☐ |

to represent the taxpayer(s) before the Internal Revenue Service for the following tax matters:

**3 Tax matters**

| Type of Tax (Income, Employment, Excise, etc.) or Civil Penalty (See the instructions for line 3.) | Tax Form Number (1040, 941, 720, etc.) | Year(s) or Period(s) |
|---|---|---|
| **Income** | **1040** | **2002** |
| | | |
| | | |

**4 Specific use not recorded on Centralized Authorization File (CAF).** If the power of attorney is for a specific use not recorded on CAF, check this box. See the instructions for **Line 4. Specific uses not recorded on CAF.** . . . . . . . . . ► ☐

**5 Acts authorized.** The representatives are authorized to receive and inspect confidential tax information and to perform any and all acts that I (we) can perform with respect to the tax matters described on line 3, for example, the authority to sign any agreements, consents, or other documents. The authority does not include the power to receive refund checks (see line 6 below), the power to substitute another representative, the authority to execute a request for a tax return, or a consent to disclose tax information unless specifically added below, or the power to sign certain returns. See the instructions for **Line 5. Acts authorized.**

List any specific additions or deletions to the acts otherwise authorized in this power of attorney: ____

**Note:** *In general, an unenrolled preparer of tax returns cannot sign any document for a taxpayer. See Revenue Procedure 81-38, printed as Pub. 470, for more information.*

**Note:** *The tax matters partner of a partnership is not permitted to authorize representatives to perform certain acts. See the separate instructions for more information.*

**6 Receipt of refund checks.** If you want to authorize a representative named on line 2 to receive, **BUT NOT TO ENDORSE OR CASH**, refund checks, initial here ____ and list the name of that representative below.

Name of representative to receive refund check(s) ►

**For Paperwork Reduction and Privacy Act Notice, see the separate instructions.** Cat. No. 11980J Form **2848** (Rev. 1-2002)

**7** **Notices and communications.** Original notices and other written communications will be sent to you and a copy to the first representative listed on line 2 unless you check one or more of the boxes below.

**a** If you want the first representative listed on line 2 to receive the original, and yourself a copy, of such notices or communications, check this box . . . . . . . . . . . . . . . . . . . . . . . . . . . . ▶ ☐

**b** If you also want the second representative listed to receive a copy of such notices and communications, check this box. ▶ ☐

**c** If you do not want any notices or communications sent to your representative(s), check this box . . . . . . . ▶ ☐

**8** **Retention/revocation of prior power(s) of attorney.** The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the Internal Revenue Service for the same tax matters and years or periods covered by this document. If you **do not** want to revoke a prior power of attorney, check here. . . . . . . . . . . . . ▶ ☐

**YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.**

**9** **Signature of taxpayer(s).** If a tax matter concerns a joint return, **both** husband and wife must sign if joint representation is requested, otherwise, see the instructions. If signed by a corporate officer, partner, guardian, tax matters partner, executor, receiver, administrator, or trustee on behalf of the taxpayer, I certify that I have the authority to execute this form on behalf of the taxpayer.

▶ **IF NOT SIGNED AND DATED, THIS POWER OF ATTORNEY WILL BE RETURNED.**

| Signature | Date | Title (if applicable) |
|---|---|---|
| Print Name | | |
| Signature | Date | Title (if applicable) |
| Print Name | | |

**Part II** **Declaration of Representative**

**Caution:** *Students with a special order to represent taxpayers in Qualified Low Income Taxpayer Clinics or the Student Tax Clinic Program, see the separate instructions for Part II.*

Under penalties of perjury, I declare that:

- I am not currently under suspension or disbarment from practice before the Internal Revenue Service;
- I am aware of regulations contained in Treasury Department Circular No. 230 (31 CFR, Part 10), as amended, concerning the practice of attorneys, certified public accountants, enrolled agents, enrolled actuaries, and others;
- I am authorized to represent the taxpayer(s) identified in Part I for the tax matter(s) specified there; and
- I am one of the following:

