Chapter 2: Ethics

Corrections were made to this workbook through January of 2005. No subsequent modifications were made.

INTRODUCTION

According to a report issued by the General Accounting Office in October, 2003[1] over 55% of nearly 130 million taxpayers in 2001 used a paid tax preparer. However, the IRS found that using a preparer does not ensure taxpayers that they are paying the least amount of tax due. GAO estimates that as many as 2 million taxpayers overpaid their 1998 taxes by $945 million because they failed to itemize deductions, and half of these used preparers.

One area of concern expressed in the GAO report deals with refund anticipation loans (RAL). Some tax practitioners fail to tell the taxpayer the true cost of the RAL. The report cited one example where a taxpayer was due a refund of $1,234 but only received a check from the preparer for $334 after paying the various RAL and preparation fees. This is a great concern since the estimated number of RALs increased from 10.8 million in 2000 to 12.1 million in 2001. An investigation in New York City visited 43 preparers and found that only 27 mentioned the annual percentage rate and fees associated with RALs.

The GAO report points out that the SB/SE division of the IRS has responsibility for assessing and collecting monetary penalties against paid preparers who do not comply with tax laws. They assessed approximately $2.4 million in penalties in calendar years 2001 and 2002 but collected only $291,000, or 12%, of the penalties. This included all or some portion of the penalties from 44% of the preparers penalized. Penalty collection has not been a priority for SB/SE since activities related to problems such as abusive tax shelters are seen as more important.

The IRS's Criminal Investigation (CI) Division investigates paid preparers suspected of criminal or fraudulent behavior. However, they focus on the most egregious cases due to overall resource limitations, leaving many cases uninvestigated. Recently CI increased its caseload and has more than doubled the number of paid preparer investigations in 2002 compared to 2001. CI also referred substantially more cases for prosecution in the first quarter of 2003.

From 2001 to 2002 CI investigations resulted in the indictment and sentencing of 134 paid practitioners. Of these, 119 were incarcerated.

Because of the increase in tax shelters, earned income tax credit fraud, and the general problems uncovered in the accounting industry, the IRS has taken a stronger position on ethics awareness. Part of this stronger focus requires that enrolled agents have at least two hours of ethics training each year. Various other state and national professional organizations have also established an ethics CPE requirement.

1. 1GAO-04070

TYPICAL ETHICAL DILEMMAS

Please take a few minutes to answer the following questions. At the end of the chapter, the same questions will be asked to see if responses change.

1. While preparing Sam's return, Amy sees that Sam sold a truck to Jeff for $25,000. Amy remembers preparing Jeff's return and reporting a purchase price of $35,000. What should Amy do?

2. Accurate Tax and Accounting has many employees. Employee Jill prepares a partnership return for Alice and Tim's Fish Emporium. Employee Bill prepares Alice's individual return from the information Alice provided. Does Bill have a responsibility to make sure Alice gave him a copy of the K-1?

3. In reviewing Linda's 2002 tax return, Tax Preparer Jessy sees that he inadvertently reported $800 of supplies as $8,000. Linda refuses to file an amended tax return. What should Jessy do?

4. Armando prepares Mr. and Mrs. Smith's 2003 joint income tax return. The Smiths divorce in 2004 and both come to Armando for preparation services. Can Armando provide services to both individuals?

5. Terrell has a small machine shop and reports tool depreciation on his 2003 tax return. When he comes back in 2004, he tells his preparer, Louis, that he is now divorced and no longer has Schedule C income or expenses. Louis questions his lack of Schedule C income and Terrell says he is not going to file a Schedule C since he sold the equipment. Terrell also refuses to report the proceeds from the tool sale. What should Louis do?

6. Samantha, a tax professional, finds Marcie's parents' income is too large to claim the education credit. She notices Marcie took the credit. Marcie otherwise qualifies, but her parents paid her tuition and fees. What should Samantha do?

7. The Costellos, a "blended family," come to Mario's office. Each is single or separated and each claims head of household filing status. Each taxpayer also claims a different child for the HOH status. All Costellos use the same address. What should Mario do?

8. Sasha is claiming EITC based on self-employment records. She tells Max, her tax preparer, that she has $10,000 of income with no expenses. What should Max do?

9. Upon having his return prepared, Brian finds out that he owes more tax than expected. He tells his accountant, Betsy, that he was mistaken and actually has $150,000 less Schedule C income than he showed on the records he gave Betsy. What should Betsy do?

10. Same situation as in question #9 except, Betsy suggests the ending inventory should be $150,000 less. What is Betsy's liability?

11. Same situation as in question #9 except, Brian screams that the return is wrong and asks for his information back so he can go to another preparer. Betsy has spent three hours setting up the depreciation schedule. Brian refuses to pay any fee. What should Betsy do?

12. Harvey leaves his firm, Honest Accountants, and establishes a practice next door. His former clients request their files from Honest Accountants, even though they were given copies of their return when they were originally prepared. What information is Honest Accountants required to give the clients?

13. When Greg is questioned about the number of miles he drove for business, he asks his preparer, Ada, how many he claimed last year. What should Ada say?

14. When questioned about the number of miles he drove for business, Abdul asks his preparer, Marcus, how many miles sound reasonable. What should Marcus say?

15. Harriet receives cash rent for her farm land from a family partnership in which she is active. The Eighth Circuit U.S. Court of Appeals has ruled this rent is not SE income. The IRS has issued an official non-acquiescence for all other circuits. Harriet refuses to pay SE tax on the rent. What should the preparer do?

16. Janice, when preparing the tax return of her managing partner's close friend, Michael, is asked by Michael to take a position that the tax courts ruled against. Michael says he is willing to gamble. The managing partner tells Janice to go ahead and do as Michael asks. What should Janice do?

17. Lizzy, a 24-year-old taxpayer, tells her accountant, Peter, that she has nine children to claim as dependents. She said she did not bring their social security numbers but would fill them in when she got back home. She did not want to electronically file the return. What should Peter do?

18. Bea, a new client, comes into the office on January 15 and must have her tax return completed immediately in order to get a car loan. She does not have her W-2 form, but has written down the amounts she said were on the last pay stub. What should the preparer do?

19. When completing the tax return at the last minute, Helmut discovers that his client, Lee, has a net operating loss. Lee is not available to ask if he wants to elect out of carrying his loss back. What should Helmut do?

20. Inga is behind on completing returns. She asks a junior partner to complete a return. Sam, the client, comes to pick up the return before Inga has time to review it. Sam must have the return immediately, as he is leaving town. Sam expects to see Inga's signature on the return. What should Inga do?

DEFINITION

Ethics is derived from a variety of 14th century words; *ethik* (Middle English), *ethique* (Middle French), *ethice* (Latin), and *ēthikē* (Greek). It is defined as the discipline dealing with what is good and bad, as well as with moral duty and obligation. It can be a set of moral principles or values or a theory or system of moral values. Ethics are the principles of conduct that govern an individual or a group or their guiding philosophy.

Given the long history of the word *ethics*, it should be easy to define and measure. However, since ethical decisions often include significant subjective or situational variables, it can sometimes be difficult to determine if a given decision would be ethical; this leads to the problem of correlating one's personal ethics with law and practice guidelines.

One way a person can determine if a decision is ethical is to ask how he would act if no one else was looking. Is the answer consistent with the action undertaken? People typically make choices based on asking, "What is the right thing to do?" Unfortunately, if his idea of the "right thing" differs from his employer's, problems can arise.

PROFESSIONAL ORGANIZATIONS, CODES OF ETHICS, AND PROFESSIONAL CONDUCT

Most professional organizations have a code of ethics or professional conduct that they expect their members to follow. Failure to follow this code can result in denial of membership. Most organizations' codes are similar to the one shown below.

National Association of Tax Professionals Code of Ethics

As a member of the National Association of Tax Professionals...