**a** Attorney—a member in good standing of the bar of the highest court of the jurisdiction shown below.
**b** Certified Public Accountant—duly qualified to practice as a certified public accountant in the jurisdiction shown below.
**c** Enrolled Agent—enrolled as an agent under the requirements of Treasury Department Circular No. 230.
**d** Officer—a bona fide officer of the taxpayer's organization.
**e** Full-Time Employee—a full-time employee of the taxpayer.
**f** Family Member—a member of the taxpayer's immediate family (i.e., spouse, parent, child, brother, or sister).
**g** Enrolled Actuary—enrolled as an actuary by the Joint Board for the Enrollment of Actuaries under 29 U.S.C. 1242 (the authority to practice before the Service is limited by section 10.3(d)(1) of Treasury Department Circular No. 230).
**h** Unenrolled Return Preparer—an unenrolled return preparer under section 10.7(c)(1)(viii) of Treasury Department Circular No. 230.

▶ **IF THIS DECLARATION OF REPRESENTATIVE IS NOT SIGNED AND DATED, THE POWER OF ATTORNEY WILL BE RETURNED.**

| Designation—Insert above letter **(a–h)** | Jurisdiction (state) or Enrollment Card No. | Signature | Date |
|---|---|---|---|
| **c** | **2002-xxxxx** | | |
| | | | |
| | | | |

Form **2848** (Rev. 1-2002)

### Preparation of Power of Attorney

While powers of attorney can be used to represent individuals, corporations, partnerships, associations, employee plans, trusts, and estates, only individuals may serve as representatives under powers of attorney. Corporations, law firms, CPA firms, or other similar entities may not represent clients under powers of attorney.

### Acts Authorized



Powers of attorney (POA) allow representatives to sign returns only in situations where the taxpayer is incapacitated through disease or injury or is in a position of continuous absence from the United States for a period of more than 60 days.

Unenrolled tax preparers are limited in their ability to represent clients. They may only represent clients **before** the examination function of the IRS.

POA representatives are permitted to receive refund checks, but they may not endorse a check on a taxpayer's behalf. The limitations on endorsement relating to the different types of representatives are found in section 10.31 of *Circular 230*. While the law places limitations on POA representatives, taxpayers may also choose to limit the duties that their representatives will perform under their powers of attorneys.

## CENTRALIZED AUTHORIZATION FILE

The Centralized Authorization File is also known by the acronym CAF. The CAF contains information on third parties who are authorized to represent taxpayers before the IRS and/or to receive and inspect confidential taxpayer information. A major benefit of the CAF is that it is a consolidated database for use by all IRS employees to determine if an individual is qualified to serve as a taxpayer representative. The CAF number is assigned with the filing of the first power of attorney.

After a taxpayer executes a Form 2848, the form must be sent to the appropriate designated IRS processing point. The mailing address for the appropriate CAF center is based on the taxpayer's states of residence. The addresses can be found on the instructions to Form 2848.

### Third Party Designees

Beginning in 2002, taxpayers were granted "checkbox authority" on their tax returns to designate paid preparers to receive the taxpayer's information from the IRS. These third party designees **may receive information relating to refunds or payments, responses about information on or missing from a return, and communications with the IRS in response to errors in math or penalty notices**.

However, checkbox designees are **not authorized** to communicate with the IRS on issues concerning **appeals proceedings, collection notices, examination inquiries, or under-reporter notices.** Additionally, checkbox designees **cannot represent taxpayers or practice before the IRS** unless they have a **valid taxpayer's power of attorney**.

Taxpayers are not permitted to have different third party designees and powers of attorney representing them for the same tax period. The *Power of Attorney* Form 2848 and the *Authorization to Receive Information* Form 8821 both have precedence over any third party designations.

# FINANCIAL PRIVACY — GRAMM-LEACH-BLILEY ACT AND RELATED FEDERAL TRADE COMMISSION RULES

## INTRODUCTION

Today's tax professionals are generally aware of the provisions of the Gramm-Leach-Bliley Act (Privacy Act). They see notices banks send to their customers, and many have sent privacy notices to their own customers in order to comply with the bill. However, they may not be aware of the training issues included in the bill. The Privacy Act requires practitioners to train their employees how to protect the privacy of their clients' financial information.