I will keep myself informed of State and Federal laws that apply to my field of practice.

I will to the best of my ability apply these laws for the protection of my clients.

I will recognize the individual needs of each and every client.

I will observe the client's right to privacy and confidentiality.

I will adhere to the Standards of Professional Conduct.

NATP's Standards of Professional Conduct

The Board of Directors of the National Association of Tax Professionals has adopted a set of standards governing members' professional conduct.

The purpose of these standards is to establish a threefold responsibility of our members.

Our first responsibility is to our clients. Members should make every effort to protect the interests of the client and advise the client when the client is taking the wrong course of conduct. The client is responsible for any decisions made when the tax return is prepared. When the client signs the tax return, it has the force of an affidavit.

The second responsibility is to the member himself. Members should conduct their practice so that it will not jeopardize their professional reputation or self-respect. The member should not be unreasonable in requiring proof of statements made by the taxpayer.

The third responsibility is to the government. In this respect, a member should always bear in mind the member is governed by the law, regulations, and decisions that make up their field of tax practice.

Our members play an important role in shaping the attitude of the public towards voluntary compliance with the applicable laws.

Standard No. 1
A member must be ever mindful of the nature of the representation that may be needed to protect a taxpayer's interests. When appropriate, the member should recommend that the client consult with an attorney or another person admitted to practice before the Tax Court.

Standard No. 2
The responsibility of a member to review advice previously given and returns previously prepared and filed depends upon the nature of the contract between the member and the client. A member shall have a clear understanding with the client, whether responsibility ends with the preparation of a tax return or whether the member is expected to inform the client of later developments of law which may materially affect the tax return as prepared or the advice given.

Standard No. 3
In situations where the applicable law is unsettled or where the application of the law to the facts at hand is uncertain, the member has a duty to explain the probable effects of the various alternatives to the taxpayer who must make the final decision about the position to be taken.

Standard No. 4
A member must not permit the client to treat an item having a bearing on the liability in a manner for which there is no reasonable basis in law or fact. Should the client insist upon the item being stated on the return incorrectly, the member should withdraw and refuse to prepare the return.

Standard No. 5
If the client will not permit enough disclosures to calculate the proper tax due, then the member should withdraw from the assignment.

Standard No. 6
A member should resolve all doubts in favor of the client, providing there is a reasonable basis in law and fact for the position taken, and the client is advised of the alternatives and the probable effects thereof.

Standard No. 7
A member should avoid the appearance of an unduly close business relationship with representatives of the Internal Revenue Service.

Standard No. 8
A member has no obligation to communicate with the Internal Revenue Service with respect to a person who the member suspects has been grossly negligent or who may have committed fraud against the government.

Standard No. 9
Members have a responsibility to refrain from disclosing confidential information acquired during their work except when authorized or legally obligated to do so. A member has a responsibility to inform subordinates, as appropriate, regarding the confidentiality of information acquired while working and monitor their activities to assure the maintenance of that confidentiality. Members have a responsibility to refrain from using, or appearing to use, confidential information acquired while providing professional services for unethical or illegal advantage, either personally or through third parties.

Standard No. 10
A member has a responsibility to refrain from false or misleading advertising as to ambiguous claims in regard to years of experience, volume of returns done, education, certification, etc. that would lead to false impression.

Standard No. 11
A member has a responsibility to comply with tax laws and regulations, including, but not limited to, the timely filing, payment, and accurate preparation of all personal and business tax related documents and obligations relating to the member or his/her business. If a member pleads guilty or is convicted of any criminal offense under the revenue laws

of the United States or any state, or of any offense involving dishonesty, or breach of trust, or is disbarred from practicing before the Internal Revenue Service or in any state, the membership shall be subject to termination pursuant to the requirements of NATP's bylaws.[2]

REASONS FOR UNETHICAL BEHAVIOR

A number of factors can contribute to unethical behavior. These include, but are not limited to the following:

- Following the instructions of a client or employer
- Wanting to please a client for fear of losing the client's business
- Fear of someone discovering past errors corrected on future returns
- Knowing no one will ever find out what was done
- Thinking that it is okay because everyone else does it
- Perception of pressure from peers or co-workers, not acting like a team player

While these all may seem like valid reasons for a given course of action, they are just excuses and cannot justify unethical behavior.

INTERPRETING THE LAWS

One of the ethical issues that tax professionals constantly face emerges out of the many gray areas of tax law. In resolving a dispute, the IRS may assess a negligence penalty for the substantial underpayment of tax. However, the preparer often relies upon a court case or ruling when preparing the return. Unfortunately this ruling may not have been exactly on point. In these situations, the preparer can avoid the penalty for both his client and himself if he adequately discloses his position.

Preparers disclose such positions by attaching a Form 8275-R, *Regulation Disclosure Statement,* or 8275, *Disclosure Statement,* to the tax return in question. The preparer or taxpayer uses the 8275-R to disagree with a regulation, and the 8275 to disclose other questionable positions.

There are a number of arguments tax preparers can make to support their position. These include:

- Substantial authority standard,
- More likely than not standard, and
- Reasonable basis standard.

The fact that returns from prior years have been audited and the auditors did not change the item in question does not, standing alone, satisfy the substantial authority standard.

Note. The weight of various sources for substantial authority can be found in Chapter 13, Rulings and Cases, in this workbook.

2. The NATP Code of Ethics and Standards of Professional Conduct are reproduced with the permission of the National Association of Tax Professionals.

Substantial Authority Standard

Basing a tax position on substantial authority will avoid an accuracy penalty. If an item is supported by substantial authority, it is treated as though it was properly reported on the return. Any tax resulting from the item is not included in the understatement of tax penalty calculation.

This is an objective standard involving an analysis and application of the law to relevant facts. In order to determine if substantial authority exists, the preparer must balance the weight of the authorities favoring the position against the weight of the authorities supporting contrary positions. It is possible to have substantial authority for more than one position on a given issue. Although a preparer may believe that substantial authority exists, such a fact in itself will not determine this issue.

Indeed, the Tax Court has held that the advice of paid professionals alone does not constitute substantial authority. The weight of an authority depends on its relevance and persuasiveness, and the type of document providing the authority. Although a court case or revenue ruling may have some facts that match the issue in question, it does not constitute substantial authority if the ruling is not applicable to the case at hand. If an authority only reaches a conclusion, it is not as persuasive as one that relates the facts to the applicable tax law. If the authority has deleted information, such as a private letter ruling, it is given less weight because the deleted information might affect the conclusion. For this reason, a revenue ruling is given more weight that a letter ruling. Accordingly, an older ruling is given less weight than a more current one. If the document is more than 10 years old, it holds very little significance. However an older document is given weight based on its persuasiveness and relevance to the issue.

Absent any particular authority on an issue, a well-reasoned construction of the code and regulations may provide substantial authority on that issue. If the authority supporting the IRS position on an issue is more substantial than the authority supporting the taxpayer, the taxpayer does not have substantial authority.

To assist tax preparers in determining whether a position should be disclosed to avoid the substantial understatement penalty, the Secretary of the Treasury must publish a list of positions for which it believes there is no substantial authority and which also affect a significant number of taxpayers.[3] Unfortunately such a list has not been published to date.

Documents addressed directly to a taxpayer constitute substantial authority. These include:

1. Letter rulings,
2. Determination letters,
3. A technical advice memorandum in which the taxpayer is named, and
4. An affirmative statement in a revenue agent's report for the taxpayer's prior tax year. This rule does not apply if:
    - There is a material omission of fact, a misstatement of fact, or a change of facts on which the written determination was based; or
    - The written determination has been modified or revoked.

More Likely Than Not Standard

To meet this standard, the taxpayer must have a **greater-than-50%** chance of having her argument accepted. The tax preparer should have a list of all favorable rulings, as well as those that did not receive a favorable result.

3. IRC §6662(d)(2)(D)

Reasonable Basis Standard

Reasonable basis is achieved if the argument is **based on one of the authorities** that can be used under the substantial authority standard. This is true even if the position does not meet the substantial authority test. The reasonable basis standard is significantly higher than the "not frivolous" or "not patently improper" standard. However, the standard is not achieved if the issue is merely arguable.

Disclosure

The regulations have an exception for adequate disclosure which permits disclosure by attaching a Form 8275-R or 8275 to the tax return. The preparer or taxpayer uses the 8275-R to disagree with a regulation and the 8275 to disclose other questionable positions.

> **Example 1.** Mr. and Mrs. Louis rent their individually owned farmland to Family Farms Partnership, in which they are partners with their children. IRC §1402(a)(1) states:
>
> > *There shall be excluded rentals from real estate and from personal property leased with the real estate (including such rentals paid in crop shares) together with the deductions attributable thereto, unless such rentals are received in the course of a trade or business as a real estate dealer; except that the preceding provisions of this paragraph shall not apply to any income derived by the owner or tenant of land if (A) such income is derived under an arrangement, between the owner or tenant and another individual, which provides that such other individual shall produce agricultural or horticultural commodities (including livestock, bees, poultry, and fur-bearing animals and wildlife) on such land, and that there shall be material participation by the owner or tenant (as determined without regard to any activities of an agent of such owner or tenant) in the production or the management of the production of such agricultural or horticultural commodities, and (B) there is material participation by the owner or tenant (as determined without regard to any activities of an agent of such owner or tenant) with respect to any such agricultural or horticultural commodity.*

Although the Eighth Circuit Court of Appeals agreed with the taxpayers in the *Bot*, *Hennen,* and *McNamara* cases, the IRS issued an official nonacquiescence statement.[4] Therefore, in order to prevent penalties, the tax preparer has attached the following Form 8275-R to Louis's 2003 tax return.

4. AOD/CC-2003-03, October 20, 2003

For Example 1

Form **8275-R** (Rev. February 2002)
Department of the Treasury Internal Revenue Service

Regulation Disclosure Statement

Use this form only to disclose items or positions that are contrary to Treasury regulations. For other disclosures, use Form 8275, Disclosure Statement. See separate instructions.

► Attach to your tax return.

OMB No. 1545-0889
Attachment Sequence No. **92A**

Name(s) shown on return	Identifying number shown on return
Mr and Mrs Louis	111-22-3333

Part I **General Information** (See instructions.)

(a) Regulation Section	(b) Item or Group of Items	(c) Detailed Description of Items	(d) Form or Schedule	(e) Line No.	(f) Amount
1 1402(a)(1)	SE tax	Rent received from Family Farm Partnership	Sch E	3A	10,000
2					
3					

Part II **Detailed Explanation** (See instructions.)

1 Rent received from Family Farm Partnership is not included in self-employment income. This is based on the fact that the rental agreement between the landlord and tenant is an arm's-length agreement with a fair market rent being paid. There is no provision in the rental agreement that requires the landlord to participate in the operations of the tenant. In addition

2

3

Part III **Information About Pass-Through Entity.** To be completed by partners, shareholders, beneficiaries, or residual interest holders.

Complete this part only if you are making adequate disclosure for a pass-through item.

Note: *A pass-through entity is a partnership, S corporation, estate, trust, regulated investment company (RIC), real estate investment trust (REIT), or real estate mortgage investment conduit (REMIC).*

1 Name, address, and ZIP code of pass-through entity	**2** Identifying number of pass-through entity
	3 Tax year of pass-through entity / / to / /
	4 Internal Revenue Service Center where the pass-through entity filed its return

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 14594X Form **8275-R** (Rev. 2-2002)

For Example 1

Form 8275-R (Rev. 2-2002) Page **2**

Part IV **Explanations** *(continued from Parts I and/or II)*

Part II - 1 Continued:

one of the landlords, Mrs. Louis, does not participate in the tenants operation. Since IRC §1402(a)(1) requires that rents be "derived under" an arrangement that requires the landlord's material participation in the tenant's operation, it does not apply in this case.

The IRS considers disclosure adequate if the following conditions are met:

- The taxpayer has clearly furnished all information required by the applicable forms and instructions.
- The money amounts entered on the forms are verifiable.
- The items are listed separately rather than combined.
- The information on the return is disclosed in the manner previously shown.

ACCURACY-RELATED PENALTIES

On December 30, 2003, the IRS released Treasury Decision 9109. These provisions cover tax-avoidance transactions, information reporting penalties, and accuracy-related penalties, and they apply to returns filed after December 31, 2002, in connection with transactions entered into on or after January 1, 2003.

Regulations prohibit reliance on tax advice to establish a reasonable cause and good faith defense to accuracy-related penalties if a taxpayer fails to disclose a reportable transaction. Both the Treasury and the IRS believe that good faith requires that taxpayers be forthcoming and that a taxpayer construe the Temporary and Final Disclosure regulations to broadly favor disclosure. The final regulations provide that failure to disclose a transaction is a strong indication that the taxpayer failed to act in good faith, which would bar relief under IRC §6664(c).

The final regulations also adopt the requirement that a taxpayer may not rely on an opinion or advice that a regulation is invalid to establish that she acted with reasonable cause and in good faith, unless she **disclosed her position** that the regulation is invalid.

OFFICE OF PROFESSIONAL RESPONSIBILITY

Prior to 2002, the Director of Practice administered the tax preparer regulations contained in Circular 230.[5] In an attempt to increase compliance within the tax practitioner community, that department was reorganized into the Office of Professional Responsibility (OPR). The reorganization into the OPR has doubled the number of employees. One of OPR's first projects was to determine if practitioners entitled to represent taxpayers before the IRS were in compliance with their personal tax obligations.

In the year ending September 30, 2003, the OPR uncovered violations and took disciplinary action against 135 enrolled agents, CPAs, and attorneys. The principal violation in 58 of these cases was failure to meet personal tax obligations. In other words, the violators failed to either file their own returns or pay their tax liability. The increased activity in the OPR has many tax professionals concerned. Consequently, the OPR has released information regarding its activities.

5. 31CFR Part 10

COMPLAINT PROCESSING

The OPR has a process for considering Circular 230 violations, which includes tax compliance as defined in Subpart D. Once OPR receives information of a possible violation, it investigates to find the relevant facts. In some cases, there is sufficient information to allow OPR to dismiss the matter without action. If no such information is available, OPR will write the tax practitioner to outline the allegations that have been made and request a response. This can result in one of three possible actions:

1. The practitioner's explanation provides OPR with enough information to dismiss the complaint.
2. The practitioner may acknowledge the violation occurred.
3. The practitioner raises material facts that must be investigated before OPR can make a conclusion.

When OPR finally concludes that a violation occurred, it attempts to reach an agreement with the practitioner on the appropriate sanction. If there is no agreement, the case may go to litigation. Litigation occurs before an independent administrative law judge, where the process has many of the elements of a civil trial. If either the OPR or the practitioner disagrees with the administrative law judge's decision, they can appeal to the Department of Treasury and then to federal district court.

TYPES OF SANCTIONS

Circular 230 provides numerous sanctions:

- A reprimand, which is not "public record"
- Censure, which is "public record" although it does not prevent future representation of taxpayers before the IRS
- Suspension or disbarment, in the most serious cases

The type of sanction imposed by the OPR is based upon the facts of the case. The OPR considers such factors as the following:

- **The nature of the noncompliance issue.** The OPR looks for failure to file, late filing, late payment, and underreporting. It also scrutinizes late Form 941 and estimated payments.
- **Pattern of noncompliance.** Typically the OPR looks at the most recent five-year period. It is concerned with a pattern of noncompliance, but a single serious problem may be the basis for a sanction.
- **Significance of the noncompliance.** A penalty of less than $50 for late payment is generally not significant. A late return with substantial payment due is more significant than a late return with a refund due. OPR will also consider the amount of time for the late filing or payment.
- **Evidence of attempts to correct the problem.** For example, a pattern of two years of late returns followed by three years of timely filed return may indicate a change in behavior. An installment agreement that is kept current may also provide evidence of attempts to correct.
- **Evidence of aggravating or mitigating factors.** Failure to cooperate to resolve a tax compliance problem, such as ignoring IRS correspondence or a return that must be secured by a revenue officer, is considered an aggravating factor. Personal circumstances that demonstrate that the noncompliance was an unusual event in an otherwise compliant tax record are an example of a mitigating factor. This includes family emergencies that temporarily distract attention from business or personal tax matters.