## BACKGROUND

The Gramm-Leach-Bliley Act was created in 1999, and the regulations became final on May 24, 2000. The Federal Trade Commission Safeguards Rule, which implement the security provisions of the act, became effective on **May 23, 2003**. The Safeguards Rule requires specific financial institutions to implement comprehensive protection programs to ensure the security and confidentiality of their customer information.

The act was created to protect the privacy of the personal financial information that businesses obtain from consumers and customers. Businesses that provide financial products or services to individual clients for their personal, family, or household needs are subject to the provisions of the Act.

> **Note.** The Safeguards Rule may be found on the Federal Trade Commission's website at: www.ftc.gov/privacy/privacyinitiatives/safeguards.html.

## WHO MUST COMPLY?

The Safeguards Rule applies to many types of businesses. Some businesses that must comply with the Safeguards Rule are:

- Tax preparers,
- Check cashing services,
- Mortgage brokers,
- Appraisers,
- Non-bank lenders,
- Courier services, and
- Retailers that issue credit cards to consumers.

The Federal Trade Commission has authority to enforce this law for any of these financial institutions that are not covered by other regulatory agencies, such as the Federal Banking Agency, Securities and Exchange Commission, Commodity Futures Trading Commission, or state insurance authorities.

The regulations cite specific guidelines that must be followed. Since they protect customers' personal information, these guidelines make excellent business sense.

## THE SAFEGUARDS RULE

Any organization required to comply with the Safeguards Rule, including tax preparers, must implement an information security program. As a part of the program the organization must:

- Designate an employee or employees to coordinate the program,
- Identify reasonably foreseeable internal and external risks to the security, confidentiality, and integrity of customer information and assess the sufficiency of any safeguards in place to control the risks,
- Design and implement safeguards to address the risks and monitor the effectiveness of these safeguards,
- Select and retain service providers that are capable of maintaining appropriate safeguards for information and require them, by contract, to implement and maintain such safeguards, and
- Adjust the information security program in light of developments that may materially affect the program.

An information security program is defined as the administration, technical, and physical safeguards used to access, collect, distribute, process, protect, store, use, transmit, dispose of, or otherwise handle customer information.

The security programs of individual tax preparers may vary in scope, but they must meet these requirements. The Safeguards Rule allows preparers to design programs that are appropriate to the size and complexity of their individual businesses. Practitioners should tailor their programs to the sensitivity of their customer information.

The information security program requires the development, implementation, and maintenance of a comprehensive information security program that is written and accessible. The objectives of the program are threefold:

1. Insure the security and confidentiality of customer information,
2. Protect against any anticipated threats or hazards to the security or integrity of such information, and
3. Protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.



## SITUATIONS

The following examples could occur in a tax preparer's office. The Safeguards Rule implies that a plan should be devised that prevents these situations from occurring.

**Example 22.** PDQ Tax Service has a computer in its waiting room. Customers can access the Internet while waiting for their appointment. The computer is connected to the office network and could allow a skilled user to access the company's tax preparation software program and clients' private information. The use of passwords to access the tax data would prevent this violation.

**Example 23.** Sally's Tax Service has a table at the reception desk where completed tax returns are stacked while waiting for customers to pick them up. The reception desk is often left unattended while the employee is using the copier. Consequently, anyone could come in and take a completed tax return. Keeping completed returns in a locked file cabinet would prevent this violation.

**Example 24.** The employees of Tom's Tax Office discard incorrect returns in the wastebasket. The wastebaskets are ultimately dumped into a bag and put in the dumpster. Anyone having access to the dumpster could obtain these returns simply by opening a bag of trash. Shredding incorrect returns before placing them in the wastebasket would prevent this violation.

**Example 25.** Speedy Tax Professionals leave "returns-in-process" on their desks when they leave at night. The janitorial staff has easy access this information. This violation can be corrected by having employees lock the work-in-process in their desks or file cabinets when they leave work for the evening.

These examples are just a few of the ways customer information can be accessed by unauthorized people. The Safeguards Rule requires that a plan be put into place that will prevent these potential breeches of privacy.