COMPLIANCE CASE EXAMPLES

The following are actual examples of rulings of the OPR. These have been released for the following purposes:

- Illustrate the types of misconduct that may result in disciplinary action
- Remind practitioners of their responsibility to comply with Circular 230 and the consequences that can result from noncompliance
- Remind IRS personnel of their duty to make referrals to the OPR of suspected violations
- Provide transparency and public accountability as to the manner in which OPR carries out its mission; OPR's mission is to foster excellence in tax professional services to taxpayers by setting, communicating, and enforcing standards of competence, integrity, and conduct

The Director stated he will not consider these cases as precedents in future disciplinary actions and that each future case will be resolved on the basis of its unique facts and circumstances.

Failure to File Payroll Tax Forms or Remit Employee Trust Funds

In one case, a tax practitioner was charged with multiple instances of failure to file Form 941 as well as multiple failures to make timely payments of payroll trust funds. As a defense, the practitioner asserted economic hardship. The practitioner refused to consent to suspension, causing the Director to schedule a hearing before the administrative law judge. Prior to this hearing, the practitioner consented to a three-year suspension.

Failure to File Individual Income Tax Returns

In this case, the practitioner failed to file individual income tax returns for four years, failed to pay his taxes one year, and was assessed a penalty for failing to adhere to an installment agreement. He also owed a civil penalty that was assessed.

When the practitioner was notified of the allegations, his attorney indicated the practitioner had filed all tax returns and paid all outstanding balances. He also stated the practitioner was not aware of the civil penalty but would pay it.

Negotiations resulted in the practitioner's consenting to an indefinite suspension with the right to petition for reinstatement after 12 months. The petition was granted provided that the practitioner:

- File all federal tax returns in a timely manner,
- Pay all outstanding federal tax balances (or enter an installment agreement to do so),
- Remain in good standing with state licensing authorities,
- Remain free from further allegations of misconduct, and
- Otherwise comply with Circular 230 regulations.

Preparation of False Returns

This case was the result of a misconduct referral to the Director. The referral came from a mortgage company and alleged that the practitioner prepared false returns that the company had relied on when granting loans. A real estate broker engaged the practitioner to prepare returns for his clients, who then submitted the completed tax returns to the mortgage company with a loan application. The returns substantially overstated the taxpayer's income. Based on the tax information, the lender approved a number of loans on which the borrower defaulted. This resulted in the mortgage company sending the Director a letter alleging disreputable conduct.

Initially, the practitioner declined to consent to suspension. An administrative complaint alleged that the practitioner knew or should have known that the returns prepared were incorrect, since they reflected significantly more self-employment or business income than the returns the borrowers previously filed with the IRS. After receiving the complaint, the practitioner offered to consent to an indefinite suspension.

One OPR investigation found that the practitioner had underreported corporate income by over $50,000 in one year and claimed more than $45,000 in unsubstantiated expenses over the next two years. In this case, the tax practitioner agreed to a three-year suspension.

According to CI, the behavior of criminal paid preparers varies. Some preparers were found to have created false forms such as W-2s and filed returns on behalf of deceased taxpayers. Others bought social security numbers and names of dependents from taxpayers with multiple children in order to allow other clients to claim dependent-related tax credits.

The CI cites one preparer who regularly advised clients to fraudulently claim tax credits for dependents and child care, although the client had no children. The action of this preparer resulted in a loss to the Treasury of between $1.5 and $2.5 million between 1997 and mid-2000.

Conviction of Federal Tax Offense

When the tax practitioner filed his Form 8554, *Application for Renewal of Enrollment to Practice before the Internal Revenue Service*, he disclosed he was convicted of a federal felony. He attached a letter from his attorney and a copy of the U.S. Attorney's statement of charges. The practitioner had been charged with falsely claiming head of household filing status, exemptions for children, and the earned income credit on Form 1040A for several clients. Based on this information, the Director sent the practitioner a complaint. The nature of the complaint allowed the IRS grounds for an expedited suspension from practice under §10.82 of Circular 230.

The practitioner responded with a letter stating he worked outside the tax preparation business operated by his spouse. He stated he had not prepared the returns in question, but permitted his spouse to sign his name as the preparer. He further stated he had not been able to stop the spouse's preparation of false returns and that he had tried to keep the family together despite the spouse's misconduct. In mitigation of a possible suspension he said he had incurred substantial fines and legal fees.

The practitioner supplied information showing the U.S. District Court had convicted him of multiple counts of willfully aiding in the preparation of fraudulent returns. He had been sentenced to three years of probation for each count and ordered to make restitution of lost taxes.

The practitioner consented to an indefinite suspension with the right to petition for reinstatement after 24 months. The Director accepted the offer with the understanding that the petition would be granted, provided the practitioner was not subject to further allegations of misconduct.

Duty to Return Client Records

The Director received this case in a misconduct referral from a taxpayer. The taxpayer claimed the practitioner refused to return the taxpayer's records, which were needed to prepare the taxpayer's federal individual tax returns for several years. An employee of the OPR telephoned the practitioner to disclose the allegation, and the practitioner agreed to return the records.

Three weeks later, the taxpayer telephoned the Director, stating the practitioner had again refused to return records. The Director then sent the practitioner an allegation letter suggesting a possible violation of §10.28(a) of Circular 230. Section 10.28(a) requires a practitioner to return records necessary to file federal tax returns upon the taxpayer's request. After the Director failed to receive a response from the practitioner, he sent a reminder letter. Shortly thereafter, the taxpayer notified the Director that the records had been returned.

The Director's opinion is that the practitioner was aware, or should have been aware, of the duty of returning records in accordance with §10.28(a). Since the practitioner ultimately complied, the Director decided against initiating a suspension, censure, or disbarment. Instead, the Director issued a letter of reprimand. The reprimand does not affect the practitioner's eligibility to practice before the IRS.

OTHER RECENT CASES

In January 2004, an administrative law judge issued a decision that disbarred a CPA, who was a former IRS CI agent from practice before the IRS. The complaint alleged that the CPA was misrepresenting the law to taxpayers, and that he failed to file his own tax returns for four years.

The erroneous advice he provided included telling clients that they were not required to file returns because the Sixteenth Amendment to the Constitution was not properly ratified. He also advised clients that they did not need to file returns because IRC §§861 through 865 define "other income" in a manner which excluded their earnings.

The judge said the significant problem with the CPA's advice was that it was absolutely wrong. The judge noted that the CPA's assertions have been addressed by many courts and that they are no longer afforded the dignity of repeated explanations as to why the claims have no merit.[6]

In an unrelated case on December 31, 2003, the Department of Justice announced that a preliminary injunction had barred a lawyer and a CPA, and the organizations with which they were affiliated, from representing clients before the IRS, preparing federal tax returns, and otherwise obstructing IRS tax administration through frivolous and harassing tactics.[7]

Yet another practitioner was disbarred from practice for giving false or misleading information to the IRS. The practitioner signed as a licensed power of attorney after his license had not been renewed, thereby making the practitioner ineligible to practice before the IRS.

REDUCING THE RISK OF A SANCTION

A tax practitioner can reduce the risk of a sanction by following these steps:

- Resolve any noncompliance problems as soon as possible.
- File all delinquent returns, pay all taxes, penalties, and interest, and take steps to prevent future noncompliance.
- If full payment of tax liabilities is not possible, obtain an installment agreement and make all payments when due.
- If penalties are assessed, seek abatement if possible.
- Cooperate with the OPR to resolve any problems by contacting the OPR at opr@irs.gov.

CIRCULAR 230 ISSUES

Tax professionals are often concerned about inadvertently running afoul of Circular 230 regulations. The following situations are covered by the regulations, but the IRS and a tax practitioner may interpret them differently.

§10.20. INFORMATION TO BE FURNISHED

A practitioner must, on a proper and lawful request, promptly submit records or information to the IRS unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged. If the practitioner does not possess the information, he must notify the requesting IRS employee of the identity of a person who has that information.

6. The decision is available at http://www.irs.gov/pub/irs-utl/banister.pdf.

7. The DOJ news release can be found at http://www.usdoj.gov/tax/03_730.htm.

Example 2. Thomas Timid is representing his clients Harry and Henrietta Hardnose in an audit. The Hardnoses are very busy and resent the IRS questioning their tax return. Consequently, they have not cooperated in expediting the audit process. At one audit interview, the Revenue Agent requests documents that she wishes to inspect. She lists them on a three page form and presents the list to Timid. Since Timid does not possess these records, he forwards the request to Mr. Hardnose. Timid assumes that Mr. Hardnose has fulfilled the request when he does not hear from him. A few weeks later, Timid receives a second request stating that the information has not been received. Since a copy of that letter was also sent to Mr. Hardnose, Timid does not reply to the revenue agent.

Since Timid did not respond directly to the revenue agent regarding either the initial request or the follow-up letter, he is technically in violation of §10.20.

§10.21. KNOWLEDGE OF CLIENT'S OMISSION

A practitioner who knows that the client has not complied with the tax laws, or has made an error or omission from the return, must advise the client of the noncompliance, error, or omission.

Example 3. Sally Observant, a tax practitioner, notices a new painting when she visits her hairdresser. She comments that the painting looks like something her artist client would paint. The hair stylist acknowledges that the client was the artist and that they traded a year's visits to the shop for the painting. When Sally prepares the artist's return she does not see any income reported for the painting, but does not say anything to the client.

While Sally is not required to audit her clients, §10.21 does require that she discuss the omission with the client.

§10.29. CONFLICTING INTERESTS

This regulation is very clear. A practitioner shall not represent a client in practice before the IRS if the representation involves a conflict of interest. A conflict exists if:

- The representation of one client will be directly adverse to another client, or
- There is significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibility to another client, a former client, or a third person or by a personal interest of the practitioner.

This does not preclude the practitioner from representing the client if:

- The practitioner reasonably believes she will be able to provide competent and diligent representation to each affected client,
- The representation is not prohibited by law, and
- Each affected client gives **informed consent, confirmed in writing**.

The practitioner must retain copies of the written consents for at least 36 months after last representing the affected clients, and these consents must be provided to any officer or employee of the IRS on request.

Some conflicts of interest are easily recognized, while others are more difficult to spot.

Example 4. Carl and Ruth have been Sally's clients for 15 years. One day Ruth tells Sally that she is filing for divorce. Carl has been having an affair with his secretary for a number of years, who is now pregnant. The divorce is messy but is finalized in 2003. Both Carl and Ruth ask Sally to help file their 2004 federal income tax returns.

Question 4A. Is there a conflict of interest if Sally prepares the returns of both Carl and Ruth?

Answer 4A. Yes. Tax issues such as claiming dependent children, alimony, education credits, earned income credit, etc. create the conflict of interest.

Question 4B. Can Sally prepare both returns if she believes she can provide competent advice to both parties?

Answer 4B. Yes. She must obtain a written consent from both Carl and Ruth and keep it on file for 36 months after the completion of the returns.

Example 5. Heather provides tax and accounting services to ABC Trucking, Inc., and their three shareholders. Heather discovers that one of the shareholders has not been disclosing all of her income from the corporation on her Form 1040. This could ultimately lead to the IRS examining the tax return of the corporation.

Question 5A. Is there a conflict of interest if Heather continues providing services to the dishonest shareholder?

Answer 5A. Yes. She has a duty to disclose to the corporation that they may be liable for audit because of the dishonest shareholder's actions

Question 5B. How can Heather solve her problem without disclosing information to the corporation and other shareholders?

Answer 5B. Heather should decline her engagement with the dishonest shareholder.

Example 6. Randall represents Eric and Odelia and prepares their 2001 joint tax return. The return is selected for audit in 2004. During the audit, the revenue agent uncovers substantial unreported income arising from Eric's business. Eric and Odelia were divorced in 2003.

Question 6A. Should Randall continue to represent both Eric and Odelia in the audit?

Answer 6A. No. There is a conflict of interest if Odelia chooses to claim innocent spouse treatment on the unreported income.

Question 6B. What should Randall do in this situation?

Answer 6B. He should decide which client he wishes to represent and advise the other party to secure representation from another practitioner.

§10.30. SOLICITATION

A practitioner may publish the availability of a written schedule of fees and disseminate this information. The practitioner may charge no more than the rate(s) published for at least 30 calendar days after the last date on which the schedule of fees was published.

Example 7. Choi Tax Service includes a copy of their fees schedule with the tax organizers they mail their clients on January 25, 2004. When they process their first tax returns on January 31, 2004, they find their tax software company has increased its per-return charge.

Question 7A. Can the tax service increase its fees to cover their added cost?

Answer 7A. Yes. They must wait until February 24 before charging the new fees.

Telemarketing

Under the old regulations of §10.30(a)(2), practitioners could not solicit prospective clients using telemarketing. Section 10.30 (a)(2) stated;

No attorney, certified public accountant, enrolled agent, enrolled actuary, or other individual eligible to practice before the Internal Revenue Service shall make, directly or indirectly, an uninvited solicitation of employment in matters related to the Internal Revenue Service. Solicitation includes, but is not limited to, in-person contacts and telephone communications.

Under the new regulations, Section 10.30(a)(2) now reads:

A practitioner may not make, directly or indirectly, an uninvited written or oral solicitation of employment related to the Internal Revenue Service if the solicitation violates Federal or State law or other applicable rule, e.g., attorneys are precluded from making a solicitation that is prohibited by conduct rules applicable to all attorneys in their State(s) of licensure.

Do Not Call List

Many tax preparers call their clients each year to schedule tax appointments. They also make calls to determine why a client has dropped their services. With the advent of the National Do Not Call Registry these preparers are not sure when or if they are allowed to make telephone contact without violating federal law.

Both the Federal Trade Commission (FTC) and the Federal Communications Commission (FCC) regulate telemarketing practices. The following information deals with the Telemarketing Sales Rules (TSR) which are enforced by the FTC. The FCC regulations can be reviewed at the FCC website.[8] Some states also have similar laws.

What Calls Are Covered? The Do Not Call provisions of the TSR cover any plan, program, or campaign to sell goods or services through interstate phone calls. This includes calls by telemarketers who solicit consumers, often on behalf of third party sellers. It also includes sellers who are paid to provide, offer to provide, or arrange to provide goods or services to consumers.

What Calls Are Not Covered by the National Do Not Call Registry? Being listed on the registry does not prohibit calls from political organizations, charities, telephone surveyors, or companies **with which a consumer has an existing business relationship.**

Existing Business Relationships. If a client is listed on the registry, a company with which that client has an established business relationship may call for up to 18 months after the client's last purchase, last delivery, or last payment. However, if the client asks the company not to call again, the company must honor the request not to call. **If the company calls again, it may be subject to a fine of up to $11,000.**

If the client makes an inquiry or submits an application to the company, the company can call for three months. Again, the client can request that future calls not be made.