## IRC §7216 — DISCLOSURE OF RETURN INFORMATION

Rules regarding disclosure of information have been in effect since July 2001. However, they merit review for those professionals who are not in compliance. Tax return preparers are subject to the privacy rules that relate to the disclosure of clients' nonpublic personal information. They are also subject to IRC §7216, which restricts the use and disclosure of customers' federal tax information. The Privacy Act does not authorize a financial institution to disclose nonpublic personal information in a way that is prohibited by other laws. Therefore, the restrictions in IRC §7216 supersede the Privacy Rules. Return preparers who use tax return information for any purpose other than to prepare tax returns could be subject to a $250 penalty for each unauthorized disclosure up to a maximum of $10,000. IRC §7216 further states that tax preparers who intentionally or recklessly take such actions could be subject to criminal penalties and fines up to $1,000 or up to one year in prison.

## CUSTOMERS AND CONSUMERS

The Privacy Act discusses the differences between consumers and customers. While all customers are consumers, not all consumers are customers. **Customers** are individuals who obtain financial products or services for personal, family, or household purposes. **Consumers** evaluate information that a business submits and determine whether they wish to become customers. **Customers** are one type of consumer. They have ongoing relationships with tax preparers who provide them with specified financial products or services.

However, there is an exception to the financial privacy rules. Consumers or customers that are businesses or wish to obtain information for business purposes are not covered by the Privacy Act. Tax preparers who prepare business returns for entities such as corporations, partnerships, and trusts **do not** have to comply with the Privacy Act for these particular clients. However, **tax preparers who prepare business Schedule C for proprietors who file Form 1040 are covered by the Privacy Act.**

The notice rules differ for consumers and customers. The differences are:

- All customers must be given initial privacy notices.
- Initial notices (or short form notices) must be given to consumers who are not customers only if the practitioner intends to disclose nonpublic personal information about the consumer to nonaffiliated third parties.
- Practitioners must give annual privacy notices to individuals as long as they remain customers, unless they opt out after initial notice.
- Practitioners are not required to send annual notices to consumers who are not their customers.

**Note.** All consumers are entitled to the same protections from disclosures of their nonpublic personal information regardless of whether they become customers. The transition from consumer to customer generally occurs when there is some form of contractual agreement.

**Example 26.** Robert meets with David, a tax practitioner, and discusses the possibility of hiring him to prepare his tax return. During the meeting he gives David personal information about his income and net worth. In this instance, Robert is a consumer. If he later makes a decision to retain David to prepare his return, his status will change to that of customer.

## COMPLIANCE PROVISIONS

### Customer Notification

Federal Trade Commission regulations require practitioners to provide their customers with information about how nonpublic personal information will be used by a practitioner. Such notices must provide customers with the following types of information:

- Types of nonpublic personal information that are being collected
- Nonpublic personal information that could be disclosed
- Parties to whom the information could be disclosed
- Client's right to opt out of the privacy notification
- Policies regarding the sharing of information of former clients
- Practices of the tax practitioner that protect the confidentiality and security of clients' nonpublic personal information

Notices must be easily understood. The regulations state that the information should utilize concise sentences, paragraphs, and sections, short explanatory sentences, and bullet lists whenever possible. In addition, the notices should use everyday words, active voice, and avoid legal or highly technical business terminology. There are additional requirements. The FTC regulations go into considerable detail on this subject.

**Note.** It is important that notices call attention to their nature and significance by using large type size, bold face, or other forms of highlighting to distinguish this type of information.



Practitioners should provide annual notices to individuals as long as they remain in a customer relationship. Customers may elect to opt out of receiving annual notices. The initial notice can provide customers with information on how they may opt out. Annual notices must be provided on a consistent basis and at least once in each period of 12 consecutive months.

If a practitioner does not furnish the nonpublic personal information of his or her customers to any nonaffiliated third parties, the practitioner can use a simplified notice. Such simplified notices will be sufficient if they:

- Describe the categories of nonpublic personal information the practitioner collects,
- State that the practitioner does not share nonpublic personal information except as authorized by law, and
- Describe the policy and practice the practitioner uses to protect the confidentiality and security of the information.