A client whose number is not on the national registry can still prohibit individual telemarketers from calling by asking to be put on the company's own do not call list.

Additional Information. Information on how to access the national Do Not Call registry, how to be listed on the registry, and other compliance issues can be found by visiting the registry website at http://www.ftc.gov/bcp/conline/pubs/alerts/dncbizalrt.htm.

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8. http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-03-153A1.pdf

§10.31. NEGOTIATION OF TAXPAYER CHECKS

A practitioner who prepares tax returns may not endorse or otherwise negotiate any check issued to a client by the government in respect of a federal tax liability.

Example 8. Juan has a tax preparation service. He files tax returns for a number of migrant workers. Since these workers do not have a permanent address, some ask that their refund checks be sent to Juan's office. Periodically the clients check in to see if they have any mail. Juan's friend, Garcia, hired Juan to file his return and when Garcia came to pick up his mail, he asks Juan to cash his $54.00 refund check.

Question 8A. Can Juan cash the refund check?

Answer 8A. No.

Question 8B. What should Juan do?

Answer 8B. He should suggest that Garcia go to a local bank with the proper identification to cash the check.

§10.34. STANDARDS FOR ADVICE ABOUT TAX RETURN POSITIONS AND FOR PREPARING OR SIGNING RETURNS

A practitioner may not sign a tax return as a preparer if he determines that the tax return contains a position that does not have a realistic possibility (the realistic possibility standard) of being sustained on its merits unless the position is not frivolous and is adequately disclosed to the IRS.

The practitioner may not advise the client on such a position unless:

- The practitioner determines that the position satisfies the realistic possibility standard, or
- The position is not frivolous and the practitioner advises the client of any opportunity to avoid the accuracy-related penalty in IRC §6662 by adequately disclosing the position and requirements for adequate disclosure.

Realistic Possibility

A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well informed analysis of the tax law and the facts by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a **one in three, or greater, likelihood of being sustained on its merits**. The possibility that the tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled may not be taken into account.

Example 9. Leonardo files a tax return for Farmer Jim. He treats an exchange of a group of steers for a group of breeding cows. He plans to cite *Wylie v. United States*, 435 U.S. 944 (1978), as his authority in the event of an audit. This case predates the regulations that state animals must be of the same sex to qualify for like-kind treatment. Therefore, this is not substantial authority, and Leonardo has gone against the regulations.

Frivolous

A position is frivolous if it is patently improper. The IRS has a publication availably on its web site entitled *The Truth About Frivolous Tax Arguments.* Some of the listed frivolous arguments include:

- The filing of a tax return is voluntary.
- Wages, tips, and other compensation received for personal services are not income.
- Only foreign source income is taxable.
- Federal Reserve Notes are not taxable.
- The Sixteenth Amendment to the United States Constitution was not properly ratified, thus federal income tax laws are unconstitutional. African Americans can claim a special tax credit as reparations for slavery and other oppressive treatment.
- Taxpayers are entitled to a refund of social security taxes paid over their lifetime.

AICPA Position

The American Institute of Certified Public Accountants recommends its members use a five-step approach when providing tax advice. These five steps are as follows:

1. Make a "due diligence" review of all pertinent facts.
2. Consider the reasonableness of assumptions and representations.
3. Compare the relevant facts with pertinent tax law.
4. Compare the economic substance and the business purpose of the transaction to its tax consequences.
5. Base a conclusion on the previous four factors.

CONTINUED ENFORCEMENT

FRIVOLOUS RETURNS

A large number of taxpayers now challenge the validity of the tax system and the need to file tax returns. Other taxpayers file for refunds based on positions that courts have long since found invalid. These arguments fall into six broad categories, each of which has several contentions:

1. The voluntary nature of the federal income tax system
   a. The filing of a tax return is voluntary.
   b. Payment of tax is voluntary.
   c. The IRS must prepare federal tax returns for a person who fails to file.
2. The meaning of income, including taxable income and gross income
   a. Wages, tips, and other compensation received for personal services are not income.
   b. Only foreign-source income is taxable.
   c. Federal Reserve Notes are not taxable.
3. The meaning of certain terms used in the IRC
   a. Taxpayer is not a citizen of the United States, thus is not subject to the federal income tax laws.
   b. The United States consists only of the District of Columbia, federal territories, and federal enclaves.

c. Taxpayer is not a "person" as defined by the IRC, thus is not subject to the federal income tax laws.

d. The only "employees" subject to federal income tax are employees of the federal government.

4. Constitutional amendment claims

a. Taxpayers can refuse to pay income taxes on religious grounds by invoking the First Amendment.

b. Federal income tax laws constitute "taking" of property without due process of law, violating the Fifth Amendment.

c. Taxpayers do not have to file returns or provide financial information because of the protection against self-incrimination found in the Fifth Amendment.

d. Compelled compliance with the federal income tax laws is a form of servitude in violation of the Thirteenth Amendment.

e. The Sixteenth Amendment to the U.S. Constitution was not properly ratified, thus federal income tax laws are unconstitutional.

f. The Sixteenth Amendment to the U.S. Constitution does not authorize a direct nonapportioned federal income tax on U.S. citizens.

5. Fictional legal bases

a. The IRS is not an agency of the United States.

b. Taxpayers are not required to file a federal income tax return because the instructions and regulations associated with the Form 1040 do not display an OMB control number.

c. African Americans can claim a special tax credit as reparations for slavery and other oppressive treatments.

d. Taxpayers are entitled to a refund of the social security taxes paid over their lifetime.

6. "Untaxing" packages or "untaxing" trusts

a. An "untaxing" package or trust provides a way to legally and permanently avoid the obligation to file federal income tax returns and pay federal income taxes.

All of these arguments are subject to the IRS penalty assessed for filing a frivolous return. Details of these arguments can be found by visiting the IRS website.[9]

TAX SHELTER

The proposed regulations maintain the definition of a tax shelter as it appears in IRC §6662. The term *tax shelter* means a partnership or any other entity, or any investment plan or arrangement, or any other plan or arrangement with a significant purpose to avoid or evade federal income tax.

STANDARDS FOR CERTAIN TAX SHELTER OPINIONS

Section 10.35 describes requirements for practitioners providing **more likely than not** and **marketed** tax shelter opinions. A more likely than not tax shelter opinion is one that at least more likely than not resolves one or more material federal tax issue(s). If a practitioner knows, or has reason to know, that a tax shelter opinion or a more likely than not tax shelter opinion will be used or referred to by someone other than the practitioner in promoting, marketing, or recommending a tax shelter to one or more taxpayers, it is a marketed tax shelter opinion.

9. http://www.irs.gov/pub/irs-utl/friv_tax.pdf

Section 10.35 has been modified by excluding preliminary advice provided for an engagement in which the practitioner is expected to subsequently provide an opinion satisfying the §10.35 requirements from the definition of a tax shelter opinion. A practitioner may provide an opinion that is limited to some, but not all, material federal tax issues that may be relevant to the treatment of a tax shelter if the taxpayer and the practitioner agree to limit the scope of the opinion. Such a limited scope opinion cannot be a marketed tax shelter opinion, and all limited scope opinions must contain the appropriate disclosures.

Section 10.36 provides that tax advisors with responsibility for overseeing a firm's practice before the IRS take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices.

MODIFICATION OF REGULATIONS

The IRS continues to investigate ways to encourage tax professionals to act in an ethical manner. On December 30, 2003, they proposed modification of the regulations that govern the performance of tax professionals who practice before the IRS. The modifications present best practices for practitioners who provide advice to taxpayers relating to federal tax issues and submissions to the IRS. They also modify the standards for certain tax shelter opinions. The new proposed amendments would withdraw previously proposed amendments to sections 10.33, 10.35, and 10.36 that were published in 2001. Section 10.33 deals with tax shelter opinions used by third parties to market tax shelters. Section 10.35 deals with more likely than not tax shelter opinions. Section 10.36 covers procedures to ensure compliance.

In the proposed regulations, the IRS acknowledges that tax advisors play an increasingly important role in the federal tax system, which is founded on the principles of voluntary compliance. For best results, the public must have confidence in the honesty and integrity of the individuals providing the advice. The proposed regulations are the IRS's attempt to restore, promote, and maintain the public's confidence in those individuals and firms.

BEST PRACTICES

The new proposed regulations differ from the 2001 proposed regulations in a number of ways.

Section 10.33 advises tax professionals to adhere to best practices when preparing returns for the submission to the IRS or advising their clients. These best practices include the following:

- Communicating clearly with the client regarding the terms of the engagement and the form and scope of the advice or assistance rendered
- Establishing the relevant facts, including evaluating reasonableness of any assumptions or representations
- Relating applicable law, including potentially applicable judicial doctrines, to the relevant facts
- Arriving at a conclusion supported by the law and the facts
- Advising the client regarding the importance of the conclusions reached
- Acting fairly and with integrity in practice before the IRS

OTHER SOURCES OF INFORMATION

Tax Talk Today aired a broadcast regarding Circular 230 in September 2003. This broadcast can be seen by visiting the *Tax Talk Today* website.[10] The show is listed as a part of their archived broadcasts. The following is a transcript of questions and answers that were asked during the broadcast.[11]

TAX TALK TODAY — Q & A SEPTEMBER 2003

Question 1: *The gaming industry signs contracts or compacts with the IRS in which the IRS states that if dealers report income at least at a certain level, they will not be audited. When such a dealer comes into the office and displays a lifestyle in excess of the stated W2 income, but is emphatic that she will not report any additional tips received, how is the practitioner to respond, especially in view of the signed contract with the IRS?*

Answer 1: *Circular 230, Section 10.34, sets standards for tax return preparation. The question indicates that the client acknowledges and refuses to report income. The practitioner cannot participate in any way in providing false information to the IRS. If the practitioner has reason to believe that the client is misstating material information, confront the client — inform them of the consequences. If there still is a serious doubt as to material facts, get a new client. As was noted during the broadcast, a tax professional needs to learn how and when to fire a client.*

Question 2: *I completed a Certified Practitioner of Taxation (CPTx) program many years ago. This program required passing an extensive exam, I think six hours, that covered all aspects of taxation (income, estate, pension, property, etc.). The exam appeared to be the equivalent of an EA exam and maintenance of the certification requires 24 hours of CPE each year. Has IRS given any recognition to this certification? Does IRS even know this certification exists? If so, are there any considerations that IRS will be giving to holders of this certification in the future, such as Power of Attorney, client representation, etc.?*

Answer 2: *The IRS has not given recognition to professional certifications other than those of attorneys, certified public accountants and enrolled agents. We have no plans to do so in the future.*

Question 3: *EAs have to take 24 hours of CPE per year. Most EAs I know take 50–100 hrs. In certain states, CPAs do not have to take any CPE in taxes (although they may; NC is one example), and the same applies for attorneys. As a result there are many federally authorized tax practitioners who are not up to date in the law. Does the OPR intend to do anything about it?*

Answer 3: *Attorneys and Certified Public Accountants are authorized to practice before the IRS because they have been licensed by their state. The IRS does not have the legal authority to set continuing professional education requirements for attorneys and CPAs.*

Question 4: *EAs are required to obtain a certain number of hours per year in tax-related fields. Attorneys and CPAs are not required to maintain continuing education credits by attending tax-related courses.*

If a CPA or attorney is to practice before the IRS, why don't they have to maintain educational standards? Can a taxpayer check on an EA, CPA or attorney through the office of professional responsibility to see if they are maintaining their tax skills?

Answer 4: *See answer above regarding our lack of authority to set continuing professional education requirements for attorneys and CPAs. We do not maintain a list that would permit a taxpayer to check on whether an attorney, CPA or enrolled agent is maintaining his/her tax skills.*

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10. http://www.taxtalktoday.tv/

11. *Tax Talk Today,* September 9, 2003, used with permission

***Question 5:** Doesn't it defeat the purpose of professionally enrolled practitioners to permit limited representation by unenrolled practitioners who in practice get to do everything but appeals and sign closing agreements for clients?*

Along a similar vein, the centralization of the practitioner support function (and specifically the closing of the Fresno service center group) seems to have made resolution of simple issues more difficult, increased referrals (with attendant waiting periods) to local groups, and caused greater reliance on 911 forms and the Taxpayer Advocate's office. Is there any prospect of getting more efficient access?

***Answer 5:** The Office of Professional Responsibility has reminded IRS personnel of the distinction between the authority granted to unenrolled practitioners and the authority granted to enrolled agents, attorneys and CPAs. We have encouraged IRS personnel to understand these distinctions, and not permit unenrolled practitioners to exceed their authority.*

We will pass your concerns about centralization of practitioner support to the officials responsible for this function.

CONCLUSION

At the beginning of the chapter, readers were asked to answer 20 questions. Hopefully the answers given match the author's answers, as follow.

1. While preparing Sam's return, Amy sees that Sam sold a truck to Jeff for $25,000. Amy remembers preparing Jeff's return and reporting a purchase price of $35,000. What should Amy do?

Amy should tell Sam that she has information that differs from what he submitted. Once Amy determines which price is correct, she should notify the other client. If the client presenting the incorrect amount refuses to correct the amount, Amy should decline the engagement.

2. Accurate Tax and Accounting has many employees. Employee Jill prepares a partnership return for Alice and Tim's Fish Emporium. Employee Bill prepares Alice's individual return from the information Alice provided. Does Bill have a responsibility to make sure Alice gave him a copy of the K-1?

When a firm deals with multiple returns for a client and its employees or shareholders, someone in the firm should cross-match all applicable information.

3. In reviewing Linda's 2002 tax return, Tax Preparer Jessy sees that he inadvertently reported $800 of supplies as $8,000. Linda refuses to file an amended tax return. What should Jessy do?

Jessy is required only to point out the error to Linda and tell her an amended return should be filed. However, Jessy is not required to force the taxpayer to comply. If Jessy prepares the amended return and gives it to Linda, it is up to Linda to file the return and pay the tax due.

4. Armando prepares Mr. and Mrs. Smith's 2003 joint income tax return. The Smiths divorce in 2004 and both come to Armando for preparation services. Can Armando provide services to both individuals?

Armando can only represent both taxpayers if they sign a written consent and Armando keeps the consent on file for three years. This is a "no win" situation for Armando. If there is disagreement between the Smith's regarding who claims the children for EITC, child credit, and dependency exemptions, only one taxpayer can win. The other may blame Armando for the loss.

5. Terrell has a small machine shop and reports tool depreciation on his 2003 tax return. When he comes back in 2004, he tells his preparer, Louis, that he is now divorced and no longer has Schedule C income or expenses. Louis questions his lack of Schedule C income and Terrell says he is not going to file a Schedule C since he sold the equipment. Terrell also refuses to report the proceeds from the tool sale. What should Louis do?

Louis should refuse to prepare the tax return.

6. Samantha, a tax professional, finds Marcie's parent's income is too large to claim the education credit. She notices Marcie took the credit. Marcie otherwise qualifies, but her parents paid her fees. What should Samantha do?

Samantha should refuse to claim the credit on the student's return only if the parents insist on claiming Marcie as a dependent.

7. The Costellos, a "blended family," come to Mario's office. Each is single or separated and each claims Head of household filing status. Each taxpayer also claims a different child for the HOH status. All Costellos use the same address. What should Mario do?

Mario should refuse to prepare the returns.

8. Sasha is claiming EITC based on self-employment records. She tells Max, her tax preparer, that she has $10,000 of income with no expenses. What should Max do?