The form of notice used by the practitioner must be such that the practitioner can reasonably expect the notice to reach his consumers or customers. Oral notice is not sufficient. Customers may agree to receive their notices in electronic form, but a hard copy in written form must be available to customers who desire them. Since the following formats do not have a reasonable expectation of delivery, they **should not be used** as the sole form of notification:

- Posting signs in offices,
- Placement of advertisements, or
- Sending notices electronically to consumers who do not obtain their products or services electronically.

Notices should include the tax practitioner's policies and procedures that protect the confidentiality and the security of clients' nonpublic personal information. For example, the practitioner could state that he will only retain the information that is needed to provide his professional services. The practitioner may also wish to include comments about any electronic safeguards that are being used to protect privacy.

A sample privacy notice that could be utilized by tax practitioners follows.

*Privacy Notice*

## Tax Whiz Tax Service, Inc.

Tax practitioners are held to financial privacy standards just like other providers of personal financial services. Tax Whiz Tax Service, Inc. is now required by law to inform clients about the importance of privacy for their personal information. We are held to high standards of confidentiality and respect your right to privacy.

## Nonpublic Personal Information We Collect

When necessary, Tax Whiz Tax Service, Inc. collects nonpublic personal information about you that you provide to us or our firm obtains from third parties with your authorization. We do not secure any more information than is necessary to complete our duties on your behalf.

## Parties to Whom We Disclose Information

We do not disclose any nonpublic information that we have gathered from current or former clients except that which is required or permitted by law. Specific types of information could be provided to our employees and, in very limited situations, to unrelated third parties who need the information in order to assist us in providing our services to you. We stress the confidential nature of all information that you share.

## Safeguard System

We only retain records relating to services that we provide so that we are better able to assist you with your needs. We may also need to retain some information in order to comply with our professional guidelines. We maintain physical, electronic, and procedural safeguards that comply with those professional standards.

## Annual Notice

This notice will be provided annually unless you elect to opt out and not receive future notices. If you wish to opt out, please contact Tax Whiz Tax Service, Inc. by telephone at 317-555-5555 or by email at optout@taxwhiz.com.

**Please contact us if you have any questions. Your privacy is very important to us.**

**Opt Out Notice**

I request to opt out of future financial privacy notices from ______________________________ .

______________________________

Signature Date

**Example 27.** Rebecca has prepared Mr. and Mrs. Ford's tax returns for several years, and the Fords have always paid in full for her services. Prior to each filing season, Rebecca sends tax worksheets to her customers that assist her in the filing of the subsequent year's tax returns. As long as these worksheets are sent to the Fords, they are considered to be customers even if they do not retain Rebecca to prepare their returns. Therefore, Rebecca must continue to send them annual privacy notices.

**Example 28.** Bonnie and Marc contemplate using the tax preparation services of Executive Tax Consultants and provide them with their personal nonpublic information. Executive Tax Consultants wants to share this information with a nonaffiliated third party mortgage broker. Before it discloses the information, Executive Tax Consultants must comply with the notice and opting out requirements for consumers. Bonnie and Marc are married and they will each have their own individual privacy rights.



### Permissible Disclosure — General Exceptions

The regulations state that there are some instances where a consumer or customer's nonpublic customer information may be disclosed to third parties without initial privacy or opting out notices. These exceptions include, but are not limited to, the following situations:

- With the consent or direction of the client provided the client has not revoked the consent or direction
- To protect against or prevent actual or potential fraud, unauthorized transactions, claims, or other liability
- To persons holding a legal or beneficial interest relating to the client
- To persons acting in a fiduciary or representative capacity on behalf of the client
- To law enforcement agencies, self-regulatory organizations, or for an investigation on matters relating to public safety
- In connection with the proposed or actual sale of the practitioner's business
- To respond to a subpoena or summons by federal, state, or local authorities

## PENALTIES FOR NONCOMPLIANCE

The Gramm-Leach-Bliley Act goes into considerable detail regarding the penalties for noncompliance. When the Federal Trade Commission encounters abusive situations in violation of the act, it may assert substantial monetary penalties. The act does not provide new opportunities for clients to file civil actions against tax practitioners. However, violation of the privacy laws could subject a tax practitioner to substantial monetary harm from litigation by a consumer or customer under the current law. It is therefore very important for tax practitioners to understand the provisions and strive to fully comply with them.