Max should question the client as to any expense. He should also understand the nature of the business and ask if another taxpayer in the same business would have business expenses. Since Max is not required to audit the client, he can claim the credit, but should tell Sasha she might receive a letter from the IRS questioning the lack of deductions.

9. Upon having his return prepared, Brian finds out that he owes more tax than expected. He tells his accountant, Betsy, that he was mistaken and actually has $150,000 less Schedule C income than he showed on the records he gave Betsy. What should Betsy do?

Betsy should refuse to prepare the return unless she is sure it was just an error on the part of the client.

10. Same situation as in question #9 except, Betsy suggests the ending inventory should be $150,000 less. What is Betsy's liability?

Betsy is subject to an aiding and abetting penalty of $1,000.

11. Same situation as in question #9 except, Brian screams that the return is wrong and asks for his information back so he can go to another preparer. Betsy has spent three hours setting up the depreciation schedule. Brian refuses to pay any fee. What should Betsy do?

Betsy is required to furnish all original information to Brian, even in a fee dispute. The depreciation schedule is a part of the original documents. However, since this schedule was never used to prepare a return, Betsy needs to return only the schedule Brian presented. Betsy should not be tempted to call the IRS and notify them of the possible tax fraud. Doing so might be considered divulging confidential client information.

12. Harvey leaves his firm, Honest Accountants, and establishes a practice next door. His former clients request their files from Honest Accountants, even though they were given copies of their return when they were originally prepared. What information is Honest Accountants required to give the clients?

If Honest Accountants has previously supplied the client with a copy of the return and all documents necessary to prepare the next year's federal tax return, it is not required to furnish additional information to the client.

13. When Greg is questioned about the number of miles he drove for business, he asks his preparer, Ada how many he claimed last year. What should Ada say?

Ada can tell the client the number of miles claimed on the prior year's return. However, Ada should remind the taxpayer that the mileage deduction is only available if he has a record of the actual miles driven.

14. When questioned about the number of miles he drove for business, Abdul asks his preparer, Marcus, how many miles sound reasonable. What should Marcus say?

See the answer to question 13. In this case Marcus could also be subject to the aiding and abetting penalty.

15. Harriet receives cash rent for her farmland from a family partnership in which she is active. The Eighth Circuit U.S. Court of Appeals has ruled this is not SE income. The IRS has issued an official non-acquiescence for all other circuits. Harriet refuses to pay SE tax on the rent. What should the preparer do?

The preparer should complete Form 8275-R to notify the IRS that a position taken on the tax return differs from the IRS ruling.

16. Janice, when preparing the tax return of her managing partner's close friend, Michael, is asked by Michael to take a position that the tax courts ruled against. Michael says he is willing to gamble. The managing partner tells Janice to go ahead and do as the Michael asks. What should Janice do?

Janice should decline to prepare the tax return.

17. Lizzy, a 24-year-old taxpayer, tells her accountant, Peter, that she has nine children to claim as dependents. She said she did not bring their social security numbers but would fill them in when she got back home. She did not want to electronically file the return. What should Peter do?

Peter should refuse to release the return until the client furnishes the social security numbers. Peter is required neither to verify that the numbers are correct nor see the social security cards.

18. Bea, a new client, comes into the office on January 15 and must have her tax return completed immediately in order to get a car loan. She does not have her W-2 form, but has written down the amounts she said were on the last pay stub. What should the preparer do?

The tax practitioner should refuse to complete the return or if he does complete the return, mark it for discussion purposes only.

19. When completing the tax return at the last minute, Helmut discovers that his client, Lee, has a net operating loss. Lee is not available to ask whether he wants to elect out of carrying the loss back. What should Helmut do?

This is a decision that Lee should make after Helmut explains the consequences. If the practitioner makes the decision without the approval of the client, he could be subject to litigation if Lee later decides Helmut made an improper irrevocable election. The tax preparer should consider extending the return and having the client pay any tax due.

20. Inga is behind on completing returns. She asks a junior partner to complete a return. Sam, the client comes to pick up the return before Inga has time to review it. Sam must have the return immediately as he is leaving town. Sam expects to see Inga's signature on the return. What should Inga do?

If Inga signs the return, she is acknowledging that she takes full responsibility for its accuracy. Therefore, Inga should try to review the return. She might give the return to the client, but ask them to hold it until she has had time to do the review. The tax preparer could also file an extension for the return.

RELATED ISSUES

Avoiding Malpractice Lawsuits[12]

Tax professionals are increasingly being sued by their clients. The reasons vary. Tax laws continue to become more complex, resulting in incorrect tax planning advice. A professional liability insurance claims administrator provided the following facts:

1. The largest percentage of accountant insurance claims comes from tax issues rather than accounting issues.
2. Large accounting firms are not in the pool with smaller firms, therefore their much publicized million dollar claims do not affect liability insurance premiums.
3. Most claims are modest, less than $50,000. The majority of the cost relates to legal fees and litigation expense, rather than the actual cost of the error.
4. The majority of malpractice claims do not go to court.
5. The rapid increase in professional liability insurance premiums is a direct result of the number of claims made.
6. A high percentage of tax professionals do not carry liability insurance.

Reasons for Claims

Malpractice claims can occur for a number of reasons:

- The tax preparer made an error when preparing the tax return.
- Tax outcome differs from the original tax plan. This could relate to an estate plan, where the final result occurs many years later. The suit may be filed by the heirs, rather than the client for whom the plan was established.
- Errors on the tax return cause the return to be audited. The client may incur a substantial tax liability and decide that as an alternative to paying the tax, he should look to the preparer for payment.
- Incorrect advice may result in claims, even if the advice is provided free. Before giving advice, the preparer should research the law and be sure the advice is correct. In addition, he should be sure the client understands the advice that is given.
- Many claims arise from fee disputes. The tax preparer cannot collect his professional fee and sues the client. The client countersues, claiming that the work performed was not adequate.

> **Caution.** Many professional insurance policies do not provide coverage if the professional sues the client.

- Some suits result from the preparer's failure to meet time deadlines for filing returns or making elections. The tax professional needs to keep a file which identifies the various deadlines. If the client needs to furnish additional information before a deadline can be met, the preparer can be held liable for failure to remind the client.

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12. Tax professionals who are involved in a malpractice suit or have concerns regarding malpractice suits should read *Avoiding Tax Malpractice* by Robert Feinschreiber and Margaret Kent, published by CCH Incorporated (2000).

How to Avoid Claims

A tax professional should avoid any confrontation with clients. The old adage, "the client may not be right, but he is never wrong," holds. The costs of defending a malpractice claim can cost many times the amount of the claim.

Malpractice experts advise that a professional avoid words such as **expert** and **guarantee.** Claiming expertise on an issue places the preparer on a higher level than the average preparer. Therefore, the courts are more likely to side with the taxpayer in these cases. The use of the word **guarantee** can be the cause of all types of confusion. Is the preparer guaranteeing that the return will be timely prepared? Is she guaranteeing it is 100% accurate, even if the client did not submit all of the required information? Are there any circumstances where the preparer does not guarantee the return?

Tax preparers should consider the use of retainers. They have the advantage of insuring the client will pay their fee and they also spell out the terms of the engagement.

Client files should contain as much documentation as possible. If a tax issue is researched, the result of the research should be included. A copy of all the information the client presents for preparing the tax return should be kept. Notes regarding any oral statements made to the client about the possibility of the IRS disagreeing with the position taken on the return should also be kept.

Cost of a Malpractice Claim

The cost of a malpractice claim may exceed the cost of the error. In addition to ordinary or compensatory damages, the taxpayer may sue for punitive damages, legal expenses, accounting expenses and mental anguish. The cost of a claim to the tax professional can be substantial, even if the taxpayer does not win his suit.

In the event a tax preparer receives notice of a lawsuit, he should contact an attorney that specializes in malpractice claims.